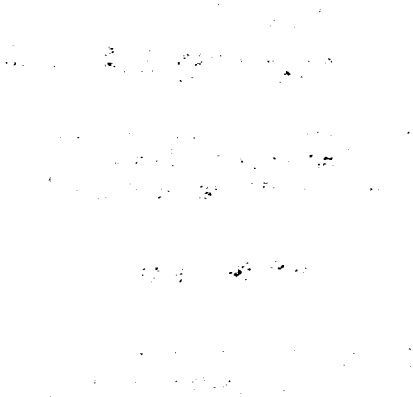
NAFTA

What's it all about?

Government of Canada
Gouvernement du Canada

Canada



NAFTA what it's all about?

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NAFTA

What's it all about?

External Affairs and International Trade Canada

NAFTA — What's it all about?

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Suggestions for Further Reading

The NAFTA is a complex document that builds on and complements a range of domestic and international laws, agreements and practices. This guide provides an introduction to what it contains and what it means, but a thorough explanation of some of the subtleties and complexities of modern international trade practice and the agreements that guide it would require a much more extensive volume. Those who want to explore some of the issues raised in this guide, may wish to consult the following:

Globerman, Steven, ed., *Continental Accord: North American Economic Integration* (Vancouver, Fraser Institute, 1991).

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Related government publications of interest include:

Department of Finance, *The North American Free Trade Agreement: An Economic Assessment from a Canadian Perspective* (Ottawa, November, 1992).

Government of Canada, *North American Free Trade Agreement: Canadian Environmental Review* (Ottawa, October, 1992).

Steering Group on Prosperity, *Inventing Our Future: An Action Plan for Canada's Prosperity* (Ottawa, October, 1992).

Investment Canada, *Investing in Canada's Future* (Ottawa, June, 1992).

List of Abbreviations and Acronymns

AD	Antidumping
BOPs	Balance of payments
CAMI	The joint GM-Suzuki automotive project in Ingersoll, Ontario
CEIC	Employment and Immigration Canada
CFE	Commision Federal de Electricidad — Mexico's state-owned electricity company
CITT	Canadian International Trade Tribunal
CMA	Canadian Manufacturers' Association
CRTC	Canadian Radio-Television and Telecommunications Commission
CVD	Countervailing duty
CWB	Canadian Wheat Board
EC	European Community
ECC	Extraordinary Challenge Committee
EIPA	Export and Import Permits Act
FAO	Food and Agriculture Organization
FIPA	Canadian Foreign Investment Protection Agreement
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GDP	Gross domestic product
GNP	Gross national product
GPT	General preferential tariff
GSP	Generalized system of preferences (U.S.)
IC	Investment Canada
ICSID	International Centre for the Settlement of Investment Disputes
IEC	International Electrochemical Commission
ILO	International Labour Organization
IMF	International Monetary Fund
ISO	International Organization for Standardization
ITA	International Trade Administration (U.S. Department of Commerce)
ITAC	International Trade Advisory Committee
ITU	International Telecommunications Union
MFN	Most-favoured nation
NAFTA	North American Free Trade Agreement
NEWMEX	New Exporters to Mexico Program

NGO	Non-governmental organization
NTB	Non-Tariff Barrier
OAS	Organization of American States
OECD	Organization for Economic Co-operation and Development
PEMEX	Petroleos Mexicanos
QRs	Quantitative restrictions
R&D	Research and development
SAGITs	Sectoral Advisory Groups on International Trade
SME	Square-metre equivalents
SPS	Sanitary and phytosanitary
TIP	Technology Inflow Program
TPLs	Tariff-preference levels
TRIMs	Trade-related investment measures
TRIPs	Trade-related intellectual property
TRQ	Tariff rate quota
UHT	Ultra-high temperature
UN	United Nations
UNCITRAL	United Nations International Commission on Trade Law
UPOV	International Convention for the Protection of New Varieties of Plants
USDA	United States Department of Agriculture
USITC	United States International Trade Commission.
USTR	Office of the U.S. Trade Representative
WHO	World Health Organization
WIPO	World Intellectual Property Organization

Competition is your best friend. If there's no competition, then you become fat and lazy.

Len Vanderlugt, President, Aldershot Greenhouses Ltd.

If you run your business well and do your pricing properly, free trade won't hurt you.

Greg Parker, Food Roll Sales (Niagara) Ltd.

Foreword

Five years ago, we were in the midst of vigorous debate about the economic future of this country. We debated whether we should open our economy to greater competition and secure a new set of rules to govern our trade relations with the United States. Canadians put forward their views with great passion and conviction. In the end, Canadians wisely chose free trade.

Five years later, the debate has flared up again. There is, however, a fundamental difference in its substance. Five years ago, we staked our faith on what might be; today we can talk about what is. Despite the problems generated by a tough global recession and a spate of difficult disputes with the United States, there is now clear evidence that the Canada-U.S. Free Trade Agreement (FTA) is working. It is laying the foundation for a stronger, more prosperous, more resilient and more confident Canada, a Canada that is a vibrant part of the global economy.

As Canadian companies become more competitive and more confident exporters as a result of their U.S. experience, they are turning to opportunities beyond our borders. In fact, our trade commissioners around the world are reporting an upsurge in inquiries from Canadian companies that want to compete in new markets. At the same time, overseas exporters and investors are increasingly finding Canada a good place to do business.

We live by trade and are critically dependent on rules that ensure a fair basis for all our partners. Because our future depends on it, we have been at the forefront in every major trade negotiation. We know that we remain burdened by the protectionists — at home and abroad — and we know that the only effective weapon against them is a good rule book, premised on open markets; a rule book that is constantly updated and improved. We are a nation with many advantages — an educated workforce, abundant resources and an efficient infrastructure. We need to reward private initiative and encourage entrepreneurs to approach the future with the confidence necessary to exploit new opportunities. The FTA, and now the North American Free Trade Agreement (NAFTA), can provide the foundation for economic vigour.

One of the most telling votes of confidence in the FTA came from the people of Mexico. They looked at the Canada-U.S. FTA and, in large measure, asked to be part of it. The NAFTA looks to the rules of the FTA and extends them to Mexico. That is why much of the onus in these negotiations was on Mexico. Canada and the United States had already adjusted to the rules of the FTA. Now it is Mexico's turn.

In taking this approach, Mexico has shown tremendous courage. There are no precedents for a country like Mexico negotiating on an equal footing with developed, fully industrialized

countries. Mexico's success has created hope for other developing countries in the world. It has told them that trade rather than aid is the constructive way forward.

The successful conclusion of the NAFTA means that Canadians have gained vastly improved access for goods, services and investment to a growing market of more than 85 million people on the same basis as our American competitors. In this case, the past is not a good indicator of the future. Unlike Canada, Mexico was a closed economy. Our exports to Mexico have been modest; until now, they could sell to us, but we could not sell to them. The NAFTA will open the Mexican economy to Canadian and U.S. firms and provide significant scope for new business.

The NAFTA negotiations encouraged Canada and the United States to take advantage of their experience over the past four years to strengthen the FTA. Improvements have been made to the rules of origin, customs administration, financial services, and much more. These changes provide Canadian-based firms with an even more stable and predictable framework within which to pursue new opportunities, now extended to an integrated market of 360 million consumers.

Finally, by establishing that expansion of the FTA regime to other countries is a matter of joint decision, we have laid the basis for an orderly expansion of the rules of fair and open trade to other countries of the hemisphere and beyond.

This handbook provides Canadians with a comprehensive guide to the NAFTA. In the months to come, as we debate the legislation that will implement the Agreement into Canadian law, Canadians will want to study and understand the NAFTA and make up their own minds. It is my hope that this handbook will provide a good place to start.

Michael Wilson
Minister of Industry, Science and Technology,
and
Minister for International Trade

Introduction

History also shows that regional integration can help advance multilateral economic co-operation.

Having made the fundamental choice to open up the world, to accept the challenge of competition, it can make very good sense for governments to pursue both regional and multilateral objectives in trade policy. Regional trade liberalization can offer economies of scale, opportunities for specialization, a magnet for foreign investment, a stronger collective voice in the world's economic councils, and often important political gains as well. In a regional context, among like-minded neighbouring countries, it can sometimes be easier to solve problems than in a larger, global context.

Arthur Dunkel, Director General, GATT

Introduction

Shortly before noon on Thursday, December 17, 1992, Prime Minister Brian Mulroney sat down in the Parliamentary Reading Room and signed the North American Free Trade Agreement. The same day, President George Bush in Washington and President Carlos Salinas de Gortari in Mexico City put their pens to an agreement that creates free trade among the three nations of North America. While legislative approval must follow, the ceremonies ended a process begun on February 5, 1991, with the decision by the three leaders to create a free trade area. Negotiations formally began in Toronto, on June 12, 1991.

The 14 months of negotiations involved the most comprehensive set of private-sector and federal-provincial consultations undertaken by any Canadian government on a trade agreement. This resulted in an agreement that is significant on several counts:

- For the first time ever, a developing country sat down with two industrialized countries and created an agreement that opens its economy to the challenges and opportunities of the North American marketplace. It sets an important precedent for trade and economic co-operation between the industrialized countries of the North and the developing countries of the South.
- This agreement provides a new set of rules to cover what is fast approaching a $500 billion annual flow in three-way trade and investment. It opens the door to a vast new potential in trade and investment relations among the three countries.
- This agreement extends the benefits of the Canada-U.S. FTA to Mexico. It strengthens and expands that accord to provide an even firmer foundation for trade and investment. It provides a framework of rules within which private-sector entrepreneurs can expand their market and investment activities. It is tailored for the demanding conditions of a large, open economy and will make the three economies more capable of taking on broader competition on a global basis.

Why Canada Participated in the NAFTA

The North American Free Trade Agreement (NAFTA) represents both a response and a challenge to changing international business. Some $3 trillion in goods are now exchanged annually around the globe. The most impressive increases have been in intra-industry trade, while consumers have benefited from increased specialization and choice. Spurred on by improvements in communications and transportation technology, and the resulting advances in business organization and finance, the natural barriers to international trade have diminished significantly.

A Broadly Based Agreement: The Consultative Process

Private-Sector Collaboration

Throughout the negotiations, Ministers and senior officials consulted closely with the Canadian private sector both through formal consultative arrangements established for this purpose and in discussions with a wide range of private-sector groups, labour representatives, environmentalists and academics.

This model for consultations was successfully established during the negotiation of the Canada-U.S. Free Trade Agreement with the creation of the International Trade Advisory Committee (ITAC) and 15 Sectoral Advisory Groups on International Trade (SAGITs). In the months before the Government decided to join the NAFTA negotiations, Ministers established the third generation of the ITAC and the SAGITs and, throughout the negotiations, Ministers and senior officials met regularly with them both to report on progress and to ensure that Canadian participation reflected the interests, needs and concerns of a wide and representative group of Canadians.

More than 75 formal meetings and many more informal discussions were held across Canada. The advice provided was vital both in preparing the objectives for the Canadian negotiating team and in pursuing them. Both the ITAC and the 15 SAGITS provided the negotiators with pertinent, detailed information on every aspect of the negotiations, ranging from rules of origin to dispute settlement.

Federal-Provincial Consultation

Mirroring the private-sector collaboration were intensive federal-provincial consultations. Again, the model had been established by the FTA process. Meetings of Canadian Ministers responsible for trade have become a valued part of federal-provincial co-operation. During the NAFTA negotiations, six meetings of Ministers were supplemented by discussions by telephone and in person, as well as many meetings and discussions between officials to consider every aspect of the negotiations. As a result, Canadian negotiators could deal confidently with their U.S. and Mexican counterparts not only on the traditional trade policy agenda that falls largely within the federal government's jurisdiction, but also with the increasing number of issues of shared jurisdiction and provincial competence.

These consultations reflect the dynamics of co-operative federalism. Trade agreements are critical to both the country and to each province. Trade accounts for between 8 and 27 cents of every dollar in provincial Gross Domestic Product and is an increasingly important source of jobs for Canadians in every part of the country.

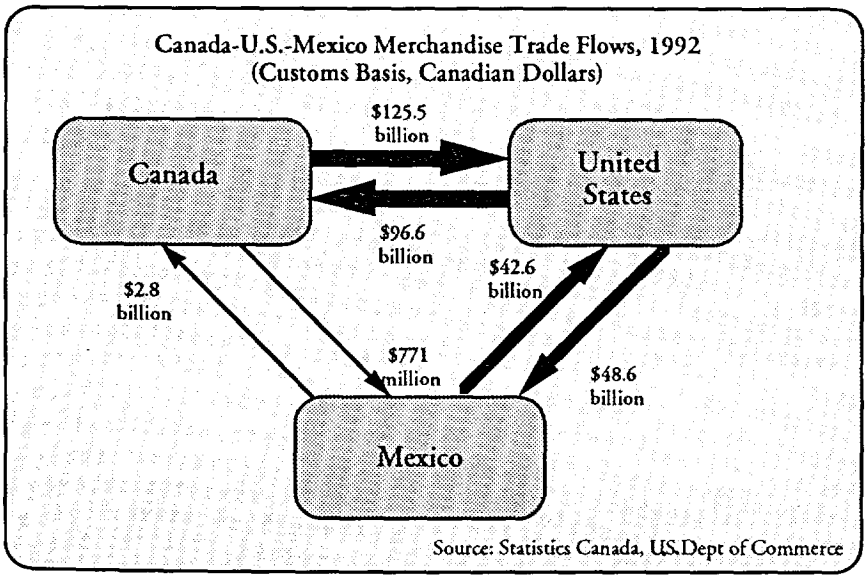
Parliamentary Consultation

As was the case with the FTA, the NAFTA has been thoroughly debated within the federal Parliament, in provincial legislatures, during Question Period and in special debates dealing with all aspects of the Agreement and the negotiations. Committees in both the House of Commons and the Senate have studied it. It has also been debated in provincial legislatures and several provinces have had their own committees examine the Agreement.

Flows of capital and knowledge are now at least as important as the flow of goods in international exchange. In the past, tariffs and other border measures were the issue. Today, domestic policies are critical in influencing domestic and international investments. The flow of money increasingly transcends all borders. The competition for investment is tough to the point where many countries are opening their economies unilaterally, adopting more open, market-oriented fiscal and regulatory policies.

The Canadian Context:

Canada has not been immune to the process of globalization. Canadian firms have become more integrated into the global economy, while Canadian consumers have been able to choose from an ever widening array of goods and services. Over one quarter of Canada's wealth is now generated by the exports of Canadian goods and services. Canada's future prosperity is thus critically dependent on our continuing capacity for change and adjustment to the influences and demands of the global economy.



Ours is a medium-sized, open and trade-dependent economy. We have always been at the forefront of those advocating that the new international economy be based on clear rules, mutually agreed and fairly administered. The world of the 1990s has led to a more contractual and detailed approach to rule making. In addition to the multilateral framework of rules provided by the General Agreement on Tariffs and Trade (GATT), Canada must also be alert to opportunities that arise on a regional or bilateral basis.

Regional responses to the internationalization of economic activities in Europe and Asia, as well as in the Americas, have presented Canada with a direct challenge. The FTA was the first response to that challenge. The Canada-U.S.-Mexico negotiations built on that achievement.

Meeting the Challenge

After the Government took office in 1984, it concluded that Canada's past prosperity had made it complacent about the precarious position that it faced as a trading nation. Determined to take the steps necessary to renew and strengthen the Canadian economy rather than resist the forces of global change, Canada has sought to harness them to its advantage.

The Government's approach was to make the private sector the driving force of this economic renewal. Government policies created an environment that would encourage and reward entrepreneurship and facilitate adaptation to the changing international economic demands. By opening Canada's economy to greater international competition and by encouraging Canadian-based firms to adopt global business strategies, Canada could remain one of the most prosperous nations on earth. The Government's economic strategy was based on three interrelated and mutually reinforcing goals aimed at:

- removing obstacles to growth;
- encouraging entrepreneurship and risk taking; and
- supporting those in genuine need who could not adapt quickly enough to changing circumstances.

This strategy was based on establishing domestic policies designed to encourage Canadian-based firms to make products that the world will buy at prices that the world is prepared to pay. Directly related to these policies were efforts to create a more open economy and promote more diversified trade and investment relations.

As international markets and production were becoming more global in scope and outlook, Canada was in danger of being pushed to the margins of the world economy if it did not participate in this trend. Not only were we not equipped to expand our participation in global markets, we were in danger of losing our own market. Canada needed more companies able to take on the competition both at home and abroad. We had to change from a branch plant to a world-class economy and we needed the rules to give firms and workers both the incentive and the reward for taking on the competition.

Trade agreements provide opportunities; results come when firms and workers take advantage of those opportunities. Over the past few years, the Government has taken steps to strengthen Canada's capacity to adjust to changes in the economy. It has placed greater emphasis on retraining and job counselling. It is working with the provinces to ensure that both federal and provincial programs are attuned to changing circumstances.

> *The perception in some quarters that the FTA has had a negative impact on the economy is not supported by the evidence. Canada's access to the U.S. market has improved since the Agreement, with 15 of 22 Canadian industry sectors gaining market share; Canada's exports to the United States have reached record highs; and net foreign direct investment inflows turned positive in 1990 and 1991 after nearly two decades of net outflows. Canada has already benefited from the FTA in a number of ways....*
>
> The Royal Bank of Canada, *Econoscope*, November 1992

The FTA – Key to Our Strategy

To make Canada a good place in which to do business, we needed stable prices, sufficient venture capital, a hospitable regulatory climate and a fair tax system. As a trading nation, the key to this strategy was getting our trade relationship with the United States right. The Canada-U.S. FTA proved a practical way to address that goal.

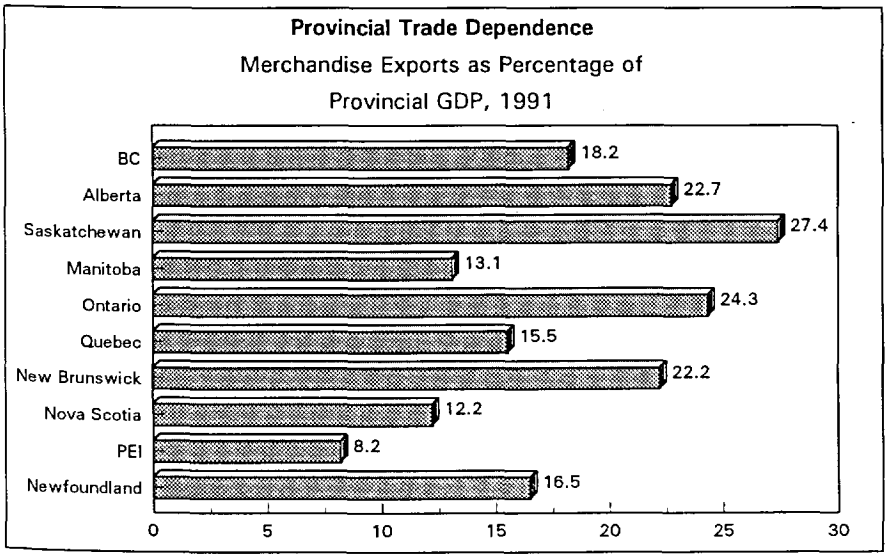
The FTA placed our economic relationship with the United States on a solid, more open, rule-based footing. It allowed us to reinforce our position as a strong and sovereign nation by reaping the benefits of a closer trade and economic relationship with the largest economy in the world and the country that is our most important trading partner.

The FTA not only tackled the traditional barriers to trade in goods, but also made it possible for the many export-oriented service firms in Canada to take on U.S. competition on an equal footing. It established rules to govern bilateral investment flows and made business-related cross-border travel easier. It resolved a number of long-standing problems and set up procedures to make it easier to address the inevitable disputes that arise in a $250-billion-a-year trading partnership.

A Broadly Based Strategy

The FTA was only one element in Canada's trade strategy. Concurrently, Canada was at the forefront in launching a new round of global trade talks at the GATT. Our objectives in each forum were the same:

- to gain as much access to world markets as possible for competitive Canadian producers, workers and investors;
- to secure that access with balanced, mutually advantageous rules; and
- to enshrine that access in agreements that include equitable and expeditious procedures for resolving any problems.



At home, a series of trade-promotion initiatives were introduced to complement trade-policy developments. These include Going Global, Pacific 2000, Europe 1992 and, most recently, Access North America.

At the same time, Canada has opened its own market to the benefit of Canadian firms and consumers who thus gain access to capital, goods and services in greater variety and at competitive prices.

The Strategy is Working

With price stability comes new confidence among both investors and consumers. Canadian inflation is now one of the lowest among industrial countries, lower than it has been for 30 years, and interest rates have also fallen significantly.

Canada is beginning to see evidence of a strong recovery led by the exports of manufactured products to the United States. Real manufacturing output per person in Canadian industry rose by 0.4 per cent in 1991 and continued to rise in 1992 and into 1993. The employment picture is also turning around. The Canadian economy generated more than a million new jobs over the past eight years, many of them related directly to exports.

In the past three years, employment in managerial, administrative, professional and technical occupations increased by nearly 200 000. We need more jobs, but the economy will not be able to sustain them unless we are prepared to become competitive on a world scale.

The fundamentals of our economy and trade are coming together. As the economy is successfully restructuring, our trade performance is leading the way. Canadian merchandise trade with the United States has increased steadfastly during the first four years of FTA implementation. Our trade is also becoming steadily more diversified and more competitive as new exporters, new products and new markets are added to our export profile.

Naturally, more remains to be done, in particular the dismantling of interprovincial trade barriers, including discriminatory standards, employment requirements and provincial procurement preferences. These constitute an unnecessary drain on productivity. The Canadian Manufacturers' Association (CMA) has estimated that these barriers cost the country about $6 billion per year.

It is also critical that we bring the Uruguay Round of GATT negotiations to a successful conclusion. The Uruguay Round offers greater benefits in a wider range of markets. The interdependence of the various trade agreements further underlines the need to complete the Round. In some respects, the NAFTA anticipates the results of the Round, such as in the chapters on financial services and intellectual property; in others, a successful Round will complement and strengthen the rights and obligations of the NAFTA, such as for agriculture and the draft subsidies code.

The Road to Agreement

Informal discussions between U.S. and Mexican officials in 1989-90 considered the prospect of a bilateral United States-Mexico free trade agreement. In June 1990, U.S. President Bush and Mexican President Salinas committed their governments to negotiating a free trade agreement between their countries. In Canada, the Government consulted with parliamentary, provincial, private-sector, academic and other interested parties and concluded that there was broad support for Canadian participation in the negotiations. On June 12, 1991, the three trade

The GATT in Brief

- The GATT is a multilateral trade agreement to which more than 100 countries now adhere. Headquartered in Geneva, Switzerland, it is Canada's main trade agreement with most of the world except for the United States.
- The GATT constitutes a contractual framework of rules stipulating the kinds of trade policies and practices that its members may pursue in regulating trade in goods. It is the main global forum for the progressive liberalization of trade.
- These rules, which cover a wide range of practices, are grounded in the principle of non-discrimination among members. The two most important rules provide for most-favoured-nation treatment (article I) and national treatment (article III).
- The GATT allows members to negotiate free trade areas and customs unions among themselves as long as such agreements provide for more liberal trade among member countries and do not raise barriers to non-members (article XXIV).
- Through its dispute-settlement provisions (articles XXII and XXIII), the GATT provides a forum for the settlement of conflicts among members based on the principles of law and conciliation rather than power and retaliation. Decisions by panels have gradually strengthened the legal foundations of the GATT.
- Through successive "rounds" of trade negotiations, GATT members have succeeded in eliminating some 80 per cent of the tariff protection in effect in industrialized countries at the GATT's founding in 1947, as well as most of the quantitative protection then in effect.
- The Uruguay Round, initiated at a Ministerial meeting of the GATT at Punta del Este, Uruguay, in September 1986, is the eighth and most ambitious round yet in the GATT's periodic negotiations. In keeping with the changing nature of international trade, it proposes to extend its disciplines to trade in services, trade-related investment measures and trade-related intellectual property matters.

Michael Hart, *Trade – Why Bother?*

ministers from the United States, Mexico and Canada met in Toronto to formally begin the negotiations.

The Objective: Open and Secure Access throughout North America

Canada had three basic goals in the negotiations, each of which was achieved in the NAFTA.

1. **Gain access to the Mexican market:** Canada sought to gain access for Canadian goods, services and capital to Mexico — one of the fastest growing and most promising economies in the world — on an equal footing with the United States.

   This was achieved. The Agreement eliminates all Mexican tariffs and import-licensing requirements (except on some agricultural products), some immediately and the rest over the course of the transition period. Canadian firms will be able to participate in virtually the whole Mexican economy and significantly expand business opportunities

in previously closed sectors, such as autos and parts, financial services, trucking, energy and mining.

The NAFTA does not greatly change the access for the United States or Mexico to the Canadian market, but it does fundamentally change Canadian and U.S. access to the Mexican market. For example, most automotive products — by far the largest Mexican export to the Canadian market — entered Canada duty-free under the terms of the Canada-U.S. Auto Pact. At the same time, the Mexican Auto Decree virtually excluded Canadian companies from participating in the Mexican market. The NAFTA provides a set of balanced rights and obligations to create a level playing field.

2. **Improve and protect the FTA:** Canada sought to resolve the trade problems that had occurred during the past few years with the United States, while ensuring that there was no reduction in the benefits and obligations of the FTA.

   Canadian negotiators successfully pursued this goal by obtaining clearer and more predictable rules of origin, an extension of duty drawback provisions, an improved mechanism for consultation and dispute settlement, a strengthened sideswipe exemption from U.S. safeguards and a reduced U.S. capacity to retaliate in dispute-settlement cases.

   The principles of transparency and due process permeate the Agreement. Building on a GATT provision (article X, which establishes that fair rules, openly administered, should be the basis of modern trade relations), the NAFTA strengthens the security and predictability of Canadian access, particularly to the Mexican market but also to the U.S. market. It provides business with sound rules as well as access to procedures to redress grievances. It further constrains the U.S. capacity to take arbitrary and capricious retaliation against our trade, providing added confidence and stability for traders and investors throughout the free trade area.

   Canada also successfully ensured that the NAFTA protects vital Canadian interests, including the Auto Pact, cultural industries and supply management. The Agreement allows Canada to maintain the Auto Pact safeguards, continue quotas to support supply management for poultry and dairy products, exempt the cultural industries from the NAFTA as they were from the FTA and maintain the government's freedom to act in the area of social services.

3. **Ensure that Canada remained an attractive location for investors:** Canada wanted to ensure that the NAFTA would not undermine Canada's capacity to keep and attract investment. This was achieved. We have ensured that, to both foreign and domestic investors, Canada will continue to be an inviting base of operations for the North American market.

> *New economic policies, such as those adopted in the NAFTA, have made Mexico one of Latin America's most promising export markets.... Mexico is soon slated to become an industrial power.*
>
> David Burton, President, Cynergy Group International

The NAFTA and the FTA

From the beginning, Canada insisted that the NAFTA enhance the FTA and in no way erode the benefits that Canada had already realized as a result of either the GATT or the FTA. In the end, all of Canada's FTA benefits were either protected or improved during the NAFTA negotiations.

The ability of the three governments to transform the Canada-U.S. FTA into a more comprehensive trilateral trade agreement, open to signature by other countries, has obvious implications for the continuing application of the FTA. When negotiating the FTA in 1987, Canada and the United States decided that the combination of overlapping and duplicating rights and obligations in the FTA and the GATT could best be addressed by means of a precedence clause. This clause provided that, in the event of conflict between the FTA and the GATT, the FTA would prevail unless specifically provided otherwise.

The degree of overlap between the FTA and the NAFTA is more extensive and more complicated because much of the language has been adjusted to make it more suitable for accession by other parties. Canada and the United States have agreed to address this overlap by using the same procedure used in 1947, when the multilateral GATT replaced the 1938 Canada-U.S. Reciprocal Trade Agreement.

Canada and the United States have agreed that the NAFTA, with all of its improvements, will supersede the FTA. The NAFTA either incorporates by reference, replaces with trilaterally agreed improvements or makes generic all the FTA obligations between Canada and the United States. As a result, Canada and the United States were able to agree to suspend the FTA as long as they are both parties to the NAFTA. Essentially, the rights and obligations set out in the FTA remain in effect, but in an updated and improved agreement.

Definitions

Gross Domestic Product (GDP) vs. Gross National Product (GNP) — GDP is the measure of the flow of goods and services produced by the economy over a specific time period, normally a year or a quarter. When income from investments and possessions owned abroad minus income earned in the domestic market accruing to foreigners is included, it becomes GNP.

Generalized Preferential Tariff (GPT) (Generalized System of Preferences (**GSP**) in the United States) — This is a system of non-reciprocal tariff preferences for the benefit of developing countries. It grants the duty-free or preferential entry to imports from eligible developing countries up to a certain dollar value or import percentage limit. It is intended to encourage diversity in developing countries' production and exports.

Most-Favoured-Nation (MFN) Treatment — This is one country's commitment to extend to another country the lowest tariff rates that it applies to any third country. This fundamental principle of non-discriminatory treatment of imports was incorporated into article 1 of the GATT and is one of the foundation stones of the world trading system.

The Road to Agreement: Chronology of Events

1990

June 10	Mexican President Carlos Salinas de Gortari and U.S. President George Bush decide to pursue a comprehensive free trade agreement.
September 24	Prime Minister Brian Mulroney formally advises presidents Salinas and Bush of Canada's interest in participating in discussions to assess the feasibility of trilateral free trade.

1991

February 5	Prime Minister Mulroney, President Salinas and President Bush announce their decision to negotiate the NAFTA.
April 7-10	During a state visit to Canada by President Salinas, four joint co-operation agreements are signed: • Canada-Mexico Double Taxation Agreement — the first such agreement that Mexico has signed with another country; • Film and Television Co-production Agreement — to broaden financing and production opportunities for the film and television industries of both countries; • Export Development Corporation/Petroleos Mexicanos Memorandum of Understanding — for a US$500 million line of credit to promote the sale of Canadian goods and services to PEMEX; and • Export Development Corporation/Secretariat of Finance Memorandum of Understanding.
June 12	Toronto, Ontario — Ministerial meeting to launch the NAFTA negotiations: Industry and International Trade Minister Michael Wilson (Canada); Trade Representative Carla Hills (United States); and Secretary of Commerce Jaime Serra Puche (Mexico).
July 8-9	Washington, D.C. — First meeting of Chief Negotiators: John Weekes (Canada); Julius Katz (United States); and Herminio Blanco (Mexico).
November 25	Mexico City — At the eighth Canada-Mexico Joint Ministerial Committee, two documents are signed: • Memorandum of Understanding on Cultural Relations and • Agreement on Museums and Archaeological Co-operation.

1992

January 6-10	Washington, D.C. — First version of consolidated draft text prepared (meeting of most negotiating groups at Georgetown University).

January 27-31	Monterrey, Mexico — "Canada Expo '92" trade fair, the largest Canadian trade promotion event ever organized in Latin America. Expo '92 was designed to expand Canadian sales and investment opportunities in Mexico; 200 Canadian companies participated.
February 11	Canadian Senate Foreign Affairs Committee begins hearings.
March 18	Canada gives Mexico $1 million in environmental assistance.
April 4	Mexico City, Mexico — Canada and Mexico sign Memorandum of Understanding on Co-operation in Telecommunications.
May 4	Mexico City, Mexico — Canada and Mexico sign Memorandum of Understanding on Co-operative Labour Activities.
July 29-August 1	Washington, D.C. — Sixteenth meeting of chief negotiators.
August 2-12	Washington, D.C. — Seventh trilateral Ministerial Meeting.
August 12	An agreement in principle is reached on the NAFTA.
September 8	Canada, the United States and Mexico release a provisional legal text of the NAFTA.
September 17	Washington, D.C. — Environment Ministers agree to establish a Trilateral Environmental Commission to improve co-operation on environmental issues.
October 7	San Antonio, Texas — Prime Minister Mulroney, President Bush and President Salinas witness initialling of the NAFTA by Minister Wilson, Ambassador Hills and Secretary Serra.
November 3	The *Canadian Environmental Review* of the NAFTA is released.
November 13	The Department of Finance releases the report, "The NAFTA, An Economic Assessment from a Canadian Perspective."
November 17	A subcommittee of the House of Commons Standing Committee on External Affairs and International Trade begins public hearings into the NAFTA, in Ottawa and nine other Canadian cities.
December 17	The heads of the three governments sign the Agreement.
	1993
February 25	Bill C-115, an act to implement the NAFTA, is introduced in Parliament.
March 17-18	Negotiations on additional accords on the environment and labour begin in Washington.
	1994
January 1	The NAFTA is scheduled to enter into force.

The NAFTA: An Overview

The Agreement and its accompanying tariff schedule is over 2 000 pages. It is divided into eight parts:

The Preamble records the political commitment of the three governments in entering into the Agreement.

Part One establishes the objectives and scope of the Agreement and other general provisions applicable to the Agreement as a whole, including general definitions.

Part Two sets out the rules for trade in goods, including rules of origin, national treatment, general market access conditions and safeguards and special provisions addressed in the four sectoral chapters relating to trade in agricultural goods, energy goods, textiles and clothing and automotive products.

Part Three deals with technical barriers to trade.

Part Four sets out the disciplines on government procurement.

Part Five addresses the conduct of business and contains chapters dealing with cross-border trade in services, investment, financial services, rules of competition and temporary entry.

Part Six deals with intellectual property protection.

Part Seven contains the institutional, dispute-settlement and transparency provisions of the Agreement.

Part Eight consists of the final provisions dealing with annexes, entry into force, accession and duration.

Each Part is divided into chapters. Chapters are further divided into articles, which are subdivided into paragraphs and subparagraphs. For ease of reference, the articles are numbered according to the chapter in which they are found. Article 401, for example, is the first article in Chapter Four dealing with rules of origin.

A number of articles call up annexes located at the end of each chapter. Following a generic approach, the article establishes the basic obligation, whereas the annex develops how it will be implemented by each country, where such implementation in any way deviates from the basic principles or is an integral part of the Agreement. Again, for ease of reference, the annex numbers correspond to the paragraph and article establishing the annex. For example, paragraph 1 of article 401 establishes the basic rule of origin for the Agreement; annex 401 provides the detailed provisions specifying how that rule is to be applied.

Throughout the text, words that have a meaning that is critical to interpreting the text or that vary from their plain, generic meaning, are defined. The definitions are found in the final article of each chapter for words used in that chapter (for example, article 415 for rules of origin). Words that have a special or critical meaning and that are used the same way throughout the text are defined in article 201.

Highlights of the NAFTA: What's In, What's Changed, What's Not

- Like the FTA, the NAFTA forms an integral part of the GATT-based multilateral trade relations system and is fully consistent with the GATT requirements.
- Most tariffs between Canada and Mexico will be phased out in 10 years. In many cases, the tariffs will be eliminated more quickly. The faster phase-outs include such key Canadian export interests as fertilizers; sulfur; aluminum ingots; agricultural, construction and resource machinery; rail and industrial equipment; selected wood pulp and paper items; telecommunications equipment; pre-fabricated housing; printed circuit boards; medical equipment; and auto parts.
- Market-access provisions include new rules on duty drawback, allowing Canadian manufacturers greater flexibility in using input from non-NAFTA sources when these are incorporated into exports of manufactured products to other NAFTA countries.

Definitions

Duty Drawback — Import duties or taxes repaid by a government in whole or in part, when the imported goods are re-exported or used in the manufacture of exported goods.

Duty Waiver — The forgiveness, in whole or in part, of import duties when certain conditions are met.

Escape Clause or Snapback — A provision in a bilateral or multilateral agreement permitting a signatory nation temporarily to suspend tariff or other concessions when imports threaten serious harm to the producers of competitive domestic goods.

Emergency Safeguard — Actions in the form of additional duties or import quotas applied to fairly traded imports, which nevertheless cause or threaten serious injury to domestic producers

Exemption — Provisions in trade agreements, which exempt particular products or situations from a general rule.

- Disciplines on customs administration are greatly improved. There are clear rules on how the Agreement will be interpreted and administered by the customs authorities, with clear procedures for the redress of grievances.
- The rules of origin have been revamped to make their application more transparent and more certain, narrowing the scope for disputes resulting from differences in interpretation and application.
- The NAFTA strengthens Canada's vehicle and parts industry and adds new opportunities for Canadian firms and workers to expand production by adding a previously closed market of 85 million consumers. By removing, over time, existing Mexican restrictions, the NAFTA will not only create a truly integrated North American auto industry but also a fully integrated market for autos and auto parts. All Mexican

restrictions, including all tariffs on originating automotive goods, will be eliminated during the 10-year transition period.

Improvements in the calculation of the rules of origin are designed to avoid future disputes, such as those involving Honda production in Alliston, Ontario, and the GM-CAMI plant in Ingersoll, Ontario. North American content rules are raised to 62.5 per cent for cars, light trucks and major components and 60 per cent for other automotive products.

- While the textile and apparel rules of origin are tougher in the NAFTA than the FTA, requiring the yarn, fabric and garment to be made in North America to qualify for NAFTA preferential duties, quotas providing preferential access to the U.S. market for goods that are made in Canada but do not meet the rules have been substantially increased.

- Constrained by slow progress on trade in agricultural products in the Uruguay Round, the three countries have put together a series of bilateral arrangements. The FTA agriculture provisions have been carried forward into the NAFTA. Canada and the United States have each negotiated separate arrangements regarding market access with Mexico. Canada was able to expand market opportunities for red meat and grains, while fully retaining our existing system of national supply management for dairy and poultry activities.

- Standards provisions build on the extensive progress made in the Uruguay Round. They provide clear rules aimed at reducing the scope for using standards as a disguised barrier to trade, while preserving the right of governments to regulate within their own borders and to promote such important goals as protecting the environment.

- The inclusion of land transport will allow Canadian truckers to organize their North American traffic more efficiently. The Agreement provides that truckers can carry cargo from one country to the other, but reserves local cargoes to truckers based in that country; for example, Canadian truckers can pick up a load in Mexico and carry it to the United States, then pick up another load in the United States and carry it to Canada or vice-versa, but they cannot carry cargo from one part of the United States to another. American and Mexican truckers can pick up and deliver international traffic in Canada, but they cannot pick up and carry goods between Canadian cities.

- The extension of cross-border services to specialty air services should open new opportunities for Canadian high-tech companies specializing in aerial surveys, mapping, remote sensing and similar export-oriented activities.

- The Agreement clearly establishes that social and health services provided by the federal and provincial governments remain unaffected by the NAFTA. Canadians are free to design and implement whatever social services they want and may reserve these activities to Canadians. The cross-border services and investment chapters, for example, spell out that Canada maintains its ability to provide social and health services, including day-care and public education.

- The investment chapter covers a broader range of operations and business activities than the FTA. It includes important provisions for resolving certain types of disputes between governments and investors from other NAFTA countries. Canadian investors

gain greatly improved access to Mexico, while Canada retains its existing foreign-investment policy. The addition of investor-state arbitration, building on provisions in Canada's bilateral investment agreements, will give Canadian investors in the United States and Mexico added confidence and security.

- The inclusion of intellectual property provisions similar to those proposed in the GATT Uruguay Round provides an agreed basis for addressing this increasingly important area of international trade. This should boost innovation in Canada and increase the attractiveness of Canada as a site for world-class investments.
- The financial services chapter — banking, securities and insurance — opens up the growing Mexican market with tighter rules of general application and subject to the dispute-settlement provisions of the Agreement.
- Chapter Nineteen of the FTA, providing for binding bilateral review of antidumping and countervailing duties, has been made a permanent feature of the NAFTA. Both Canada and the United States were satisfied that these procedures have worked to their mutual benefit. The NAFTA extends them to Mexico, at the same time ensuring that Mexico will introduce a transparent regime based on due process.
- The NAFTA preserves the right of each party to apply its antidumping law and countervailing duty law to goods imported from the other parties. To ensure a generally consistent application of such legislation in the three countries, Mexico has agreed to institute certain amendments to its legislation and procedures.
- The NAFTA does not introduce any new rights or obligations regarding subsidies. The rules remain as they are set out in the GATT and affirmed in the FTA. Governments in all three countries remain free to assist economic activity to promote important objectives, such as regional development. Goods that benefit from such assistance and cause material injury to producers in other markets may be subjected to countervailing duty proceedings. The special dispute-settlement provisions for countervailing duty proceedings of the FTA have been incorporated into the NAFTA.
- The institutional provisions include greater emphasis on mediation and conciliation, improvements to the panel-selection process and specialized provisions for certain issues (for example, financial services) as well as the addition of a permanent Secretariat (with offices in each country) to support the Free Trade Commission.
- The inclusion of an accession clause ensures that, in the future, the NAFTA will not need to be renegotiated should other countries seek membership. By requiring that countries negotiate their accession, Canada will have a full opportunity to assess the application and ensure that Canadian business is granted opportunities in the applicant's market equivalent to those extended by the NAFTA.
- The Agreement retains the Canadian exemption for cultural industries established in the FTA, article 2005, and applies it vis-à-vis Mexico and any future NAFTA member.
- The NAFTA recognizes the importance of domestic and international environmental objectives. It preserves the rights of governments to set high environmental standards. It affirms the right of governments to protect the environment, even when these steps conflict with their trade obligations, provided such steps do not involve unnecessary discrimination or introduce disguised restrictions on trade. It establishes that the

trade-related obligations in certain international environmental agreements can override obligations in the NAFTA. Any panel established to address an environmental issue may call on the help of a board of scientific experts. Discussions are now under way to lay the ground for co-operative programs aimed at strengthening the enforcement of environmental standards.

- The Agreement confirms the rights of the three governments to set high labour standards and affirms their commitment to the rigorous enforcement of workers' rights. Further discussions have begun on tripartite (labour, business and government) co-operation on improving and enforcing labour standards throughout the free-trade area. The NAFTA does not contain a social charter similar to that of the European Community (EC). The EC is a more comprehensive association that seeks to achieve a high degree of political and social integration, while the NAFTA is limited to trade and related economic issues.
- Water in its natural state, including any interbasin diversion, is not covered by the NAFTA. Only when water is considered a commercial good, such as in bottles or tanks, will water exports be affected. Other natural resources, such as oil, gas, copper and trees, remain under Canadian sovereignty. There is no obligation to exploit them or put them up for sale.

Canadian Water Policy

The Canadian government's federal water policy, announced in 1987, prohibits any interbasin transfer or diversions of water. It states that the federal government will "take all possible measures within the limit of its constitutional authority to prohibit the export of Canadian water by interbasin diversions and strengthen federal legislation to the extent necessary to implement this policy."

Pathbreaking into New Areas

The NAFTA makes important strides into new areas of trade policy, in particular, the environment and labour adjustment.

The Environment:

The environmental provisions in the NAFTA represent a significant achievement. All three countries confirmed their commitment to sustainable development. The trade obligations under specified international agreements (for example, endangered species, ozone depletion, hazardous wastes) will take precedence over the NAFTA. The Agreement urges governments not to establish "pollution havens" by lowering standards to attract investment. Panels dealing with contentious issues that involve environmental issues will have access to scientific expertise. The NAFTA incorporates the GATT exemption that allows governments to protect their environment even when the necessary measures conflict with the Agreement.

One of the outcomes of the NAFTA negotiations has been a much heightened awareness of the continental dimension of environmental concerns. As a result of the NAFTA, future economic development will be implemented with greater environmental awareness. It will be subjected to increased environmental monitoring and enforcement. In turn, additional resources that flow from increased economic activity should enhance efforts to address environmental concerns in North America.

The process associated with the review has provided clear evidence of the benefit of taking environmental concerns into consideration at every stage of the negotiating process. Frequent and substantive contact between the Environmental Review Committee, environmentalists and the negotiators played an important role, not only in optimizing the environmental provisions of the NAFTA, but also in shaping other provisions that do not specifically address the environment. This process, used for the first time in the negotiation of a trade agreement, has established a precedent for the future.

Canadian Environmental Review of the NAFTA

The income generated in Mexico by freer trade will assist the Mexican government in the enforcement of its standards, which are good on paper but have been difficult to police. Modern industrial planning emphasizes environmental responsibility through the most efficient use of resources. Companies recognize that adding the most up-to-date pollution-abatement technology and energy-efficient equipment to their plants will reap, in many cases, long-term financial rewards that offset the initial costs.

Labour Adjustment:

The Agreement is sensitive to the need for firms and workers to adjust to the new competitive opportunities. The transition period and the provisions allowing each country to introduce emergency safeguard and temporary snapback measures are designed to allow orderly adjustment.

These adjustments should not be onerous, since Mexico already benefits from relatively low tariffs or tariff-free access to Canada for many products. Indeed, the biggest challenge for Canadians arising from the NAFTA will be to identify the best means to seize opportunities offered by the larger North American market.

The fears raised in some quarters about the competitive advantage of Mexican wage levels in NAFTA are overplayed. Canada has already been competing with nations where labour costs are lower, but our competitiveness is based on much more than labour costs. Our competive advantages flow from the skills and knowledge of Canadian workers; from the strength of our private and public sector services, such as telecommunications, insurance, health care and roads; from our level of technological development; and from our access to — and relatively low cost of — debt and investment capital.

Implementing the NAFTA

Canada

On February 25, the Government introduced legislation (Bill C-115) into the House of Commons implementing the NAFTA. Second reading allows for substantive debate on the principle of the Bill. After a vote, it is referred to a committee for clause-by-clause study, following which it is reported back to the House. On third reading, the House considers any amendments and then votes on the legislation. The Bill is then considered by the Senate where the process is similiar. If the Bill is amended, it is returned to the House for reconsideration. If there is no amendment, it is put forward for Royal Assent. After the Bill is proclaimed into force, Canada will be in a position to exchange letters of ratification with the United States and Mexico.

Ratification of the NAFTA, which is part of the treaty-making process, is an executive act accomplished by Order-in-Council.

United States

President Bush signed the Agreement on December 17, 1992, thereby ensuring that legislation implementing the Agreement will be eligible for congressional consideration under the so-called "fast-track" procedures. The Clinton administration has already begun working closely with Congress to prepare the implementing legislation. That legislation can then be tabled, studied by various congressional committees and then debated by both Houses of Congress on the basis of the strict timetable laid out in the fast-track procedures.

Under these procedures, Congress cannot amend the implementing Bill and thereby indirectly change the Agreement. A simple majority is required in both the House of Representatives and the Senate to enact the implementing Bill, which, after it is signed into law by the President, will enable the United States to bring the Agreement into force.

Mexico

President Salinas sent the NAFTA to the Mexican Senate on December 18, 1992. After study by a committee, the Agreement must receive the approval of two-thirds of the Senate. Even before signing the NAFTA, the Mexican administration had begun consultations with both the Senate and the Chamber of Deputies.

After ratification, the NAFTA will have the force of domestic law. The Mexican Administration has already begun to amend more than 30 domestic laws to bring them into conformity with NAFTA obligations.

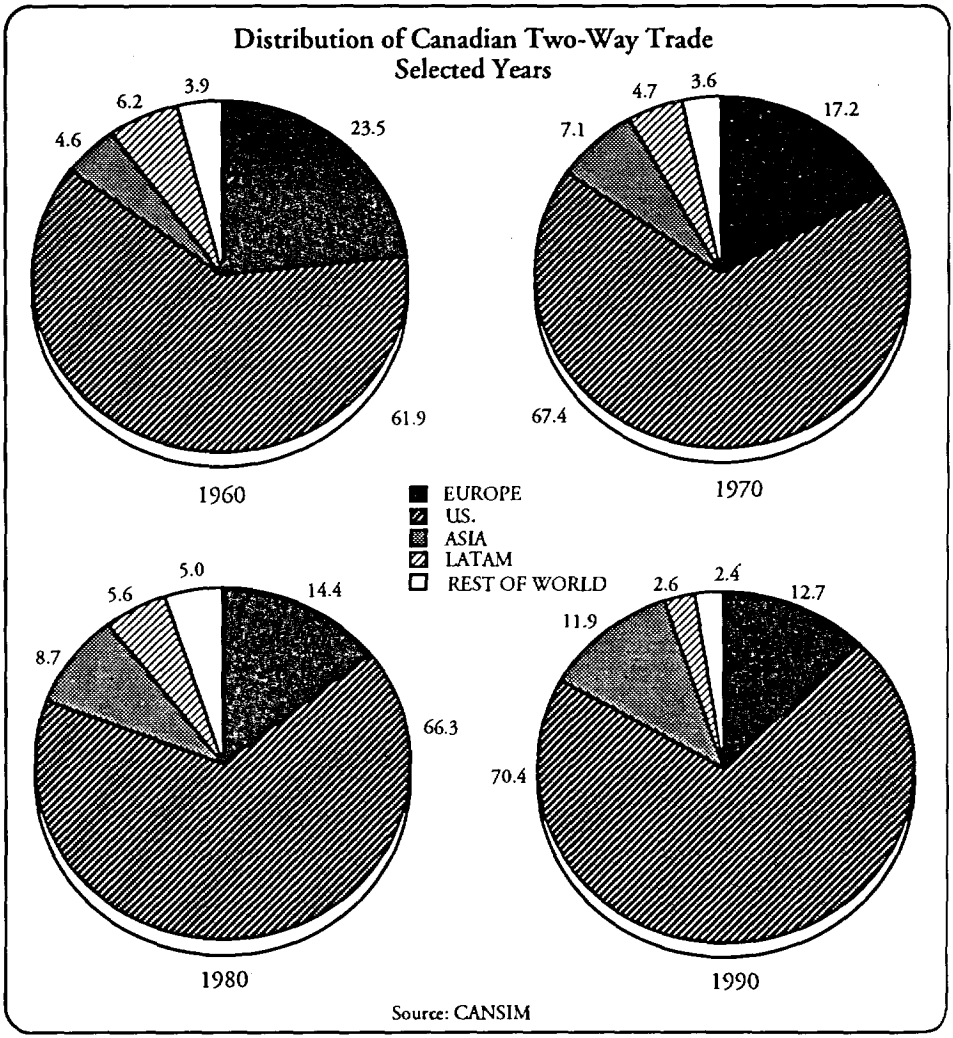
An Outward Looking Trade Agreement:

The NAFTA provides a solid foundation for the future. It includes provisions to broaden its coverage, both in terms of issues and of membership. A similar accession clause to that of the GATT is included in the Agreement. It allows countries to negotiate their way in by accepting the same obligations as the other members. In future, expansion will no longer require that negotiations start again from scratch. Canada will not have to renegotiate its terms of access to the U.S. or Mexican markets every time a new country accedes to the NAFTA.

The NAFTA as a Development Instrument:

The NAFTA is not only good trade and economic policy, it is also good foreign and development policy. By helping countries to adopt the necessary tools to restructure and modernize, the development of new market opportunities for Canadian firms and workers will be promoted. In addition, the conditions for positive human, environmental and community development in countries less prosperous than our own will be created.

> *Canada can compete with Mexico better inside the NAFTA than outside. Our analysis shows that, although Mexican labour costs are 7.5 times smaller than Canadian costs, Canada's workers have productivity levels 6.5 times higher than Mexico's. The cost of capital is lower in Canada, and capital productivity is higher. Canada thus has a competitive edge in the production of high-productivity and capital-intensive goods, while Mexico has a competitive advantage in the production of goods intensive in low-skilled labour. The NAFTA will put all member countries on an equal footing, which will be to Canada's advantage.*
>
> Department of Finance, *The NAFTA: An Economic Assessment from a Canadian Perspective*


Distribution of Canadian Two-Way Trade
Selected Years
3.9
6.2
4.6
23.5
61.9
1960
4.7
3.6
7.1
17.2
67.4
1970
EUROPE
US.
ASIA
LATAM
REST OF WORLD
5.0
5.6
8.7
14.4
66.3
1980
2.6
2.4
11.9
12.7
70.4
1990
Source: CANSIM

Explanatory Notes

Three years ago, we exported nothing to the United States. Today, we export between 15 per cent and 20 per cent. In fact, without access to the U.S. market, we would wither and die because the Canadian market just isn't big enough.

Paul Helliwell, Gamma Foundries

Preamble

The Preamble represents the hopes and aspirations of the three countries and provides the political context within which the governments negotiated the NAFTA. The political commitments made in these paragraphs provide an agreed basis for the future interpretation of the intent of the three governments in entering into this Agreement.

The Preamble states the political desire of Canada, the United States and Mexico that the Agreement provide a framework for future expansion to other countries prepared to accept its obligations. It sets out their commitment to promote sustainable development and ensure that the Agreement will not frustrate their capacity to pursue environmental objectives. It similarly states their commitment to protect, enhance and enforce workers' rights. It indicates that it is their view that the effective functioning of the Agreement should lead both to a steady improvement in working conditions as well as a more competitive economy.

Mexican Market Opportunities: General

Mexico is a fast-growing economy that will require telecommunications products, processed foods, transportation expertise, environmental services and new technologies. These are areas where Canada is an acknowledged leader. In 1991 alone, Mexican imports grew by 22 per cent.

Mexico is already Canada's largest trading partner in Latin America. Canadian business has begun to increase its presence in Mexico with over 200 Canadian companies participating in the successful Canada Expo '92 held in Monterrey in January 1992. In 1992, 5 100 Canadian business visitors sought assistance from the Embassy; in 1991, the comparable figure was 2 100. Over the next four years, the Canadian government will spend $27 million through the Access North America program to increase our exports to Mexico. A Canadian Business Centre, operating on a cost-recovery basis and in partnership with Canadian industry, will soon be opened in Mexico City. The New Exporters to Mexico Program (NEWMEX) will introduce Canadians to Mexican customs procedures, shipping and labelling rules as well as financial and legal requirements. The Fairs and Missions Program for Mexico will expand, adding more than 40 events annually. An extensive program of workshops and sectoral market studies will be prepared and updated regularly.

Canada's Trade Laws in Brief

The Customs Tariff — One of Canada's oldest pieces of legislation, the Customs Tariff sets out the rates of duty for thousands of individual products and the manner in which duties are to be calculated. As well, it lists products that may not be imported.

The Customs Act — This Act provides the legal basis for the activities of Canada's customs agents. It involves a wide range of detailed rules prescribing requirements related to the entry of goods and the payment of duties.

The Export and Import Permits Act — This Act provides the authority for the Government to control the export and import of certain goods.

The Special Import Measures Act — This Act allows Canadian producers, harmed by dumped or subsidized imports, to seek temporary relief or protection from such imports by means of a special antidumping or countervailing duty.

The Canadian International Trade Tribunal Act — This Act establishes the Canadian International Trade Tribunal (CITT), which has four main functions: to determine whether or not Canadian producers are injured by imports of dumped or subsidized goods; to hear appeals in customs matters; to determine whether goods are being imported in large quantities and at low prices so as to cause serious injury; and to review certain procurement practices. The CITT also carries out other economic enquiries on behalf of the Government, most related to import-policy questions.

Part One — General Part

Chapter One — Objectives

This chapter sets out the framework, object and purpose of the Agreement. In effect, it provides the guiding principles for the interpretation of the Agreement as a whole. These principles — national treatment, most-favoured-nation treatment and transparency — are then worked out in detail in the chapters that follow.

Article 101 establishes the free trade area — Canada, the United States (with the exception of Guam, the Commonwealth of the Northern Marianas, American Samoa and the U.S. Virgin Islands; Puerto Rico is included in the NAFTA) and Mexico — and states the conviction of the three signatories that the Agreement is consistent with their obligations under the GATT article XXIV. It underlines their intent to establish an agreement that complements and is consistent with the global trade regime based on the GATT.

GATT Article XXIV

This article provides the basis in international trade law for free trade agreements and customs unions. Member countries of the GATT are generally obliged to treat all other contracting parties the same, i.e., extend most-favoured-nation treatment, unless they are parties to an agreement consistent with article XXIV. In the case of a free trade agreement, the members must remove tariff and non-tariff barriers on substantially all their trade within a reasonable period of time and not raise any new barriers to the trade of third countries. A free trade agreement must be notified to the GATT, and its members may examine it to determine its conformity with article XXIV and recommend changes if it does not. The GATT has examined more than 50 free trade agreements and customs unions; it has never rejected an agreement.

Article 102 sets out the object and purpose of the Agreement. Most of the provisions are similar to the political intentions contained in the Preamble, but there is an important difference: the provisions of article 102 are contractual and set out general obligations to guide the

interpretation and implementation of the rest of the Agreement. The specific obligations include:

- eliminating barriers to trade and facilitating the cross-border movement of goods and services throughout the free trade area;
- promoting conditions of fair competition in the free trade area;
- increasing investment opportunities in the free trade area;
- protecting intellectual property rights;
- establishing effective procedures for the implementation, application and joint administration of the Agreement and the resolution of disputes; and
- laying the foundation for further trilateral, regional and multilateral co-operation to expand and enhance the benefits of the Agreement.

The Agreement builds upon previous bilateral, regional and multilateral agreements. For purposes of interpretation, article 103 establishes that the NAFTA takes priority over other agreements if there is any conflict, unless some other article specifies otherwise. For example, article 2103 states that bilateral tax agreements generally take precedence over the provisions of the NAFTA, while article 104 states that the trade measures taken pursuant to certain environmental agreements take precedence over the NAFTA.

Article 105 outlines the extent of the obligations of the federal and subfederal levels of government. Like the FTA, the NAFTA is an Agreement between central governments. As all three countries are federate states and some of the issues covered by the Agreement fall within the competence of the state and provincial governments, the Agreement establishes that federal governments are responsible for the implementation of the Agreement within their territory, including by state and provincial governments.

Chapter Two — General Definitions

Chapter Two sets out definitions of specialized or important terms common to the Agreement as a whole; for example, "territory." More specialized definitions important to the interpretation of individual articles are contained in each chapter. For example, Chapter Two defines the term "enterprise" for the Agreement as a whole, while Chapter Eleven provides more specific definitions in the context of investment.

Part Two — Trade in Goods

The rules covering trade in goods are the core of any free trade agreement. The six chapters in this part set out the terms and conditions under which goods produced in one country in the free trade area will enjoy access to the other countries.

Chapter Three sets out the basic rules covering national treatment and traditional tariff and non-tariff barriers, such as export and import taxes and quantitative restrictions. Chapter Four describes the critically important rules of origin that make it possible to determine which goods are eligible for treatment under the more liberal tariff provisions of the NAFTA. Two annexes attached to Chapter Three describe the more complex provisions that apply to the automotive and textiles and clothing sectors, including special provisions important to interpreting the rules of origin.

Chapter Five outlines a series of procedural obligations relating to customs administration, which aim to ensure that customs requirements will, to the maximum extent possible, facilitate rather than impede trade flows. Chapters Six and Seven provide a number of rules specific to the energy and agriculture sectors, while Chapter Eight sets out the rules covering emergency safeguard actions. Most of the provisions of these chapters build on existing rights and obligations in the GATT, its codes and ancillary agreements, and the Canada-U.S. FTA.

> *The objectives of free trade agreements should be to free trade, not to manage trade to the detriment of either nonmembers or weaker members. They should be comprehensive in scope, including sectors where protection is most entrenched, and cover the whole range of trade restraints, including tariffs, non-tariff barriers, and procedural protectionism. At the same time, they should exclude more subtle types of protectionism exercised through unduly restrictive rules-of-origin and local content provisions. Such exclusionary features against non-free trade agreement suppliers and investors would lock free trade agreement members into inefficient patterns of specialization and deprive them of badly needed sources of external capital.*
>
> Sylvia Saborio, U.S. Overseas Development Council

Chapter Three
National Treatment and Market Access for Goods

One of Canada's principal goals in the negotiations was to achieve free and secure access to the Mexican market within a clear code of conduct that would ensure that Canadian producers could enjoy the same opportunities as their U.S. and Mexican competitors throughout the free trade area. These goals were largely achieved within the market access chapter.

Article 300 makes the fundamental principle of market access applicable to the provisions of the auto and textiles annexes, and the energy and agriculture chapters.

Article 301 incorporates the basic national treatment obligation of the GATT into the NAFTA. This means that, once goods have been imported into any member country, they will not be subject to discrimination. Such an obligation is an essential part of any agreement eliminating trade barriers, since it prevents their replacement by internal measures favouring domestic goods over imports.

The obligation prevents, for example, any country from imposing internal taxes, such as excise or sales taxes, or regulations and laws respecting purchase and use, which discriminate against imported products. It is thus a guarantee that imported goods from the partner countries will be treated the same as products of domestic origin. This helps producers, traders, investors, farmers and fishermen to plan and invest with greater confidence.

National treatment does not mean that imported goods have to be treated in the same way in the foreign market as they are in their country of origin. For example, Canada can prohibit or restrict the sale of imported firearms, as long as the sale of domestically produced firearms is also prohibited or restricted. Similarly, all goods, imported or domestic, must continue to meet Canadian bilingual labelling, metric measurement and similar requirements.

The NAFTA, like the FTA, clarifies the manner in which the GATT's national treatment obligation applies to measures adopted by provinces or states (article 301). It requires the federal government to ensure that a province or state not discriminate against imported products in measures falling within its jurisdiction.

The NAFTA provides for the elimination of all tariffs on goods that meet the rules of origin set out in Chapter Four (article 302). Tariffs are generally to be eliminated according to one of four major phase-out categories (annex 302.2):

- immediately upon the entry into force of the Agreement on January 1, 1994;
- in five annual steps (1994-1998);
- in 10 annual steps (1994-2003); and
- in 15 annual steps (1994-2008) for a limited number of U.S. goods.

The phased elimination of tariffs between the United States and Canada will continue on the basis of article 401 of the Canada-U.S. FTA. The base rates for calculating the phased elimination on trade with Mexico are those that were in effect on July 1, 1991 for Canada. The base rates generally incorporate the Generalized Preferential Tariff (GPT) for Canada and the Generalized System of Preferences (GSP) for the United States, both of which accord Mexican goods lower tariff treatment than most-favoured nation (MFN) GATT rates. For Mexico, the base rate will be its import duties applied in practice (ranging up to 20 per cent) rather than the much higher rat (up to 50 per cent) established through its GATT obligations. There are also special rules for joint production.

Because Mexico benefits from Canada's GPT, and many products enter Canada under the terms of the Auto Pact, almost 80 per cent of Mexican goods already enter the Canadian market duty-free. Canada included most products in either the immediate or five-year categories and limited 10-year phase-outs to sensitive products.

Chapter Three also includes provisions providing for accelerated tariff elimination, rounding of rates and valuation along lines similar to the FTA.

Tariff Phase-Outs

Mexican Tariffs on Canadian Goods

Immediate	Five-year	Ten-year
fish items	metal articles	furniture
telecommunications equipment	selected machinery	pharmaceuticals
fertilizers and sulphur	parts of electrical eqpmt	toys

Canadian Tariffs on Mexican Goods

Immediate	Five-year	Ten-year
furniture parts	light trucks	apparel
telecommunications eqpmt	machine tools	footwear
machinery and eqpmt	rubber products	toys

Tariff Acceleration

Canadian firms can adjust rapidly to new competition. Soon after the implementation of the FTA, the Government was petitioned by industry to reduce tariffs more quickly. As a result, Canada and the United States negotiated two supplementary tariff agreements, which accelerated tariff elimination on over 650 tariff items covering more than $8 billion in two-way trade. A third negotiation is in progress. Experience suggests that tariff acceleration is also likely to happen under the NAFTA.

Article 303 provides a major improvement upon the obligations in FTA article 404 regarding duty drawback and similar programs, such as free trade zones. Under the FTA article 404, Canada and the United States agreed to eliminate the refund of customs duties levied on imported materials and components when these are incorporated into goods exported to each other after January 1, 1994. They have now agreed to revise these provisions by allowing a longer phase-out of existing drawback until January 1, 1996, for Canada-United States trade and January 1, 2001, for Canada-Mexico and United States-Mexico trade. As well, a modified form of drawback will continue to allow Canadian manufacturers to be able to collect a refund equal to the lesser of the duties paid on imported inputs or the duties liable on exports of the final product to the United States or Mexico. In order to qualify for these benefits, Mexico must allow production in its Maquiladora (free trade zones) to be available for domestic consumption, a practice that is now generally prohibited. Drawback remains available for trade with non-NAFTA countries.

Definitions

Quantitative Restrictions (QRs) — Explicit limits or quotas on the physical amounts of particular products, which can be imported or exported during a specified time period, usually measured by volume but sometimes by value. The quota may be applied on a selective basis with varying limits set according to the country of origin, or on a global basis, which only specifies the total limit and thus tends to benefit more efficient suppliers. Quotas are frequently administered through a system of licensing.

Valuation — The appraisal of imported goods by customs officials for the purpose of determining the amount of duty payable. The GATT Customs Valuation Code obliges governments to use the transaction value of imported goods or the price actually paid or payable for them, as the principal basis for valuing goods for customs purposes.

There are three exceptions to the general drawback obligation (annex 303.6):

- Full drawbacks will continue to be permitted on citrus products like lemons and oranges.
- Duties paid on fabric imported and made up into apparel and subsequently exported to the other country can be recovered if the apparel does not qualify for preferential tariff treatment when traded between the United States and Canada. The rules of origin establish quotas for preferential tariff treatment for apparel made up from imported fabrics and/or yarns. Should trade rise above these levels, Canadian manufacturers using imported fabrics and/or yarns will be able to apply for drawback of Canadian duties paid on fabric incorporated into apparel exported to the United States.
- The U.S. sugar re-export program is exempted for exports to both Canada and Mexico.

Articles 304 through 307 build on articles 404 and 405 of the FTA by requiring the elimination of duty waivers or remissions that are based on performance requirements. The Agreement provides for the elimination of waivers wherever they are tied to specific performance requirements, such as production in one country or export to another country. Like

the FTA, a number of specific programs are grandfathered including trade in the automotive sector. Articles 305-307 set out detailed rules for the duty-free temporary admission of goods and other circumstances when, for example, duties are only collected on the value of work done in one country, such as repairs.

Under article 308, the three countries have agreed to reduce, over 10 years, their MFN rates on computers, most computer peripherals and computer parts to match the lowest prevailing rate in any of the three countries.

Market Opportunities: Consumer Products

Imports of consumer products are growing, concentrated in fashion, novelty, high-technology, promotional, specialty and/or low-volume items, leisure and sporting goods.

Some 70 per cent of Mexico's 85 million inhabitants are under 30 years of age. This growing young urban population, enjoying higher incomes generated by enhanced economic conditions, has a marked preference for imported products, as a result of the easing of import restrictions and the favourable image of such products.

Total imports of consumer products reached $7.5 billion in 1991, representing some 20 per cent of total consumption. Good prospects for Canadian business in this sector include jewelry, accessories, apparel, furs, medicinal and pharmaceutical products, soaps and toiletries, toys and games, sporting goods, books, stationery and related products, tableware, gift ware, wood articles and furniture.

Article 309 largely duplicates FTA article 407 incorporating the GATT obligations regarding import and export restrictions. Unless specifically permitted under the Agreement, existing quantitative restrictions (QRs) are to be eliminated. The practical effect is that Mexico will need to eliminate virtually all of its remaining QRs. Remaining exemptions from this general obligation are set out in annex 301.3. For Canada, the annex replicates the provisions of the FTA article 1203 relating to restrictions on the export of logs and unprocessed fish. In order to ensure that there is no erosion of Canada's rights under the GATT article XI to maintain import quotas on supply-managed commodities, the provisions of article 703 in Chapter Seven (agriculture) take precedence over this article.

Article 310 incorporates the FTA article 403 prohibiting the introduction of new customs user fees such as merchandise-processing fees and requiring the phased elimination of existing fees. The U.S. merchandise-processing fee will be eliminated for Canada on January 1, 1994, and phased out for Mexico by June 30, 1999. Canada has no such fees.

The United States and Mexico require that imports be marked with their country of origin. Annex 311 provides for rules regarding marking requirements, thereby providing Canadian producers with greater certainty in meeting these requirements.

Articles 312 and 313 build on the FTA articles 805 and 806. The first requires that the parties eliminate any blending requirements involving imported and domestic distilled spirits. The second concerns the mutual recognition of distinctive distilled products. All three countries

will now recognize Bourbon and Tennessee Whiskey as distinctive products of the United States, Canadian Whiskey as a distinctive product of Canada and Tequila and Mescal as distinctive products of Mexico.

Article 314 duplicates the FTA article 408 regarding export taxes. Neither Canada nor the United States apply export taxes as a matter of general policy. Mexico, however, has made extensive use of such measures as part of its price control regime. Article 314 specifically prohibits export taxes or duties on bilateral trade unless the same tax is applied on the same goods consumed domestically, while annex 314 grandfathers a limited number of existing export taxes related to price controls on food in Mexico.

Definitions: The Tariff

The tariff is the heart of traditional trade policy. It is a tax on imports and sets the rate at which imported goods are taxed. The term tariff usually refers to a list or schedule of articles of merchandise with the rate of duty to be paid to the Government for their import. There are various kinds of tariffs including:

Ad Valorem Tariff — a tariff calculated as a percentage of the value of goods clearing customs, for example, 15 per cent ad valorem means 15 per cent of the value.

Specific Tariff — a tariff levied on the basis of some physical unit, such as so many cents a litre.

Compound Tariff — either a combination of an ad valorem tariff, plus a specific tariff, or a provision that an ad valorem or specific tariff will apply, whichever is higher; also called a "mixed tariff."

Tariff-rate Quotas — application of a higher tariff rate to imported goods after a specified quantity of the item has entered the country at the usual tariff rate during a specified period.

Bound Rates — rates that cannot be increased beyond an agreed level, usually MFN tariff rates resulting from GATT negotiations and thereafter incorporated as an integral part of a nation's schedule of concessions. If a GATT member raises a tariff to a higher level than its bound rate, the beneficiaries of the previously lower rate have a right to retaliate against an equivalent value of the offending country's exports or to receive compensation. Compensation usually takes the form of reduced tariffs on other products that they export to the offending country.

General Tariff — a tariff applied to countries that do not enjoy either preferential or MFN tariff treatment. Where the general tariff rate differs from the MFN rate, the general tariff rate is generally higher.

Tariff Escalation — a situation in which tariffs on manufactured goods are relatively high, tariffs on semi-processed goods are moderate and tariffs on raw materials are non-existent or very low. Such escalation is said to discourage the development of manufacturing industries in resource-rich countries.

Tariff Schedule — a comprehensive list of goods that a country may import and the import duties applicable to each.

Michael Hart, *Trade Why Bother?*; USTR, *A Preface to Trade*

Article 315 is similar to the FTA article 409 and the GATT articles XI and XX. The GATT obligations recognize that circumstances may arise when export restrictions may be necessary. These circumstances include situations of short supply, conservation of natural resources where domestic production or consumption is also restrained and restrictions imposed in conjunction with domestic price stabilization schemes. The article requires that export restrictions for such purposes not disrupt normal trading patterns.

For example, Canadian steel producers use huge quantities of Pennsylvania coking coal because it is both ideally suited to steel making and because its location is cost-effective. Article 315 prevents the United States from arbitrarily cutting off access to this coal unless restrictions are also placed on its use by U.S. producers on a proportional basis. Even then, the United States must use the least disruptive measures so as not to materially alter established patterns of trade.

The NAFTA for the first time establishes a Committee on Trade in Goods (article 316) to maintain broad oversight over all market access issues. This should ease problems that may arise in the administration of this chapter and facilitate the movement of goods throughout the free trade area. Article 318 provides definitions for items, such as advertizing films and customs duties.

Low wages are just not a main source of competitive advantage for the knowledge-intensive industries that play an ever larger role in modern economies. If low wages were the key to investment decisions, the poorer regions of Canada and the United States would account for disproportionate shares of domestic business investment. In fact, relatively low-wage regions of both Canada and the United States generally receive disproportionately small shares of business investment, including manufacturing investment.

Business Council on National Issues

Annex 300-A:
Trade and Investment in the Automotive Sector

For Canada, satisfactory provisions for more liberal trade with Mexico in automotive products that were also sensitive to the requirements of the Auto Pact were a critical objective in the negotiations. Various Mexican auto decrees have essentially closed the Mexican auto industry to foreign competition. Five major vehicle assemblers (General Motors, Ford, Chrysler, Nissan and Volkswagen) participate in the Mexican market but have been largely precluded from rationalizing their production along North American lines. Both parts and assemblers produce in Mexico for the U.S. and Canadian markets. Close to 90 per cent of Mexican automotive imports already enter Canada duty-free under the Auto Pact. Until now, little Canadian or U.S. production has been exported to Mexico.

Under the NAFTA, the closed Mexican market will be opened to North American competition over a 10-year transition period. At the end of the transition period, parts and vehicles produced in Canada will enjoy the same access to the Mexican market as Mexican parts and vehicles have long enjoyed in the Canadian market. Canadian-based firms will be able to participate fully in the Mexican market on a national-treatment basis with "national suppliers" of parts.

Automotive tariffs in Mexico will be phased out on the basis of the following schedule (annex 300-A.2):

- the immediate reduction by 50 per cent of tariffs on passenger automobiles and remaining tariffs phased out in equal steps over 10 years;
- the immediate reduction by 50 per cent of tariffs on light trucks and remaining tariffs in equal steps over five years;
- tariffs on all other vehicles phased out in equal steps over ten years;
- the immediate elimination of tariffs on certain auto parts and duties on other parts phased out over five years with a small portion over 10 years;
- restrictions on the import of used cars will be phased out after 25 years, i.e., over 10 years starting in 2009 and ending in 2019 (annex 300-A.1.4). Canadian restrictions on used-car imports from the United States will be eliminated on January 1, 1994, under the FTA.

The NAFTA introduces a new net-cost-based rule of origin with regional value-content requirements for auto goods (Chapter Four). After an eight-year phase-in, the NAFTA will require a higher level of North American content: 62.5 per cent for autos and light vehicles and

their engines and transmissions, 60 per cent for other vehicles, their engines and transmissions, and other auto parts. In addition, the value of non-NAFTA parts will be traced through the production process to ensure a more accurate calculation of the North American content. The eight-year phase-in will allow producers to make the necessary adjustments in their North American operations over the course of two model cycles to take advantage of the NAFTA's liberalizing trade provisions. The new rules of origin were drafted in part to ensure that the kinds of problems over rules of origin raised in the GM-CAMI and Honda disputes will not recur. GM will be able to import CAMI vehicles into Mexico at preferential tariff rates if these vehicles meet the rule of origin. CAMI will have the same access to the United States as it did under the FTA.

The NAFTA (annex 300-A.2.6) gives Mexican independent parts suppliers an assurance that parts purchases will not fall below the level attained over 1991-92 (plus a percentage for market growth). These safeguards, however, will be phased out after 10 years, while the Auto Pact safeguards (which establish a production-to-sales ratio for vehicles and a Canadian value-added requirement) stay in place.

The Canadian Automotive Industry

The auto industry is one of the biggest industries in North America. It provides employment to more than 225 000 Canadians through manufacturing (137 000) and sales (90 000). It accounts for approximately 4 per cent of Canada's GDP. Auto exports represent 32 per cent of Canadian manufacturing exports.

Its health is critical to the welfare of many other sectors, including steel, textiles, electronics and rubber. As a result of the Canada-U.S. Auto Pact, the industry has operated on an integrated basis in Canada and the United States since 1965, greatly benefiting the economy in central Canada. Canada annually exports 85 per cent of its vehicle production and 90 per cent of its parts production, almost exclusively to the United States. Canada has gained an increased share of Canada-U.S. production in both assembly (increased from 14.5 per cent in 1981 to 17.5 per cent in 1991) and parts (increased from 5 to 11 per cent between 1981 and 1991).

Traditionally, the automotive industry was divided into two main segments: vehicles manufactured by overseas manufacturers and those manufactured within North America. Foreign manufacturers, usually referred to as 'transplants,' from Japan and Korea began operating in Canada soon after the Japanese government and industry agreed to voluntary export restraints in 1981. As a further incentive to foreign investment, the Canadian government set up a production-based customs rebate program, which lowers customs duties by one dollar for every dollar spent on Canadian content. Canadian production, in general, is oriented toward light trucks and passenger cars. Lower labour costs in Canada have also encouraged Canada-based production. In spite of the reorganization of the North American industry and the arrival of transplants, import penetration has, until very recently, been high. In 1990, approximately 31 per cent of vehicles sold in Canada were imported, compared to 11 per cent in 1979. About a third of these were vehicles, usually referred to as 'captive imports,' brought in by the Big Three North American manufacturers — General Motors, Ford and Chrysler.

Annex 300-B:
Textiles and Apparel Goods

The Canadian Textile and Apparel Industries

The textile and apparel industries remain a major source of employment in Canada, especially in Montreal, Toronto and Winnipeg. In 1991, the textile industry, which converts man-made and natural fibres into yarns and fabrics for use in manufacturing clothing, upholstery, household linens, etc., employed some 44 500 people in an estimated 1 060 firms. Half of the production is used by industry within Canada, especially clothing manufacturers.

The apparel industry employs some 90 000 people in over 2 000 firms. Apparel production accounts for 18 per cent and 17 per cent respectively of all manufacturing employment in Montreal and Winnipeg. In 1991, total production was valued at over $5 billion of which 10 per cent was exported, mostly to the United States. The industry is characterized by a large number of small firms, which employ less than 50 workers. Canadian apparel exports to the United States have more than doubled since 1988; Canada enjoys a surplus in its trade with the United States. For example, sales of men's suits from Canada into the U.S. market now lead all other countries except Italy.

Apparel imports from Mexico, including from the *maquiladora* operations, represent only 0.5 per cent of apparel imports into Canada. The Mexican industry produces cheaper, lower-quality items. The Canadian industry is moving into high-quality, designer apparel using computer design and new technology.

While strides in efficiency have been made, the industry remains labour-intensive, making it vulnerable to foreign competition where labour costs are significantly lower. To protect Canadian jobs, the government subjects 90 per cent of low-cost country imports to quotas; Canadian tariffs on apparel imports currently range between 20 and 25 per cent.

Under the FTA, tariff removal on apparel was set at the maximum adjustment period of 10 years (products will become duty-free on January 1, 1998); for textiles, the adjustment period is eight years. The FTA also provided for tariff-rate quotas whereby garments, fabrics and

made-up articles not meeting the rules of origin could still benefit from tariff preferences. Canada approached the NAFTA with two major objectives:

- to ensure that Canada's access to the U.S. market would not be eroded; and
- to provide an appropriate adjustment period before fully opening the market to Mexican competition.

Both objectives were substantially met. Tariff removal with the United States continues at the rates negotiated under the FTA. Full duty drawback has been extended for two years beyond the FTA expiry date of January 1, 1994. In 1996, a partial drawback system (article 303) will be put into place to reduce input costs for Canadian manufacturers who still pay duties on goods exported to Mexico and the United States. Moreover, full duty drawback for Canada-U.S. trade in apparel traded under MFN rates will be maintained indefinitely. Tariff elimination with Mexico will be phased in over 10 years for apparel (duty-free January 1, 2003) and eight years for most textiles (duty-free January 1, 2001). This will give the Canadian apparel industry the longest adjustment period available for any sector under the Canada-Mexico phase-out schedule.

The basic rule is that textile and apparel must be produced from fibre made in a NAFTA country to benefit under the Agreement, the so-called "yarn-forward" rule (for apparel, it is referred to as "triple transformation;" for fabric, it is "double-transformation"). Exceptions to this rule will give some flexibility in special circumstances. The rules of origin in Chapter Four provide for single transformation in a number of cases, and the *"de minimis"* provision of article 405 allows producers to still qualify for the NAFTA tariff preferences under the double and triple transformation rules when their products have small quantities of non-NAFTA yarn and fabric inputs. In addition, annex 300-B sets tariff-preference levels (TPLs), which will allow specified quantities of textiles and apparel cut and sewn in North America to qualify even when they do not meet the rules of origin.

Because of the specialized nature of the Canadian textile and clothing industry, the TPL exceptions to the basic rule address Canadian concerns and interests. Specifically they provide that:

- the U.S. TPL for Canada on yarn is set at a level four times 1991 exports to the United States (to 10.7 million kg);
- the U.S. TPL for Canada on non-wool fabrics and made-up articles is now established at a level nearly three times that of the FTA [from 25 million square-metre equivalents (SME) to 65 million SME];
- the U.S. TPL for Canada on non-wool apparel has been doubled from 42 million SME to 80 million SME (and 88 million SME in 1999), a level twice that of all non-wool garment exports to the United States in 1991; and
- the U.S. TPL for wool apparel will be increased by 6 per cent over five years (from 5.1 million SME under the FTA to 5.3 million SME in 1999 under the NAFTA). This is 60 per cent higher than total Canadian exports of wool apparel to the United States in 1991.

The value of the TPLs has been further enhanced by a "short supply" provision. Apparel made from fabrics or yarns identified as being in short supply will be exempt from the rules of origin. The list of short supply items includes silk, linen, fine-wale cotton corduroy, cotton velveteen, harris tweed and a range of shirting fabrics. A review clause permits the addition of other short supply items.

Section Four outlines the special safeguard that will apply during the transition period for goods falling within the coverage of the annex. Should there be a surge in imports of textile or clothing products causing serious damage to domestic producers, a country may impose a temporary restriction on imports. This right, however, is circumscribed so as not to hurt investors seeking to take advantage of the new opportunities made available by the NAFTA to restructure their operations along regional lines.

The North American Consultative Committee on Labelling for Textile Products has been charged with finding ways to eliminate unnecessary obstacles to textile trade resulting from differences in labelling requirements. Its tasks will include developing equivalent requirements for information on care and fibre content to be included on labels permanently affixed to textile products; finding common acceptable means of attaching labels; defining a common system of size measurement; developing equivalent regulations for fibre-content listing and labelling terminology; and developing a common set of pictograms and symbols.

Canada would have preferred a simpler and more open approach to trade in textiles and clothing. Nevertheless, while the rules of origin are complex and not fully attuned to Canada's specialized production, Canadian producers will still find themselves in a more advantageous situation than under the FTA or the GATT. The quotas have been increased to a significant extent allowing Canada to exploit new market opportunities in both the United States and Mexico. Meanwhile, Section Seven sets out the terms for a five-year review of the rules of origin for textiles and apparel.

Market Opportunities: Industrial Machinery and Technology

This market is expected to grow steadily over the next five years as Mexican manufacturers strive to improve productivity to compete successfully in domestic and international markets.

Demand for machine tools, metalworking equipment, plastics production machinery and equipment, materials-handling equipment and similar production equipment and technology is expected to exceed $6 billion by 1994, with imports supplying most of the total demand. The success of the Canadian industrial trade fair organized in January 1992, in Monterrey, has given an indication of what the NAFTA may offer to Canadian exporters in this sector.

Chapter Four — Rules of Origin

Rules of origin are an essential part of any free trade agreement. They provide the basis for customs officials to determine whether goods are entitled to the more liberal tariff treatment provided for in the Agreement. Under a free trade agreement, each country maintains its own external tariff, and preferential treatment is extended only to goods "originating" from a member country. In essence, the rules of origin ensure that only goods that have been the subject of substantial economic activity within the free trade area are eligible for the more liberal trade conditions created by the NAFTA.

In drafting the rules of origin, Canada, the United States and Mexico sought to accomplish three basic objectives:

- to provide clear rules that would give certainty and predictability to producers, exporters and importers, and address the problems experienced under the FTA rules of origin;
- to avoid imposing unnecessary burdens on exporters or importers claiming the NAFTA benefits; and
- to ensure that the NAFTA benefits are accorded only to goods that originate in the NAFTA countries and not to goods that are made elsewhere and that undergo only minor processing in North America.

By meeting these goals, by adding greatly improved procedures for avoiding and settling disputes that may arise in the application of the rules, and by committing themselves to develop common regulations to govern the detailed interpretation, application and administration of the rules, Canada, the United States and Mexico will create business confidence in the NAFTA's more open trade conditions. The new rules completely replace the FTA rules.

Article 401 sets out the basic rules on qualifying for preferential treatment. To do so a good must pass the following tests:

- It must be wholly obtained within the free trade area or produced entirely from such materials; or
- If it incorporates inputs sourced from outside North America, the final product must undergo a change of tariff classification, specified in annex 401; or
- Certain goods in specific circumstances must meet one of two North American value-added calculations.

Rules of Origin

This is perhaps the most critical aspect of a free trade arrangement. It describes the provisions used to differentiate between goods made in one country from those made in another for the purpose of calculating the appropriate tariffs.

There are three basic types of goods:

- those wholly originating in one country (for example, potatoes grown in the garden, logs cut in the forest, fish caught in lakes, or oil and gas taken from the ground). These are clearly "originating";
- those made of parts and materials that originate wholly from within the free trade area, such as steel made in Canada using U.S. iron ore, coking coal and various alloys; and
- those goods that incorporate material imported from a third country, i.e., a country that is not a member of the free trade area. For these goods to be considered "originating," the imported material must be transformed within the free trade area into a new and different product.

There are two basic approaches to substantial transformation: subjectively, on a case-by-case basis; or objectively, in accordance with prescribed rules. Both the FTA and the NAFTA adopt an objective, rules-based approach to substantial transformation.

The rules-based approach involves two methods, both of which are used under the NAFTA and the FTA:

- Change in tariff heading: Here the manufacturer is told exactly what changes in imported material must occur for the product to be substantially transformed. The required changes are prescribed on the basis of the chapters, headings and subheadings of the Harmonized System. This approach is simple and straightforward and will apply to most circumstances. In some cases, such as when determining the content of automobiles, an additional content requirement must also be met.
- Content requirement: This means a certain portion of the value of the good must be added within North America. While this method is flexible and allows manufacturers several ways to meet a content requirement, it also obliges them to keep records of costs as proof and requires eligible costs to be specifically enumerated.

In drafting the detailed provisions of these rules, the negotiators significantly decreased the number of goods that will require a value-added calculation. This requirement now applies only to sensitive product categories or where a change of tariff classification test would not be feasible; for example, in cases where the final product and its components are classified under the same tariff heading.

To simplify transactions for goods that are almost wholly of NAFTA-origin materials, the Agreement provides a *de minimis* rule. Under this improvement to the FTA rule, goods that may not meet the change-of-tariff-classification test may still, in most circumstances, qualify as NAFTA-origin goods as long as the value of non-NAFTA materials used in their production is not more than 7 per cent of the value of the finished goods.

Transaction Value vs. Net Cost

Calculating the transaction value method requires that the value of non-originating materials used to produce a product be subtracted from the "transaction" value, i.e., the actual price paid to the producer. The remainder is then divided by the transaction value to obtain the required percentage of North American content — in most cases, 60 per cent.

$$\frac{x-y}{x} = z$$

x = transaction value
y = value of non-North American materials
z = percentage North American content

Calculating the net-cost method begins with the total cost of a good from which a series of ineligible costs — royalties, shipping and packing, sales promotion, marketing — are subtracted to obtain the net cost. The cost of non-North American materials is then subtracted from the net cost, and the remainder is then divided by the net cost to obtain the required percentage of NAFTA content — for most goods, 50 per cent.

$$\frac{(a-b)-c}{(a-b)} = z$$

a = total costs
b = ineligible costs
c = value of non-North American materials
z = percentage of North American content

To avoid burdensome value-added calculations, the Agreement allows importers to choose between the net-cost or transaction-value test. In most instances, manufacturers will prefer the more straightforward transaction-value approach. However, for automotive products, footwear and other goods for which a separate value-content test is required, or for products where the transaction value cannot be calculated (for example, because the importer and exporter are related), the net-cost method must be used.

Special rules have been developed to address the special characteristics of production and trade in the following sectors:

- Automotive products: To qualify for the NAFTA tariff treatment, cars, light trucks and their engines and transmissions must contain at least 62.5 per cent North American content, and other vehicles and parts must have at least 60 per cent North American content, based on the net-cost formula. The higher value requirement — the FTA rule was based on a 50 per cent value requirement — will be phased in over eight years. The value of imported parts and components will be traced through the production chain to improve the accuracy of content calculations. Finally, regional content averaging provisions will give administrative flexibility to automotive parts producers and assemblers. The Agreement provides for a special averaging at the CAMI plant in Ingersoll, Ontario. There is also a special provision that temporarily reduces the required regional content level to 50 per cent, for five years, for investors establishing new plants to produce vehicles not previously made by the producer in the region and, for two years, following a refit of an existing plant to produce a new vehicle.
- Textiles and clothing: Special rules of origin for textiles and clothing are set out in annex 300-B.

The NAFTA explicitly recognizes that a product can qualify for tariff preferences from production occurring in all three countries. Article 404 allows producers to accumulate their production when determining whether a good meets a required tariff classification change or regional value content. Chapter Four also sets out provisions regarding the treatment of spare parts, tools, accessories, and packing and packaging materials when determining the origin of goods, as well as specific conditions for goods that are transshipped through non-NAFTA countries and provisions to prevent circumvention of the rules of origin.

While Chapter Four sets out the rules and conditions for determining whether a good is eligible for the NAFTA tariff preferences, Chapter Five establishes the requirements and procedures for applying and administering the rules of origin. As such, it is an integral part of the rules of origin.

For the transition period, a number of additional rules were developed to provide a basis for differentiating between goods eligible for the FTA tariff levels — most of which will be free by January 1, 1994, and all of which will be free by January 1, 1998 — and the NAFTA tariff levels. These special transitional rules are set out in Chapter Three.

Example of the Harmonized System

Tariff Item	Description of Goods and Codes	Cdn MFN Tariff
62.01	Men's or boys' overcoats, car-coats, capes, cloaks, anoraks (including ski-jackets), wind-cheaters, wind-jackets and similar articles, other than those of heading 62.03:	
	— Overcoats, raincoats, car-coats, capes, cloaks, and similar articles	
	11.00 — of wool or fine animal hair	25.0 %
	12.00 — of cotton	22.5 %
	13.00 — of man-made fibres	25.0 %
	19.00 — of other textile materials	22.5 %
	— Other	
	91.00 — of wool or fine animal hair	25.0 %
	92.00 — of cotton:	
	92.10 — Men's ski jackets, solely of cotton	30.0 %
	92.90 — Other	22.5 %
	93.00 — Of man-made fibre	22.5 %
	99.00 — Of other textile materials	22.5 %

Chapter Five — Customs Procedures

Mechanisms to Facilitate Customs Procedures

Customs Subgroup — exchanges information and consults on technical and administrative aspects. The group has a 60-day deadline to reach agreement on any issues formally notified to it.

Working Group — to facilitate co-operation and consider modifications to the NAFTA on rules of origin, customs procedures, uniform regulations, drawback and country-of-origin markings. It will meet regularly to exchange information and to ensure uniform and consistent interpretation and application. The group has 30 days to reach agreement on issues passed to it by the customs subgroup.

Uniform Regulations — will ensure that the interpretation, application and administration of the rules of origin are consistent throughout the free trade area.

One of the lessons learned from the FTA was that customs administration and the procedures for interpreting, administering and enforcing the rules of origin and dealing with other customs matters must be set out in precise detail. As a result, an entire chapter of the NAFTA is devoted to customs procedures.

Articles 501-4 (certification of origin) set out the certification procedures and record-keeping requirements that will apply within the NAFTA area. Certificates are not required for goods valued at less than US$1 000, although shippers may be obliged to produce an invoice certifying that the goods qualify as originating goods. Records (article 505) must be kept for five years for eligible goods. Verification procedures (article 506) may include written questionnaires or on-site visits. Verifications of regional value content will be based on generally accepted accounting principles as applied in the exporting country. Article 507 assures producers that their records will be kept confidential.

To facilitate trade, business has the opportunity to seek advance rulings (article 509) on the origin of goods for both tariff preference and country-of-origin marking purposes. Review and appeal procedures (article 510) are to be non-discriminatory. Equal treatment is to be applied to all producers and exporters within the NAFTA area, although each country may adapt the right of review and appeal to its own circumstances.

The three nations have agreed to develop uniform regulations (article 511) on the rules of origin and a trilateral working group with a customs subgroup (article 513) will be established to deal with problems of rules of origin, customs procedures, country-of-origin marking obligations and drawback procedures. Specific time periods are laid out to ensure expeditious resolution and implementation.

Market Opportunities: Energy Equipment and Services

Mexico's petroleum production ranks third in the world, with reserves estimated at 45 to 60 billion barrels. Canada, with its leading technology and co-operative business style, is well-placed to seize new procurement opportunities created by the NAFTA as the industry modernizes and looks outside Mexico for modern equipment, technology and services. The industry is fundamental to the Mexican economy.

Petroleos Mexicanos (PEMEX), the state monopoly controlling the exploration, exploitation and distribution of these resources, is one of the largest companies in the world. During the 1980s, much of PEMEX's earning power went to servicing Mexico's crushing debt payments. PEMEX is now catching up after a decade of minimal purchasing, updating and maintenance, and plans to spend as much as $23 billion over the next four or five years on equipment and services. Mexico's demand for electricity is increasing almost 5 per cent annually, and it will need 26 000 MW of capacity by the year 2000.

Mining Equipment and Services

Canada's mining technology is second to none in the world. Mexico is, with some exceptions, years behind recent advances and needs to revitalize this sector. It is restructuring its mining regulations to allow foreign investment and to encourage the adoption of more effective, safe and environmentally sound practices.

Foreign investment amounted to more than $580 million in 1991 matching more than $650 million in Mexican investment. As a result of the improved business climate, Mexican companies have been spending an estimated 30 per cent more on parts and projects each year, totalling some $700 million in 1990.

A study prepared by KPGM-Peat Marwick estimates that a NAFTA would stimulate a 13.2 per cent increase in mining production over its first 10 years, simply from increased economic growth and demand for basic minerals.

Chapter Six
Energy Goods and Basic Petrochemicals

In 1991, Canada exported $16 billion in energy products. Eighty per cent of those exports went to the United States. For Canada, the energy provisions of the FTA ensured that this very significant trade would be based on market principles and would be subject to very few trade restrictions. Recognizing the value of the FTA framework, Canada's key objective, going into the NAFTA negotiations, was to maintain and, where possible, strengthen the FTA rules covering energy trade. In addition, Canada wanted to ensure the disciplines on investment, services and procurement, which affected the energy and petrochemical sectors in Mexico, to put Canadians on an equal footing with Americans.

Chapter Six consolidates the NAFTA provisions relevant to energy and basic petrochemical trade and related regulatory activities. It mirrors all of the key elements of Chapter Nine of the FTA, reproducing the key FTA provisions concerning border measures, energy-specific provisions relating to trade and regulation, including the proportional access provision, as well as energy-specific national security language. Chapter Six also adds new language on energy regulatory measures. Overall, the chapter ensures equal access for Canadian companies to the Mexican market relative to their U.S. competition.

Encouraging Mexico to adopt the FTA framework proved difficult in certain areas, largely because of its constitutional and legal requirements to restrict foreign activity in the energy sector. Mexico has reserved the right to restrict foreign participation in the following activities:

- upstream oil and gas exploration and development;
- refining and processing of crude oil and natural gas;
- foreign trade, storage, distribution and transportation of crude oil, natural gas and basic petrochemicals;
- the supply of electricity as a public service and related generation, transmission and distribution; and
- exploration, exploitation and processing of radioactive materials.

The restrictions on foreign investments in these activities will apply until such time as Mexico voluntarily liberalizes its laws (as provided for in annex III of the Investment Chapter). When that occurs, Canadian investors will have access to any investment opportunities made available through liberalization.

Despite the continued existence of these limitations, the NAFTA contributes to the further removal of investment and trade restrictions associated with secondary and tertiary petrochemicals and establishes new opportunities for Canadian investors in the area of non-utility electricity generation (for example, production for its own use, co-generation and independent power production).

Canada, Mexico and the United States have agreed that governments shall not apply restrictions to imports or exports, except in limited situations consistent with the General Agreement on Tariffs and Trade (GATT), regardless of whether these restrictions are export taxes, import fees, quotas, or minimum or maximum import or export prices. These provisions parallel those applying to all non-energy goods (NAFTA articles 309 and 314). Mexico's acceptance of the obligations on import and export restrictions is conditioned by a special reservation (in annex 603.6) permitting it to restrict foreign trade of certain goods to itself as currently required by the Mexican constitution.

As part of the FTA, Canada and the United States agreed to an energy-specific proportional access obligation (article 904). Like the FTA, the national security obligation (article 607) narrows the range of generally available GATT (article XXI) and NAFTA (article 2102) justifications for invoking measures on national security grounds. The grounds for adopting measures aimed at restricting the import or export of basic petrochemical goods are limited to essentially military situations. Mexico is not subject to any of the rights and obligations created by articles 605 and 607.

Article 606 (Energy Regulatory Measures) is new to the NAFTA and will replace the existing FTA consultation provision (article 905 — Regulatory and Other Measures). It clarifies the obligation on energy regulatory bodies to apply measures consistent with the Agreement's obligations on national treatment, import and export restrictions and export taxes. In addition, Canada, Mexico and the United States have undertaken a best-efforts obligation to ensure that energy regulators avoid the disruption of existing contracts "to the maximum extent practicable" and that they provide for an orderly and equitable implementation when disruptions do occur.

> *Mexico has a vibrant economy. They know that, to compete with the best in the North American market, they must have the best machinery. We can provide them with that.*
>
> William Steel, Damark Packaging Inc.

Chapter Seven — Agriculture

Canadian agricultural producers export more than $13 billion a year to markets around the world, and Canadians consume some $9 billion in imported agricultural products every year. It is no wonder, therefore, that, for years, Canada has been at the forefront of those advocating more open and more predictable conditions for trade in farm products.

Unfortunately, the barriers faced by agricultural products vary greatly from country to country, and most of them are rooted in differing domestic programs and policies aimed at promoting price and income stability. Canada agrees that governments should be able to help stabilize farm incomes but believes this can be achieved without distorting world trade. At the same time, Canada has maintained that only a global framework of rules can effectively bridge these differences and provide a basis for gradually liberalizing and stabilizing world trade in agriculture.

Over the past six years, agricultural trade rules have been a principal focus at the Uruguay Round of GATT negotiations, and significant progress has been made in achieving Canada's goals. Problems remain, however, particularly between the United States and the European Community. Until these are overcome, a satisfactory set of global trade rules on agriculture will remain elusive. In the NAFTA, Canada was able to meet its main objectives.

- There is immediate access (article 703) for most Canadian exports to the Mexican market. The access is equivalent or equal to that enjoyed by the United States. Mexico's import-licensing system, which curbed grain imports, has been eliminated with immediate effects on wheat, barley, potatoes and corn.
- For Canada and the United States, the provisions of Chapter Seven of the FTA will continue as the basis for regulating cross-border trade in agriculture.
- Special transitional measures are maintained for the most sensitive Canadian fruit, vegetables and flowers. Supply management boards for dairy, poultry and eggs are not affected. Special arrangements also apply to sugar and sugar syrup.

The countries will work toward ensuring that subsidies to agriculture, whether they be domestic support measures or government assistance aimed at export sales, will have a minimal trade-distorting effect (article 704).

The three countries have agreed to eliminate all tariffs on agri-food products during the transition period, with the exception of dairy, poultry, egg and sugar products in the case of the Canada-Mexico bilateral arrangement. Canada imports mostly tropical fruits, coffee, fresh

fruits and vegetables out of season; about 85 per cent of imports from Mexico now enter duty-free. Most Canadian tariffs on imports from Mexico will be eliminated immediately or in five years, but some sensitive categories will be eliminated over 10 years. Similarly, Mexico will eliminate some of its agricultural tariffs on imports from Canada immediately (for example, rye, lentils, raspberries and buckwheat), some over five years and some over 10 years.

Mexico will eliminate its import licences for wheat and barley and replace them with tariffs, in the case of wheat, or tariff-rate quotas, for barley, which will be phased out over 10 years. Tariff-rate quota levels for imports will reflect historical performance in the Mexican market by Canadian and U.S. producers. In return, Canada will exclude Mexico from its import-licence requirements for wheat and barley and their products.

The NAFTA Agricultural Tariff Phase-Out

By Canada On Mexican Products

Immediate	Five Years	Ten Years
Pork	Potatoes	Fresh tomatoes
Soya-bean meal	Cabbages	Frozen cauliflower
Alfalfa meal	Raspberries	Baby carrots
Active yeasts	Wheat	Frozen asparagus
Cat or dog food	Barley	Green onions
Coffee	Corn	Cut flowers
Sorghum	Snap beans	Frozen strawberries
		Tomato paste

By Mexico on Canadian Products

Immediate	Five Years	Ten Years
Rye	Mushrooms	Apples
Buckwheat	Peppers	Vegetable oils
Broccoli	Frozen broccoli	Pork
Lentils	Frozen sweet corn	Wheat
Raspberries	Canary seed	Cereal flours
Frozen blueberries		Barley
Beef and cattle		Malt

Canadian agricultural producers will continue to enjoy the same terms of access that they have exploited in the U.S. market and, with the exception of dairy, poultry, egg and sugar products, will be able to compete in the Mexican market on the same terms as U.S. producers. Similarly, Mexico will be able to compete in the Canadian market on the same terms as Canadian and U.S. producers, with the exception of dairy, poultry, egg and sugar products, and certain fruits and vegetables, where Mexico will face a special safeguard regime, during the transition period, based on gradually liberalized tariff-rate quotas.

Most imports of Mexican fresh fruits and vegetables complement Canadian production, arriving when Canadian production is low or non-existent. At the same time, Canadian producers of apples, fresh and frozen berries and frozen potatoes should find new markets in Mexico.

The Agreement establishes a Committee on Agricultural Trade (article 706), which is responsible for monitoring and implementing the agricultural provisions. A working party on agricultural subsidies will meet semi-annually to consider ways to reduce the trade-distorting impact of subsidies and to find means of eliminating or reducing export subsidies (article 705). Various other working groups are established to reduce conflicts arising from trade in agricultural products, including an Advisory Committee on Private Commercial Disputes regarding agricultural goods (article 707).

A separate section (B) deals with rules and disciplines on sanitary and phytosanitary (SPS) measures. Rather than a patchwork of sometimes conflicting disciplines resulting from bilateral and unilateral codification, the NAFTA is based upon the multilateral rules worked out in the GATT. In this sense, they build on the progress, which has been achieved but not yet concluded, in the current GATT negotiations.

Unlike the FTA, which was handicapped by its effort to harmonize two different national standards, the NAFTA establishes clear ground rules under which governments, while keeping to the disciplines, can act in accordance with local conditions. The guiding principle is that measures are in accordance with scientific principles and are based on the appropriate level of protection from risk. In the NAFTA, therefore, the three countries agree to work toward equivalent SPS measures without reducing their particular health-protection standards.

A trilateral Committee on Sanitary and Phytosanitary Measures, meeting at least once a year, will facilitate co-operation on food safety and other sanitary and phytosanitary measures. It will have the authority to set up ad hoc working committees to resolve specific issues and it may seek the advice of the international organizations named in the Agreement, including the Codex Alimentarius Commission, the International Office of Epizootics, the International Plant Protection Convention and the North American Plant Protection Organization.

What They Do — International Agricultural Organizations

Codex Alimentarius Commission — This part of the Food and Agriculture Organization sets international standards for the food and agricultural sector from recommendations developed by independent, internationally recognized experts and extensive consultations.

The International Office of Epizootics — Based in Paris, this office tracks the prevalence of animal diseases, such as blue tongue, brucellosis and hoof-and-mouth disease with a view to minimizing the risk of spreading livestock diseases. It maintains a code to guide quarantine procedures in member countries.

The International Plant Protection Convention — This body sets standards for and tracks the prevalence of disease in plants and other biotics with a view to preventing the spread of plant diseases and pests. Under its umbrella, the North American Plant Protection Organization tracks its requirements within the NAFTA region.

Market Opportunities: Food and Agriculture

Mexico currently imports approximately $5 billion in agricultural and food products. Under the Agreement, Mexico will eliminate import-licence requirements for Canadian grains, including wheat, barley and oilseeds. These import-licence requirements will be replaced with either tariffs or tariff-rate quotas. With the TRQ system, quota levels will increase, and tariffs will be gradually phased out to provide unrestricted access to the Mexican market.

Livestock inventory levels in Mexico reflect conditions of limited arable land, water supplies and an especially acute supply-demand imbalance in the grains and oilseeds sectors. Mexico is not likely to become self-sufficient in livestock or meat in the near future, and there is demand for breeding livestock, pork and other meat products. After the United States and Japan, Mexico is Canada's third-largest customer for pork.

In the past, skim milk powder has been Canada's largest agricultural export to Mexico. In recent years, our exports have declined as skim milk production in Canada now almost matches domestic demand. Now that Mexico is attempting to increase its milk production at home, there are good market opportunities for Canadian suppliers of dairy cattle and genetic material. Imports of dairy breeding stock from Canada totalled about $4.8 million in 1990.

Changes in the eating patterns of Mexicans, due to urbanization and higher incomes, have given Canadian specialty food products (such as cookies and biscuits, frozen potato products and other frozen and microwavable products, bottled water, and convenience and snack foods) a market niche in Mexico.

We have worked very hard to establish our export markets and they are proof again that Canada, as a trading nation, is able to compete, expand and create markets for its products, even from the most remote areas of the country.

K. Lynn Riese, Riese's Canadian Lake Wild Rice

Chapter Eight — Emergency Action

Under the GATT (article XIX) and the FTA (Chapter 11), countries may take emergency action if increased imports cause injury to domestic producers. This concept is carried over into the NAFTA on a basis similar to the FTA, with separate provisions to cover both bilateral actions during the transition period as well as border restrictions applied to imports from all suppliers (global actions).

The bilateral track addresses surges that may result directly from the more liberal trade conditions provided by the NAFTA. If there is a surge in imports causing serious injury to domestic producers, the injured country may take emergency action temporarily to restore protection. To meet concerns about lower wages in Mexico, the standard required to take action will be less stringent than the FTA by allowing action to be taken against Mexican goods on the basis of a threat-of-injury finding (while the FTA limits action against U.S. goods to cases of actual injury). The duration of relief required can also be extended beyond the three-year FTA maximum, either by one year at a lower rate of duty, or until the end of the full transition period through a "soft-landing" recalculation of the duty phase-out schedule at the end of safeguard action. The bilateral provisions of article 1101 of the FTA, however, will remain in effect for trade between Canada and the United States (annex 801.1).

Article 802 specifies the criteria that must be met if a global action is to be extended to a NAFTA member. Under the NAFTA global track, one country's goods shall not be included in another's global border restrictions unless two key criteria are met: exports from that country must account for a substantial share of total imports to the affected country (defined as being among the top five suppliers of the good under investigation during the most recent three-year period), and the annual growth of its exports must be close to or more than the annual rate of growth from all sources. These criteria will ensure the exclusion of a Canadian firm that is a new, niche supplier or where Canada is the traditional, stable supplier. Based on recent trading patterns, this should normally ensure the exclusion of approximately 30 to 35 per cent of Canadian exports to the United States, but only 15 to 20 per cent of U.S. exports to Canada.

Article 803 and its annex lays out detailed procedural obligations. Once a request for emergency action has been initiated by a domestic industry, the appropriate investigating national authority [in Canada, the Canadian International Trade Tribunal (CITT); in the United States, the International Trade Commission (USITC); and, in Mexico, the Ministry of Trade and Industrial Development] gives public notice of the investigation. The NAFTA obliges them to hold public investigative hearings and provide an opportunity for cross-examination by

interested parties. If confidential information is provided, it should be accompanied by an unclassified summary.

In arriving at its decision on injury, the investigating tribunal must consider:

- the rate and amount of the increase in imports of the goods concerned;
- the share of the domestic market taken by the imports; and
- the changes in level of sales, production, productivity, capacity utilization, profits and losses and employment.

In addition, it may consider:

- the changes in prices and inventories; and
- the ability of the firms in the industry to generate capital.

Definitions: Emergency

Serious Injury means a significant overall impairment of a domestic industry.

Surge means a significant increase in imports over the trend for a recent representative base period.

Threat of Serious Injury means serious injury that, on the basis of facts and not merely allegation, conjecture or remote possibility, is clearly imminent.

Part Three — Technical Barriers to Trade

Chapter Nine — Standards-Related Measures

In the complex world of modern technology, product standards and technical regulations are essential. They protect consumers and help producers achieve high quality. For example, life jackets bought in Canada must meet certain life-saving requirements. Similarly, any electrical equipment must conform to safety regulations. Occasionally, standards or safety regulations can also be used to keep out a competitor. To prevent this sort of abuse, the NAFTA contains rules governing the use of standards. Chapter Seven addresses standards in the agricultural sector. This chapter addresses other technical barriers. It also establishes a Committee on Standards-Related Measures to monitor implementation of this chapter and to provide a forum for consultation, and it sets up subcommittees on specific subjects.

The GATT requires that countries not discriminate between domestic and imported goods in applying standards and technical regulations nor use such regulations as disguised barriers to trade. In the Tokyo Round of multilateral trade negotiations (1973-79), an Agreement on Technical Barriers to Trade provided detailed rules of procedure to help countries resolve disputes that could arise in the application of standards. It was based on the principle that no country should be prevented from taking measures to ensure protection of human, animal or plant life as long as they are not applied to cause arbitrary or unjustifiable discrimination between imported or domestic goods.

The FTA amplified these obligations by adding a number of further procedural obligations and advancing the concepts of compatibility and mutual recognition of each other's standards. The NAFTA represents a further step forward. Recognizing that standards are necessary for the protection of consumers as well as the environment and human, animal and plant life generally, the guiding principle is that standards must be non-discriminatory. They should also accord with international practice and the findings of international standardizing bodies, including the International Organization for Standardization, the International Electrochemical Commission, Codex Alimentarius Commission, the World Health Organization, the Food and Agriculture Organization, and the International Telecommunications Union.

What They Do — International Standardizing Bodies

International Organization for Standardization (ISO) — a non-governmental federation of some 90 national standards bodies. Canada is represented by the Standards Council of Canada. Established in 1947, it promotes the facilitation of trade through international standardization. Most of its work is the result of some 200 technical committees, which have, over the years, published more than 8 000 international standards. A further 6 800 international standards are currently under discussion.

The International Electrochemical Commission (IEC) — an independent non-governmental organization that works closely with the ISO in setting standards in the electrical and electronic engineering field. Both the ISO and the IEC work closely with UN organizations, such as the FAO and the WHO.

Codex Alimentarius Commission — an FAO-based organization that sets international standards in the food and agricultural sector.

The World Health Organization (WHO) — an organization, founded in 1946, that develops and disseminates information on drug safety and efficacy, develops standards on pharmaceutical issues and, in co-operation with the FAO and the International Labour Organization (ILO), develops food, chemical and other safety standards.

The Food and Agriculture Organization (FAO) — an organization, founded in 1945, that addresses problems related to food and agriculture, and co-ordinates agricultural and food safety standardization activities.

The International Telecommunications Union (ITU) — an organization, founded in 1865, that is the principal international organization concerned with the management of international telecommunications and associated standards.

Within this framework, the main objective of these articles, therefore, is to ensure that technical standards are applied on a non-discriminatory basis on products — goods and certain services — of Canadian, U.S. and Mexican origin. Where there are differences between national standards, the rules seek to neutralize, to the greatest extent possible, the impact of these differences on trade by promoting compatibility, equivalence, and notification and information exchange requirements.

Rather than seek harmonization between different national standards, NAFTA bases its approach on the principle of compatibility and equivalence. NAFTA countries are encouraged to make their standards, technical regulations and conformity-assessment procedures compatible in order to facilitate trade. In addition, NAFTA establishes a new type of equivalency test, which will allow the three countries to maintain differing regulations, while allowing trade in the regulated products. The exporting countries must show that their regulations meet the importing country's requirements, even when those regulations differ. Article 908 spells out a "conformity assessment" procedure and encourages each country to make its procedures compatible. To build confidence in the other national requirements, the chapter sets out detailed procedures on accreditation, conformity assessment, acceptance of test data, information exchanges and notification.

In January 1993, an initial five-year certification was granted by the U.S. Occupational Safety and Health Administration to the Toronto laboratory of the Canadian Standards Association, a non-profit group of five testing laboratories based in Ontario. The laboratory will now be able to certify that certain products, including heating and cooling equipment, industrial appliances, lighting and electrical equipment meet the more than 360 U.S. health and safety standards. It is the first foreign standards body to be given national recognition in the United States. Underwriters' Laboratories of Northbrook, Illinois, has already been granted Canadian approval to certify that products comply with Canadian standards.

In working toward compatibility, however, there are three guiding principles: safety levels must not be diminished; the rights of each nation to set appropriate standards must not be prejudiced; and international standardization must be taken into account. Over time, as governments and private standards organizations develop agreements leading to the mutual acceptance of test results and certification procedures, the capacity of different standards to frustrate trade should be greatly reduced.

Definitions: Standards

Conformity Assessment Procedure means any procedure used to determine that a technical regulation or standard is fulfilled.

National Treatment means that imported products are required to meet the same regulatory requirements as products of domestic origin.

Make Compatible means making different technical or regulatory requirements either identical or equivalent in effect.

Unlike the FTA, the NAFTA requires the parties to seek to ensure, through appropriate measures, that provincial, state and local governments, as well as non-government standard-setting organizations, comply with the provisions of this chapter. This was negotiated to ease the problems that Canadians had in dealing with U.S. state regulations. The sheer number of standards-setting organizations in the United States at the state and municipal level poses a large potential non-tariff barrier unless procedures are put in place to address problems as they arise. The NAFTA makes significant progress in meeting this requirement.

To promote compliance and avoid disputes, each country must notify the others of its intent to adopt or modify a standards-related measure (article 909). The notice must state the goods or services to be covered and the objective and rationale for the adoption or modification. The other countries must be given ample opportunity to comment. All standards-related measures must be published promptly and sufficient time allowed between publication and implementation to allow producers to become familiar with them. The establishment of enquiry points in each country, such as the Standards Council of Canada, should facilitate access to information about standards and procedures.

A Committee on Standards-Related Measures (article 913) will monitor the implementation of this chapter and facilitate consultation on any issues arising from standards-related measures. It can set up subcommittees and working groups to assist it in its function to facilitate

compatibility and co-operation in standards-related measures. Four standing subcommittees (annex 915) to deal with specific problems are also established.

1. **A Land Transportation Standards Subcommittee** will determine, within two-and-a-half years, standards for truck and bus drivers; within three years, standards for vehicles, including inspections, emissions, environmental pollution; within three years, standards on road signs; within one year, standards for locomotives; within six years, standards on the transport of dangerous goods using the UN Recommendations on the Transport of Dangerous Goods as a basis.
2. **A Telecommunications Standards Subcommittee** will establish a work program within six months on equipment standards.
3. **An Automotive Standards Council** will seek to facilitate compatibility of national standards, keeping in mind the impact on industry integration, extent of barriers to trade, level of trade and extent of disparity.
4. **A Subcommittee on Labelling of Textiles and Apparel Goods** will establish a work program on the harmonization of labelling requirements, including the use of pictograms and symbols, care instructions, fibre-content information and use of national registration numbers.

Exporters and consumers are the principal beneficiaries of this Chapter. Canada's high standards for health, safety and environmental protection are confirmed while, at the same time, procedures have been put in place to tackle the sometimes bewildering array of standards that face Canadian exporters and service providers to the United States, resulting from the highly decentralized approach to standards-setting adopted by the federal and state governments. In addition, these principles will help Mexico raise its standards and adopt a best-international-practice approach to its standards-setting measures. By encouraging the development of compatible standards, Canadian exporters can count on being competitive in a wider range of markets, while the Standards Committee will help to resolve technical problems before they become trade irritants.

Part Four — Government Procurement

Chapter Ten — Government Procurement

Government procurement is the purchase of goods and services by federal, provincial and local governments for their own use. Efforts over the years, particularly since the mid-1970s, to reduce discrimination, have met with some success but still leave significant segments of national procurement markets closed to full international competition.

Both the GATT and the FTA succeeded in opening up a proportion of federal procurement. The Procurement Code concluded during the Tokyo Round of GATT negotiations subjected goods purchases above a value by selected government "entities" — departments and agencies — to rules of non-discrimination. It excluded the U.S. Departments of Energy and Transport and the Departments of Transportation, Communications and Fisheries and Oceans in Canada. Defence Department procurement was also given limited coverage.

The FTA expanded the coverage of the Code by lowering the applicable threshold from US$171 000 to US$25 000. In addition, the FTA included provisions aimed at making the government market more transparent and subject to more stringent procedures to settle disputes. The FTA did not open up provincial, state or local government departments or agencies nor provincially owned public utilities and crown corporations.

In the NAFTA, Canada sought a comprehensive agreement extending national treatment obligations to all levels of government, including crown and parastatal corporations. Mexico appeared equally prepared to conclude a large deal. The continuing inability of the United States to address its legislated exceptions (for example, "Buy America" and "Small Business Set-Asides") precluded such an extensive agreement. While the goods contracts threshold remains at US$25 000 for bilateral Canada-U.S. goods contracts, the NAFTA provides:

- a contract threshold of US$50 000 for goods, services or any combination thereof;
- a threshold of US$6.5 million for construction services;
- for government enterprises (in Canada, 11 named crown corporations), a contract threshold for goods and services of US$250 000 and for construction services US$8 million;

- for the inclusion of the U.S. Corps of Engineers construction market (which, based on current levels, opens a market of approximately US$8.9 billion) and the Rural Electrification Act (which opens a market of approximately US$1.5 billion in telephone equipment purchases) in the entities list; and
- for the addition of parts of the U.S. Departments of Transport and Energy and the Canadian Departments of Transport, Fisheries and Oceans and Communications to the list of entities covered by the Agreement.

Crafting a smaller deal along the lines of the FTA was complicated by the fact that Mexico is not a party to the GATT Procurement Code. Despite this, the negotiators were able to open up a significant proportion of the Mexican procurement market, including its parastatals — crown corporations, such as PEMEX and CFE, and its petroleum and electricity institutions. The NAFTA adds some $58 billion in covered procurement to the $20 billion market already open to competition under the GATT and the FTA. It should be remembered, however, that the total procurement market in the three countries is approximately $US800 billion.

The NAFTA maintains the FTA's explicit rules on the bidding process, but because Mexico is not a signatory to the GATT Procurement Code, a somewhat different and more detailed approach was taken. Rather than affirming rights and obligations under the Code and adding additional provisions, Chapter Ten replicates much of what can be found in the GATT Code as well as the additional provisions of the FTA relating to transparency and procedural obligations.

Further negotiations (article 1024) on liberalization of procurement are to begin no later than 1998 and, depending on progress in the GATT on the Procurement Code, the provinces and states are to be encouraged to participate. Negotiations on electronic transmission of data are also to begin within a year of the NAFTA's implementation.

> *Although enthusiasm for free trade is axiomatic to economists, the truth is that not all the arguments point in that direction.... in most instances these arguments amount to debaters' points: while clever and conceivably valid under some circumstances, they ought not to detain practical-minded people who have little patience for scholastic exercises.... Protectionism's allure stems not from the economics of the national interest, but from the politics of special interests. Politics turns trade policies that are economic turkeys into political peacocks.... It is not that trade restrictions can never benefit a country in principle, it is just that they rarely do so in practice.*
>
> Alan Blinder, Princeton economist

Part Five
Investment, Services and Related Matters

Trade in goods was the key factor leading to the steady integration of the world economy in the postwar years. As trade increased, capital flows and technology exchanges gradually strengthened their roles as agents of integration. Today, the effective production and marketing of both goods and services require that firms have access to global capital and information on the best available terms and that they are able to set up facilities or joint ventures around the world. To meet this objective, it is increasingly necessary that laws and regulations affecting the flow not only of goods and services, but also of capital and technology, enhance the ability of firms to pursue global strategies.

Today, the issues of government policy that are critical to trade and competitiveness are increasingly those that foster an overall hospitable economic climate. More to the point, the focus of policy has shifted from efforts to segment markets (i.e., protect existing investment) to efforts to promote interdependence (i.e., attract new investment by both domestic and foreign investors). In effect, trade policy is becoming more domestic, while domestic policies are becoming more international.

In the years to come, as contentious negotiations increasingly focus on sensitive domestic regulatory schemes (involving such diverse issues as environmental protection, product standards, competition policy, innovation policy, income and price support programs), governments will need to consider the most effective way to negotiate rules consonant with a global economy dominated by global firms operating within and between national economies.

> *The globalisation of industrial activities and overlaps between industrial and trade policies may necessitate a broader multilateral framework for harmonization of industrial policies. A third phase of internationalization has been reached, which comprises trade, foreign investment and global networking; this globalisation implies a move beyond mere interdependence to the mixing and blending of national economies, largely due to the activities of multinational enterprises. Policy areas, which were previously considered domestic, now have spillover effects on the welfare of other countries and implications for the world trading system.*
>
> OECD, *Globalisation of Industrial Activities*, 1992

Consistent with these trends, the FTA, the NAFTA and the GATT Uruguay Round have all begun to address some of the new issues that have arisen as a result of the greater integration of the international economy, such as services, investment, intellectual property and business travel. The chapters in this part and part six reflect emerging consensus on how to structure the new rules. A striking feature of these chapters is the increasing sophistication in approach.

For example, the investment text in the FTA built on earlier bilateral and Organization for Economic Co-operation and Development (OECD) experience and was geared largely to international trade in goods; the early Uruguay Round commitment to limit negotiations to trade-related investment measures gradually gave way to broader considerations. The NAFTA text reflects an expanded outlook and is geared more to the whole range of factors involved in international business, such as trade in goods and services and the transfer of technology and strategic alliances, and covers the conduct of business rather than just investment.

Similarly, the financial services chapter of the FTA involved very specific concessions by each side; the NAFTA chapter completely recasts these obligations and expands them into a set of generic rules with some specific exceptions and concessions. In the years to come, the experience that Canada has gained in negotiating and implementing these new rules will ensure that we can continue to be at the cutting edge, both in taking advantage of emerging opportunities in the global economy and in defining the trade regime of the future.

Foes of the FTA were clearly too pessimistic about export prospects and related employment growth in many key industries. In particular, many of Canada's manufacturing sectors seem to have performed remarkably well in the U.S. market under the FTA. And there is absolutely no indication whatsoever that Canada's traditional role as a provider of natural resources to the United States has become entrenched as a result of the FTA. The U.S. market continues, in fact, to be the most dynamic market for Canadian manufacturers of high-value-added, finished goods and business services, despite its recent poor growth performance....

These industrial sectors are vital to Canada's future economy, and the FTA has allowed Canadian producers to gain export sales – thus supporting employment in these industries as well. Over the long term, it appears that free trade will likely help Canadian industry to wean itself from dependence on the more traditional sectors of the economy. Job losses associated with higher imports that have occurred under the FTA must be put in this context of short-term growth gains in many other industries and against evidence that Canadians are building a higher value-added industrial base for the future.

Daniel Schwanen, "Were the Optimists Wrong on Free Trade?,"
C.D. Howe Institute *Commentary* No. 37, October 1992

Chapter Eleven — Investment

Over the years, Canada has negotiated investment agreements both to protect the interests of Canadian investors abroad and to provide a rules-based approach to the resolution of disputes involving foreign investors in Canada or Canadian investors abroad. The FTA marked the first time that Canada entered into a comprehensive set of rules governing both inward and outward investment. The NAFTA builds on that experience. It includes a more integrated and extensive set of obligations, which will ensure that Canadian interests will continue to be protected within a set of generic rules. It also includes important new provisions for dispute resolution and addresses a broader range of issues related to the conduct of business. The NAFTA chapter thus reflects not only the addition of Mexico, but also the increasing importance of an open investment regime in underwriting economic growth and development in Canada.

The NAFTA definition of investment includes minority interests, portfolio investment, and real property as well as majority-owned or -controlled investments from the NAFTA countries. The FTA covered only U.S.-controlled investments in Canada and vice versa. In addition, NAFTA coverage extends to investments made by any company incorporated in a NAFTA country, regardless of country of origin. This approach will help ensure that Canada remains an attractive site as a "home base" in North America for Japanese and European investors. Transportation, which was excluded from the FTA, is covered by the NAFTA. This broader NAFTA coverage is also important in protecting Canadian investments in Mexico.

Canada will be able to maintain all existing restrictions on sensitive sectors in the Canadian economy, such as transportation, telecommunications, social services and cultural industries. Furthermore, Canada's ability to review major takeovers remains unaffected (apart from the extension of the FTA-based higher Investment Canada review thresholds to Mexico). Canada has further agreed to subject disputes raised by foreign investors to international arbitration elaborating on Canada's own practice of including such provisions in recent foreign investment protection agreements.

The NAFTA (articles 1102-4) provides for the better of national treatment and most-favoured-nation treatment. National treatment means that Canadian investors will be treated the same as Americans in the United States and as Mexicans in Mexico. MFN means that, if a NAFTA partner extends more favourable treatment to a non-NAFTA investor (or another NAFTA investor), it must extend this treatment to all NAFTA investors. The inclusion in the

NAFTA of an MFN obligation to the basic national treatment provision is a helpful improvement over the FTA.

Foreign Investment in Canada

Foreign investment has been essential to Canada's development as a nation and our continued prosperity. The development of the fur trade, the construction of the national railroads and the creation of our energy, automotive and mining industries were all financed with foreign help, initially mostly from Britain and later from the United States. These investors saw Canada as a good place to invest their capital. Given our small population, relative to our size and potential, foreign investment is essential to maintain and enhance our competitive advantages. Total foreign investment in Canada reached approximately $490 billion in 1992.

Foreigners hold over $202 billion in Canadian bonds, about a third of all Canadian bond holdings. Federal and provincial governments, as well as provincial utilities, are active participants in the international bond market, seeking vital capital to help build our highways, hospitals and schools. The Canadian provinces and their enterprises increasingly tap the foreign bond market and now account for 42 per cent of foreign holdings of Canadian bonds.

Foreign direct investment, through shares in corporations or ownership of subsidiary firms, constitutes the second-largest form of investment in Canada after bonds, at nearly $130 billion. U.S. investment represents 65 per cent of all foreign direct investment. Of the $115.5 billion in capital employed in manufacturing at the end of 1987, foreign investors owned 48 per cent, with the United States controlling 36 per cent of all capital. In the petroleum and natural gas industry, foreign capital accounted for 40 per cent of $75.5 billion in capital. Foreign capital made up 40 per cent of the $25.5 billion capital in the mining and smelting industry. Of the nearly $7.5 billion invested in the auto industry in 1987, 80 per cent was controlled by the United States.

The United States continues to be the largest net investor in Canada ($105 billion) followed by Japan ($59 billion) and the United Kingdom ($29 billion). In recent years, direct investment from West Germany, Hong Kong and Switzerland has risen markedly.

For our part, Canadian investment abroad totals some $220 billion. Direct investment amounts to $93 billion, largely in the United States (60 per cent), although the U.S. share has been decreasing in recent years in favour of European Community countries (20 per cent), especially the United Kingdom.

Investment Canada, *Canada's International Investment Position*, 1991

Exceptions for existing discriminatory measures are permitted. These measures are to be listed and subject to a "standstill" (i.e., they can only be liberalized and not made more restrictive). Provincial governments will have two years to list those measures not in conformity with the Agreement, which they wish to maintain. In addition, in the case of a few agreed sectors, discrimination is permitted without the standstill obligation not to introduce more restrictive measures. These unbound sectors include maritime transport for the United States;

social services for all three countries, sectors subject to constitutional restrictions for Mexico and basic telecommunications for all three countries. Additional exceptions are permitted from the MFN obligation for listed bilateral and multilateral agreements (for example, bilateral air agreements). Limits on foreign ownership in the privatization of state enterprises (i.e., crown corporations) and government functions are permitted, although a tax measure that has the same impact as expropriation is subject to the NAFTA's compensation provisions (articles 1110 and 2103).

The NAFTA will ensure that Mexico will substantially revamp its investment laws. Over time, this will bring them generally into conformity with the regimes in place in Canada and the United States. Mexico has agreed to eliminate most screening of new investment and will severely curtail its review of takeovers. Restrictions on more than 700 sectors have been reduced to a few dozen. Major areas of reform of interest to Canadian investors include mining, secondary petrochemicals, construction, agriculture, autos, most manufacturing, financial services and a wide range of general services.

The imposition of certain trade-distorting performance requirements, such as export performance, local content, domestic purchasing and trade balancing is prohibited on the entry or ongoing operation of all investments. In addition, performance requirements, such as local content, domestic purchasing and trade balancing are not permitted as conditions for receiving subsidies or other incentives (article 1106).

To protect investors, article 1109 explicitly permits the transfer of profits, dividends and the proceeds of liquidating an investment. Exceptions are permitted for withholding taxes, bankruptcy and criminal proceedings.

The non-discrimination obligations of the chapter do not apply to taxes on income, capital gains, or capital of corporations. As in the FTA, the provisions of bilateral tax treaties generally take precedence over the NAFTA provisions. The NAFTA provides greater certainty for Canadian investors in both the United States and Mexico that tax measures will not be used to discriminate against Canadian investors.

Mexico will no longer be able to resort to the historical Latin American approach to expropriation, agreeing instead to pay fair market value promptly. Expropriation is permitted only for a public purpose, on a non-discriminatory basis, and upon payment of prompt, adequate and effective compensation. Tax measures that are tantamount to expropriation are subject to the NAFTA expropriation provisions.

With growing concern for the downward harmonization of environmental standards or the creation of pollution havens, investment-related decisions must be sensitive to the environment (article 1114). In addition, the NAFTA discourages a nation from reducing environmental standards to attract an investment (whether from a NAFTA country or not).

The FTA provided for the resolution of investment disputes on a state-to-state basis. The NAFTA goes further by providing for direct investor-state arbitration. Investors may take their disputes with a host government to international arbitration for resolution through the United Nations International Commission on Trade Law Arbitration Rules (UNCITRAL). To protect their respective national interests, decisions by Investment Canada or the Mexican National Commission on Foreign Investment on whether to permit an acquisition or not, shall not be subject to dispute settlement (annex 1138.2).

A tribunal of three arbitrators, who may be nationals of the disputing countries, and a chairperson agreed to by both countries will hear such investor-state disputes. In the event that the disputants cannot agree on an arbitrator, the Secretary-General of the International Centre for the Settlement of Investment Disputes (ICSID) shall serve as the appointing authority. A roster of 45 presiding arbitrators, all of whom must meet ICSID Convention qualifications, will be created. Enforcement of arbitration awards will take place under the New York Convention or the Inter-American Convention. (When Canada and Mexico become parties to the ICSID Convention, this Convention could also be used for dispute settlement). Disputes relating to investment measures may also be resolved through the state-to-state dispute-settlement procedures contained in Chapter Twenty.

What They Do – Investment Dispute-Settlement Organizations

International Centre for the Settlement of Investment Disputes (ICSID) — Sponsored by the World Bank, it settles investment disputes on a voluntary basis between governments and foreign investors.

United Nations International Commission on Trade Law (UNCITRAL) — This is an organ of the UN General Assembly that seeks to advance the codification of international economic laws. Its model rules of arbitration provide states with an agreed formula upon which to base arbitral procedures.

New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards — Done in New York in 1958, it allows signatory countries to enforce arbitral judgments in each other's domestic courts. For example, if a Canadian firm wins an arbitral award against a Mexican firm, Canadian investors can use the Mexican courts to enforce that decision.

Inter-American Convention on International Commercial Arbitration — Done at Panama in January 1975, it provides similar services to the New York Convention for members of the Organization of American States (OAS). Canada is not a member of this Convention, and its use in the NAFTA is thus limited to the United States and Mexico. Instead, Canada will rely on the New York Convention to enforce arbitral awards.

Chapter Twelve — Cross-Border Trade in Services

As advanced industrial economies become increasingly knowledge-based service economies, it is critical that the opportunities for service industries not be limited to domestic markets. Both producers and consumers of traded services will benefit from the increased competition that will flow from growth in cross-border and international trade in services.

The Canada-U.S. FTA marked the first time that cross-border services were addressed in a general trade agreement and subjected to the traditional trade principles of non-discrimination and transparency. Since then, more progress has been made in the Geneva negotiations aimed at the establishment of a General Agreement on Trade in Services (GATS).

Such an agreement would be the equivalent for traded services to the GATT, the Agreement that translated these principles into a multilateral trade agreement for goods some 45 years ago. The GATT contributed significantly to the steady growth in trade in goods in the postwar years, a key ingredient in the rapid rise in incomes in most industrialized countries during that period. The liberalization of trade in services promises similar benefits.

The NAFTA draws on the experience of the GATS negotiations in the Uruguay Round as well as the FTA Chapter Fourteen. The NAFTA coverage applies to all cross-border non-financial services not a part of the investment chapter unless such a service is specifically excluded. Excluded services include the cultural industries of Canada and most air transportation, as well as U.S. maritime transportation services and government services, such as health and social services.

The Chapter itself sets out the basic principles governing cross-border trade in services, while a number of sector-specific annexes — professional services and transportation — outline how these principles apply to these sectors. Separate chapters on telecommunications and financial services spell out the special rules that apply in these areas.

Chapter Twelve requires that the parties extend both national and most-favoured-nation treatment to cross-border service providers of the other countries and not require such providers to establish a "local presence" as a prerequisite to providing a cross-border service except as required for legitimate regulatory reasons, such as consumer protection.

The all-inclusive approach results in wider coverage than in the FTA with land transport, some air transport and all areas of professional services now benefiting from these trade liberalizing rules.

The Service Economy

Cars, steel, clothes — are these the industries driving the North American economy? There is no doubt that they are important, but they are not the industries driving the new economy. Try telecommunications, computers and semiconductors, health and medical products, or the fast-food industry. Services and related industries are the fastest-growing sectors in the economy. What was once the frontier of international commercial policy has become the centre of policy debate. Today, more than two-thirds of the workforce, or nearly 9 million Canadians, are employed in the service sector.

In North America, the motion picture industry employs more people than the U.S. auto parts industry. The travel service industry is bigger than steel and petroleum combined. Health and medical care accounts for one-eighth of total U.S. output. It is bigger than the combined strength of auto, auto parts, aircraft, clothing and textiles, steel, mining, and oil and gas refining industries.

In Canada, almost as many people are employed in the computer industry as in petroleum refining. Computer workers earn $616 a week — 46 per cent more than the average weekly wage. Software is growing by 25 per cent annually and is now bigger than the auto industry. There are more accountants and support staff than people working in the oil and gas industry. The food service industry is bigger than the chemical industry. The services side of communications accounts for 3.8 per cent of Canada's GDP, compared to 1.7 per cent for the auto industry. Over the last 17 years, the estimated level of employment in Canada has risen by 29 per cent, totally accounted for by an increase of 46 per cent in the service sector. In contrast, employment in the goods sector dropped by two per cent.

In a recent study by Canadian economist Nuala Beck, what she calls the engines of the 1990s for the new economy fall into four clusters: computers and semiconductors; instrumentation; health and medical; and communications and telecommunications. All share a common characteristic: their success is based on knowledge, innovation and service rather than manufacturing.

Knowledge-intensive industries have created 304 000 new jobs over the past seven years, or 90 per cent of all new employment in Canada. They account for 26 per cent of total employment in Canada, up from 24 per cent in 1984. During the recent recession not every industry cut jobs — from 1990 to 1992, accounting firms, insurance carriers and advertising companies were the top three private-sector job makers.

More people in British Columbia work in communications and telecommunications than in forestry. In Alberta, new economy industries created 80 per cent of new jobs in the past seven years. In Ontario, the figure was 60 per cent or 106 000 new-economy jobs, while 95 000 jobs were lost in industries, such as steel, textiles and auto manufacturing. More Nova Scotians work as teachers and university professors than in the combined fisheries, construction and forestry industries.

Nuala Beck, *Shifting Gears: Thriving in The New Economy, 1992;* Statistics Canada

Market Opportunities: Forestry Equipment and Services

The forest sector has the potential to become an important contributor to Mexico's economy but will require considerable financial and technical assistance to improve efficiency in silviculture and the administration of public and private resources and in the manufacture and marketing of wood products.

By 1994, the market for new equipment and services is expected to reach more than $60 million, almost all of it supplied by imports. Used machinery and equipment is also in high demand in Mexico, since state-of-the-art technology is still not frequently used and is limited to the very large firms.

Market Opportunities: Environment Equipment and Services

The Mexican government is trying to reduce pollution by implementing concrete measures to enforce its laws, including increased inspections and plant closures. The new focus on enforcing stricter environmental regulations, combined with increasing pressure from both domestic and foreign public opinion, has created a growing demand from the private sector for different sources of anti-pollution equipment and related services.

Imports will supply most of the required equipment and services, particularly for industrial and municipal waste water treatment, potable water treatment and air pollution control. Interest in Canadian expertise was amply demonstrated during the Canada Expo '92 trade show in Monterrey in January 1992 and a recent environment mission that visited three cities in the north of Mexico.

Existing federal measures, which do not conform with the NAFTA, can be maintained provided they are listed in the Agreement. Reservations for state and provincial measures must be made within two years (article 1206). While these reservations allow governments to maintain existing non-conforming measures, they do not allow them to make the listed measures more restrictive in the future.

Sensitive sectors can be left "unbound," providing scope for introducing non-conforming measures in the future. Canada has inscribed a reservation to permit all layers of government full flexibility regarding public law enforcement and correctional services, income security or insurance, social security or insurance, social welfare, public education, public training, health, child care, basic telecommunications services, aboriginal affairs, minority affairs, and some air and maritime transportation services.

The chapter does not create rights or obligations on government procurement involving services — these are addressed in Chapter Ten — and does not impose any disciplines on non-discriminatory quantitative restrictions on access other than requiring that these be notified and scheduled so that service providers can be made aware of them.

The annex on professional services (annex 1210.5) sets out procedures aimed at the development of mutually acceptable professional standards and criteria, a prerequisite to any real trade in professional services. Like the FTA, it requires that licensing be based on criteria, such as competence, education, experience and professional development. There are specific

provisions for foreign legal consultants and engineers, which are designed to facilitate their practice on the basis of temporary licences, assuming they meet local standards, within different jurisdictions.

Transportation services were not covered by the FTA, mainly because of disagreement between Canada and the United States on how to deal with maritime industries. Following deregulation of land transportation, which began in 1982 in the United States and 1987 in Canada, the two countries reached agreement on a number of issues aimed at establishing a relatively open regime for the cross-border carriage of cargo by land. For Mexico, land transportation has been a closed sector to both investment and cross-border operations, a handicap that has become increasingly apparent as the Mexican economy has become more open as a result of the reforms introduced over the past few years.

The NAFTA consolidates what had already been largely achieved between Canada and the United States and extends these provisions to Mexico, laying the foundation for the development of more integrated truck, bus and rail transportation services throughout North America. Each country has agreed not to increase current discrimination and to ensure that any future laws and regulations are non-discriminatory. In addition, the NAFTA provides a six-year work program aimed at harmonizing land transport standards (Chapter Nine) and thus further facilitating the liberalization of transportation services. Finally, Canada, the United States and Mexico have agreed to open a range of specialty air services to each other's providers.

Market Opportunities: Transport Equipment and Services

Over the past four years, Canada has steadily increased its share in Mexico's protected transportation equipment sector. Canadian firms should do much better with the preferred terms of access under the NAFTA. While automotive parts exports grew from $52 million in 1988 to $83 million in 1991, vehicle exports remained low because the Mexican market was largely closed.

Under the NAFTA, restraints on imports will be removed, providing opportunities for the export of parts and vehicles. The Mexican market is the fastest growing market for auto parts in North America, and conservative estimates are that the annual growth will be over 7 per cent. With rapid urban growth in all major centres, demand for reliable and environmentally clean urban transit equipment and services should also increase.

The Mexican government has undertaken a major program of infrastructure modernization (airports, railways, roads and public transit) through the involvement of the private sector. This offers significant opportunities for steel rail, locomotives, rolling stock, track machinery, design and engineering, and the repair and overhaul of rolling stock, buses and trucks — all areas where Canada has internationally recognized expertise.

Chapter Thirteen — Telecommunications

Telecommunications is one of the essential building blocks of the new economy. The transfer of data, the electronic exchange of information and the maintenance of sophisticated intra-corporate networks are all critical to integrating the far-flung components of modern corporations into an efficient whole. With these developments, the effective functioning of a more integrated North American economy will require that such services be developed and delivered on a non-discriminatory and open basis.

The NAFTA will establish common North American rules for providers and users of telecommunications and computer services. The NAFTA chapter on telecommunications services sets out the way in which telecommunications firms in North America can gain access to public networks and services, as well as the basis for the provision of value-added telecommunications services. Firms using basic networks to sell enhanced telecommunications services or computer services or using the network to meet intra-corporate communications requirements will be the major beneficiaries.

The Agreement creates a more competitive environment for telecommunications equipment companies. The phased elimination over 10 years of all tariffs on telecommunications equipment will open the Mexican market to Canadian suppliers on the same competitive basis that currently exists between Canada and the United States and will extend a preferential rate to them over non-NAFTA suppliers.

Under the Agreement, reasonable conditions of access will allow companies to operate private leased networks for intra-corporate communications, and such firms will have the right to attach terminal devices to the network. Private leased circuits will be available on a flat-rate pricing basis (article 1302) and rates for public telecommunications services will reflect economic costs (but cross-subsidization between services will be permitted). Any restrictions must be justified as necessary to protect the public service responsibilities of the network operator, to protect the technical integrity of the network, to ensure the confidentiality of messages, or to protect the privacy of subscribers.

The chapter establishes a common approach for the standardization of telecommunications equipment attached to public networks and sets up a telecommunications standards subcommittee (article 916) to develop a work program within six months. Standards are to be brought into conformity and, for the most part, will be limited to those necessary to avoid billing-equipment malfunction, technical damage to public networks and technical interference, and

to ensure compatibility with the electromagnetic spectrum, as well as to ensure users' safety and access to the public networks.

Canada will be able to meet these obligations under its current laws and regulations. These provisions will require Mexico to introduce greater transparency in its regulations and procedures, improving the ability of Canadian companies to sell their services in Mexico and operate intra-corporate networks. The Mexican markets for enhanced telecommunications and computer services will be fully open to Canadian-owned companies who can establish in Mexico or provide their services on a cross-border basis (previously banned) from Canada effective, July 1, 1995.

The creation of an integrated North American market for such services and equipment should maintain North America's advanced technology leadership in this critical area in the decades ahead.

The NAFTA will not lead to U.S.-style deregulation, since telephone and other basic telecommunications services have been excluded from the Agreement's investment and services disciplines. In Canada, decisions affecting the industry will continue to be made by the Government and domestic agencies, such as the Canadian Radio-Television and Telecommunications Commission (CRTC). NAFTA does not alter the CRTC's current regulatory oversight of the industry nor does it affect current policies, which, among others, provide enhanced and data services on a competitive, generally unregulated basis. The establishment and provision of local and long-distance telephone and other basic telecommunications networks and services are excluded from the obligations of the Agreement. Canada's policy of limiting foreign ownership of telecommunications facilities remains at a maximum of 20 per cent.

Market Opportunities: Telecommunications

Mexico relies on imported technology in its efforts to modernize and upgrade its infrastructure and to develop a more sophisticated manufacturing capability. Canadian suppliers of electronic components, telecommunications equipment and systems, and computer software should thus find a ready market for their products.

The Mexican telecommunications sector is being deregulated and privatized, opening private investment and service opportunities in areas, such as cellular telephones, construction and the administration of microwave earth stations, fax, electronic mail and data transmission services.

Between 1990 and 1994, the telecommunications equipment market in Mexico is expected to increase at an average annual rate of 12 per cent per year to $1.5 billion, while the market for computers and computer software should grow at an even faster pace. Northern Telecom has had a plant in Mexico since 1991. BCE Inc. has a significant interest in two cellular phone companies, and other Canadian firms are also becoming active in the Mexican market.

The Canadian Telecommunications Industry

The telecommunications industry is a major source of economic activity in Canada, employing some 125 000 people and generating more than $21 billion in revenues in 1990 (carriage services $15 billion; equipment manufacturing $6 billion). Canada's Northern Telecom is the fifth-largest manufacturer of telecommunications equipment in the world. The industry is also Canada's leading high-technology industry; its R&D expenditures of $1.4 billion in 1990 represented about 16 per cent of total Canadian R&D.

The telecommunications carriage industry operates Canada's telephone and data network. Over 98 per cent of Canadian households have a telephone. The carriage industry's share of Canadian GDP has increased from one per cent in 1970 to 2.7 per cent in 1990, surpassing traditional economic mainstays like agriculture (2.3 per cent), logging and forestry (0.6 per cent) and mining (1.2 per cent).

Advances in technology are transforming the world of telecommunications. Fibre optics vastly increase transmission capacity. The advent of cellular telephones is attaching communications to people rather than places and it will soon be possible to reach individuals anywhere in the world using a personal telephone number.

In the fall of 1984, negotiating a free trade agreement with the United States was described as requiring from Canadians a leap of faith in our ability as a country to compete in a more open economic environment. Seven years on, and in retrospect, the leap does not look so enormous as some feared. In a world in which state intervention is giving way to market competition, even in the Marxist economies, the free trade agreement seems like a most timely policy choice.

Donald S. Macdonald

Chapter Fourteen — Financial Services

Canadian banks and trust, securities and insurance companies have traditionally been international players. Canadian banks were among the first international firms in the Caribbean, while life insurance companies have been active throughout parts of the Commonwealth and elsewhere for over a century. The U.S. market has always been important, and Canadian banks generate their largest share of foreign income from their U.S. operations and activities.

The FTA marked the first time that financial services were covered in a general trade agreement. It recognized the increasing importance of financial services as the grease of international trade, as well as the need to ensure that conflicting regulations in different jurisdictions do not hamper business across borders.

In terms of specific commitments, Canada exempted U.S. financial institutions from laws limiting the aggregate foreign ownership in a given firm to 25 per cent and individual foreign ownership to 10 per cent. (This is customarily referred to as the 10/25 rule.) U.S. bank subsidiaries in Canada were exempted from the 12 per cent aggregate asset ceiling on the size of the foreign banking sector and permitted to open additional branches without prior approval from the Minister of Finance. U.S. bank subsidiaries were also permitted to transfer loans to their parent companies subject to certain prudential considerations.

For its part, the United States agreed to permit domestic and foreign banks operating in the United States to underwrite and purchase without limitation Canadian government-backed securities, including provincial debt. This is especially important to Canadian governments, which float most of their debt issues in the U.S. market. Previously, the U.S. National Bank Act restricted such practice to U.S. government-backed securities. The United States also agreed to grandfather the right of Canadian banks, which, prior to legislative changes in 1978, operated in more than one state. The 1978 regulation, which ended interstate banking privileges for newcomers, had included a provision for review of those existing banks' interstate privileges after 10 years.

The United States also promised that Canadian banks would receive the same treatment as those in the United States should there be any amendment of the Glass-Steagall Act. Unlike Canadian practice, Glass-Steagall prohibits commercial banks in the United States from engaging in investment banking. In the late 1980s, when the FTA was drafted, it appeared that this Act would be revised.

Financial Services Reform in Canada

Canadian financial services — banks, trusts, insurance and securities, the so-called "four pillars" of the financial industry — were highly segregated until the 1980s. Foreseeing fierce competition and globalized financial markets as a result of advancing communications technology, policy makers have enacted a series of ambitious reforms. In 1987, the federal and provincial governments opened ownership of Canada's securities industry to foreign and domestic financial institutions. Over the past four years, the barriers to competition among the remaining pillars have fallen through revisions to the Bank Act, the Trust Companies Act, the Loan Companies Act and the Insurance Act.

The new Acts expanded the powers of the financial institutions, relaxed ownership restrictions, increased the responsibilities of corporate directors and auditors, and provided regulations governing self-dealing and conflicts of interest. They included specific provisions for the regulation of financial institutions; rules governing the amount of commercial and consumer lending that can be undertaken; the sale of securities; and a framework for measuring capital adequacy based on the standards set by the Bank of International Settlements. Lending powers for both insurance and trust companies were expanded to match those of the banks. Ownership of a Canadian bank remains limited to a maximum personal or corporate holding of 10 per cent. Any widely held trust or insurance company can own a Schedule II bank. Banks may own trust companies, although they cannot sell trust services directly. Banks and trusts may sell insurance through networking arrangements.

The new rules significantly broaden the scope of activities that trusts, banks and insurance companies can undertake. The reform package was designed to increase competition within the Canadian financial services industry and provide consumers with a greater number of competitively priced services and products.

The wave of reform and deregulation was fully reflected in the FTA (Chapter Seventeen), which aimed at opening financial services to a greater degree of international competition.

To the disappointment of the financial industries in both Canada and the United States, there was little progress on liberalization commitments between the two countries. Progress on the Canada-U.S. front was thus more a matter of form than substance, but it did provide an improved basis to press for more liberal conditions in the United States in the future.

The NAFTA moves beyond the FTA by basing market access on a set of general rules enshrining national treatment, MFN treatment, the right of consumers to purchase financial services on a cross-border basis and the right to market access through the establishment of a commercial presence. The emphasis on defining principles, rather than the à la carte approach taken in the FTA, is path breaking of the best kind, building on progress made in the Uruguay Round negotiations in drafting the General Agreement on Trade in Services.

Unlike the FTA, there are also disciplines on regulations by both state and self-regulatory institutions (i.e., stocks or futures' exchanges). In addition, the NAFTA includes, for the first

time, provisions for binding dispute settlement based on the general provisions of Chapter Twenty but with the caveat that, in financial services cases, panelists may be drawn from a special roster of 15 expert panelists. (Under the FTA, disputes — in financial services other than insurance — were to be the subject of discussions between the U.S. Treasury and the Canadian Finance Department, without any provision for rules or time limits.) The NAFTA also includes a built-in recognition of the dynamic nature of financial services trade through the establishment of a Financial Services Committee with the mandate to consider future liberalization (articles 1412-13).

For its part, Mexico has opened its market to Canadian financial institutions. Banks, insurance companies and securities dealers will be able to establish wholly owned subsidiaries in Mexico and to acquire existing firms, beginning in 1994. Over a six-year transition period, Mexico will be able to cap the degree of Canadian and U.S. participation to ensure an orderly transition to an open market (annex VII (B) — Mexico). Should foreign financial institutions attain 25 per cent of the Mexican market — a level higher than that achieved in other markets — Mexico will be allowed to maintain a cap on the affected sector for an additional period. If an independent panel determines that foreign participation in the banking sector has reached a level that is unduly influencing Mexico's payment system, Mexico will be allowed to impose a further market-share cap.

In addition to the sections on general principles and country-specific liberalization commitments, a final section outlines each country's reservations. Canada, for example, has retained the "de facto control" test to determine ownership of a financial firm. This means that a U.S.— or Mexican — incorporated financial institution controlled by Japanese or European capital is deemed to be just that and would not qualify for the NAFTA treatment in Canada (The United States and Mexico have taken a more liberal approach basing their criteria on country of incorporation).

Canadian consumers remain protected by the continuing right of governments to take reasonable actions as deemed necessary for prudential reasons. To avoid problems that may arise in the implementation and administration of this chapter, notification and consultation procedures provide an early warning system and a way of resolving problems co-operatively.

Market Opportunities: Financial Services

The Mexican market offers many opportunities to Canadian financial institutions. Mexico's needs correspond to Canada's strengths: strong capital positions and greater experience in operating large and integrated networks. Canadian banks are leaders in financial-services technology, another area where Mexico is weak. The Mexican market for insurance-related services, which ranked first in Latin America and 27th globally with US$3.5 billion in life and non-life premiums in 1991, is widely seen as another area of potential. Scotiabank recently announced that it will acquire a 5 per cent stake in Inverlat, Mexico's fourth-largest financial group. Inverlat controls a securities firm and recently purchased the commercial bank Comermex, the fourth-largest bank in Mexico.

Chapter Fifteen
Competition Policy, Monopolies and State Enterprises

With the increasing globalization of production and markets, the role of competition policy in influencing trade, investment and technology exchange has suggested the need for governments to address differences in approach to competition. Recent experience demonstrates the extent to which differences in competition policy can act as a barrier to trade or as a source of dispute. The FTA made brief reference to monopolies (article 2010); the NAFTA devotes considerably more attention to the subject.

Mexico has a high degree of corporate concentration and state enterprises. In Canada, state enterprises, or crown corporations, exist at both the provincial and federal level. The NAFTA recognizes the right of governments to establish monopolies or state enterprises but seeks to ensure that they do not unduly hamper the free flow of trade. The NAFTA defines a state enterprise as one that is owned, or controlled through ownership, by a government.

To this end, the NAFTA sets out disciplines on the activities of monopolies and state enterprises based on the principle of non-discrimination in the purchase and sale of goods where it has a monopoly. For example, sales of petrochemical feedstock by a state enterprise like PEMEX must relate to commercial considerations, such as price and quality, and the corporation will not be able to charge a higher price for oil and gas supplies to Canadian or U.S. firms operating in Mexico. A government monopoly, like Canada Post, must not charge different prices to Mexican or American firms in Canada.

Mexico will implement a competition policy, with technical assistance from Canada, and co-operate with competition authorities in the United States and Canada in their efforts to shield against anticompetitive business practices.

To work toward defining the basis for future co-operation on competition matters, the NAFTA (article 1504) establishes a Working Party on Trade and Competition. Its mandate will likely include consideration of the appropriate role for antidumping procedures in a free trade area inherited from the FTA (article 1907).

Competition Policy in Canada and in the NAFTA

A set of government measures aimed at ensuring competition and protecting consumers from unfair business practices, especially abuses of market power through price fixing is called competition policy. Its purpose is to improve the efficiency of the marketplace through competition. Among the specific practices covered by competition law are misleading advertising, price fixing, predatory pricing, bid rigging, price discrimination and the creation of cartels and monopolies through mergers and acquisitions. Legislation in Canada dates back more than 100 years. While practices, such as conspiracy, remain criminal offenses, the emphasis has shifted from the Criminal Code, which requires proof beyond a reasonable doubt for any conviction, to administrative or civil law.

Canada's *Competition Act* is administered by the Bureau of Competition Policy in the Department of Consumer and Corporate Affairs. The Director and his staff have virtual independence in enforcement. In fiscal year 1990-91, the Bureau investigated 14 517 complaints about misleading advertising; 90 were passed to the Attorney General for action. There were 1 177 complaints about restrictive practices, of which 8 were referred to the Attorney General or the Competition Tribunal. For mergers and acquisitions, 183 were examined of the 944 that were recorded.

The United States, which has a long history of intervention to encourage fair competition, has competition laws that are broadly compatible with those of Canada although competition enforcement falls to two agencies — the Department of Justice and the Federal Trade Commission. There are also many more private suits — i.e., antitrust actions brought by citizens or firms in the private sector.

During the negotiation of the FTA, Canada maintained that the scope for cross-border dumping of goods virtually disappears once the tariff and other barriers are eliminated. As a result, Canada suggested that the two countries phase out the application of their respective dumping procedures for cross-border trade and rely instead on competition laws to address any remaining problems of injurious price discrimination.

U.S. authorities agreed that Canada had a strong theoretical case but could not agree to the negotiation of a replacement regime. Instead, the two countries agreed to introduce the innovative procedures of Chapter Nineteen, provisions, which are carried forward into the NAFTA. In addition, Canada and the United States agreed to examine further the pros and cons of a replacement regime allied to existing competition rules. Work on the issues involved has proceeded over the past few years, both bilaterally and in the context of the Uruguay Round of the GATT negotiations, which involves some significant reforms of the GATT Antidumping Code.

This work will continue in the NAFTA as part of a broader examination of how to address the rules of competition in the more integrated market created by the free trade rules. Recent Canadian experience along a number of fronts, including trade in steel, however, suggests the need for Canada to pursue this issue vigorously with a view to the development of a set of rules more in keeping with the realities of a single North American market.

Chapter Sixteen — Temporary Entry

The temporary entry provisions of the FTA have proven to be one of its most helpful and important features. Firms, investors and other business travellers to the United States have found the expedited procedures of real practical help in developing North American and global business strategies.

The NAFTA extends the provisions of the FTA to Mexico and ensures that Canadian business travellers can count on secure access to Mexico in order to pursue the business opportunities created by the rest of the Agreement. It sets out the governing principles and rules under which citizens of each country may have access to the other countries on a temporary basis to pursue business opportunities without meeting a labour-market test. The NAFTA does not create a common market for the movement of labour. Each country retains its rights to protect the permanent base of its domestic workers.

Like the FTA, the NAFTA identifies four categories of travellers eligible for temporary entry. They are:

- **business visitors** who are engaged in the international business activities set out in Schedule 1. The NAFTA adds truck and bus drivers engaged in international traffic and international service providers, such as customs brokers;
- **traders and investors** who carry on substantial trade and investment between their own country and the country they wish to enter;
- **intra-company transferees** who are employed by a company in a capacity that is managerial, executive or involves specialized knowledge and who are transferred within that company or its subsidiaries or affiliates between countries; and

Business Visitors under the FTA Provisions for Temporary Entry

	1989	1990	1991
Canadians	2 750	4 950	5 558
Americans	3 782	12 353	15 858

CEIC International Services Group

- **professionals** who are listed in Schedule 2 and are seeking to enter another NAFTA country on a temporary basis to provide their professional skills. A number of new categories have been added, such as statisticians, oceanographers, geographers and seminar leaders conducting training seminars. Coverage for Quebec notaries has been clarified. Mexico and the United States have agreed to set a quota on the number of Mexican professionals who may enter the United States on an annual basis. Canada has chosen not to set a quota, and Canadian professionals will not be subject to quotas in either the United States or Mexico.

A working group, which will include immigration officials, has been established to consult on issues, including the elimination of labour certification tests for spouses of business persons, as well as transparency and dispute-settlement obligations. The United States has agreed to publish, within one year, a consolidated document on the opportunities that this chapter offers and make it widely available to Canadian business travellers.

Canada's reason for joining the NAFTA is simple and straightforward: to maintain and enhance Canadians' living standards. Canada is the second-richest country among the large industrial economies of the world, and, according to the United Nations' recently published Human Development Index, Canadians have the best quality of life in the world. But, that is today, and the objective is to secure and improve our standard of living and quality of life 10, 20, 50 years hence.

Department of Finance, *The NAFTA: An Economic Assessment from a Canadian Perspective*

Canadian business people are much more outward-looking than 15 years back. Back then, it was unusual for Canadians to try to sell abroad, but today the airports across the country are crowded with Canadians going somewhere to try to sell something.... For Canada to remain a major world trader, a national commitment must be made to improve our competitiveness in productivity, quality, and innovation.... There are many inspiring success stories of Canadian companies that have taken the global initiative, either through exports or direct investing. Those still debating the wisdom of going global should pay heed to the wise inscription on a wall plaque in the office of Roland Pelletier, President of Quebec-based Transformateur Delta. It reads: "The future belongs to those who know an opportunity when they see it and then act upon it. Qui n'avance récule."

Susan Goldenberg, *Global Pursuit: Canadian Business Strategies for Winning in the Borderless World*

Part Six — Intellectual Property

The rapid increase in technology has made the protection of innovation a key determinant of economic success. How governments approach that protection, however, requires a compromise between two conflicting goals. The owners of intellectual property — the tangible results of innovation, including patents, trademarks and copyright — have a natural interest in enjoying exclusive rights to their innovation as long as possible. A reasonably long period of exclusive rights, therefore, can act as a powerful incentive to innovation. Consumers and competitors, on the other hand, would prefer that the fruits of innovation be made generally available as quickly as possible, so that competition will both reduce prices and lead to further innovation. Most national intellectual property regimes reflect compromises between these two objectives.

The rapid internationalization of the global economy and of technology has pointed to the problems that result from differing approaches to the protection of intellectual property. Over the years, various international agreements — including the Berne Convention (literary and artistic works); the Geneva Convention (phonograms); the Paris Convention (industrial property); the Rome Convention (neighbouring rights); the Universal Copyright Convention; the International Convention for the Protection of New Varieties of Plants (UPOV); and the World Intellectual Property Organization (WIPO) — have sought to address these differences with a view to promoting global standards and procedures.

During the past six years, the contracting parties to the GATT have sought to consolidate much of these disciplines into a single code, the Agreement on Trade-Related Aspects of Intellectual Property Rights(TRIPS), to address the trade-related aspects of intellectual property protection, while ensuring that any differences in national regimes can be resolved on the basis of consultation, negotiation and dispute settlement, rather than confrontation and retaliation.

Chapter Seventeen — Intellectual Property

The NAFTA chapter on intellectual property is patterned on the TRIPS Agreement and incorporates most of its provisions. The NAFTA commits each country to provide effective protection and enforcement of intellectual property rights.

The chapter defines specific standards in the areas of copyright, sound recordings, trademarks, patents, semiconductor integrated circuits, trade secrets, geographical indications and industrial designs, and sets out rules to enforce these rights, both domestically and at the border. Respect for intellectual property provides certainty for the export of Canadian high-technology products and artistic works and promotes a better investment climate for locating research and development (R&D) facilities in Canada.

Canada, Mexico and the United States agree to comply with the substantive provisions of the Geneva Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of their Phonograms, the Berne Convention for the Protection of Literary and Artistic Works, the Paris Convention for the Protection of Industrial Property and the International Convention for the Protection of New Varieties of Plants (UPOV) (article 1701).

While national treatment is the basic principle behind the chapter, exceptions will be allowed for certain exceptions recognized by the World Intellectual Property Organization (WIPO) conventions.

Specifically, the chapter (articles 1705-13) provides that:

- Computer programs will be protected as literary works, and their owners will enjoy the right to authorize or prohibit the commercial rental of their work. Economic rights acquired by virtue of a contract, the term of protection, exceptions to the right, and limitations on translation and reproduction licences are also recognized (article 1705).
- Sound recording producers shall have similar rights to those of a copyright holder, including the right to restrict reproduction, distribution or importation of infringing works, but not the right to authorize or prohibit the public communication of a work. These rights include a commercial rental right for 50 years from the date of recording (article 1706).

- Criminal and civil offences are to be made for the illegal use of encrypted satellite signals and the manufacturing, importation, sale or making available of devices, which are primarily used in decoding such signals (article 1707).
- The registrability of trademarks may depend on use. A registration may only be cancelled after an uninterrupted period of at least two years of non-use. The use of a trademark by another person subject to the control of the owner will be recognized as use for maintaining the registration. The chapter prohibits compulsory licensing of trademarks, and permits a trademark to be assigned with or without the transfer of the business to which the trademark belongs (article 1708).
- Patents shall be available for products and processes in all fields of technology. The term of protection will be at least 20 years from the date of filing the application, or 17 years from the date the patent is granted. A country may not maintain special patent regimes for a particular product category, such as pharmaceuticals or food. A country cannot provide provisions for preferential acquisition of patent rights for inventions developed within its borders nor discriminate between products made locally or abroad. However, each country may exclude from patentability inventions, such as plants and animals other than microorganisms. This allows, for example, Canada to decide its own policy regarding the patentability of life forms (article 1709).
- The NAFTA goes beyond the provisions in the Treaty on Intellectual Property in Respect of Integrated Circuits by creating additional obligations for those who would use such designs. Mexico shall use its best efforts to implement the requirements of this article, as soon as possible, and shall do so in any event no later than 1998 (article 1710).
- The type of information considered as trade secrets and that acts contrary to honest commercial practice is defined. Rules are provided to prevent government disclosure of tests or other data obtained in the context of regulations conditioning marketing approval or in judging the safety and efficacy of pharmaceutical and agricultural chemical products (article 1711).
- The section on geographical indications sets out the circumstances under which the legitimate user of a place name may prevent others from using the name, unless it is a generic term or there is a clear record of prior use (article 1712).
- An industrial design is to be protected for at least 10 years if it is new or original; i.e., differs significantly from a known design or combinations thereof, including textile designs (article 1713).

Canada will be able to comply with these requirements on the basis of existing law and practice or as a result of changes in the NAFTA implementing legislation. Recent changes to the special patent regime for pharmaceuticals has brought Canadian law into line with international practice in that respect.

The elimination of local manufacturing criteria for issuing compulsory licences will have minimal effect, since it rarely has been used in Canada. On the other hand, the U.S. agreement to eliminate its discriminatory patent-acquisition practices removes an impediment to research activity taking place in Canada.

Section 337 in U.S. Trade Law

Section 337 of the Tariff Act of 1930 makes unlawful certain methods of competition in import trade, the effect or tendency of which is to destroy or injure substantially a domestic industry or to restrain or monopolize trade and commerce in the United States. Most cases raised under this section involve patent infringement.

Investigations are conducted by the U.S. International Trade Commission (USITC). If the USITC finds a violation, it may issue an exclusion order prohibiting the import of the product into the United States or a cease and desist order. The president may disapprove the remedy for domestic or foreign policy reasons. These provisions have been found inconsistent with U.S. GATT obligations.

Each country will ensure that its system of enforcement will deal effectively with the infringement of intellectual property but in a manner so as not to create a barrier to legitimate trade. Procedures have to be fair and equitable and not unnecessarily complicated, costly or time-consuming. Decisions in regard to the enforcement of rights shall preferably be in writing with the possibility of judicial review. Specific obligations include:

- fair and equitable procedures, evidence of proof, the use of injunctions, the recourse to damages and other remedies and the indemnification of the defendant. In order to ensure that U.S. section 337 proceedings do not discriminate between domestic and foreign owners of intellectual property, judicial and administrative procedures will have to be equivalent and must meet the same standards (article 1715);
- prompt and effective interim measures until an enforcement action is resolved (article 1716).
- use of criminal procedures and penalties in cases of willful trademark counterfeiting or copyright piracy on a commercial scale (article 1717).
- retention at the border of goods suspected of being counterfeit or pirated. To ensure that the interests of legitimate traders are not harmed, provisions are included to reduce the ability of customs authorities to harass legitimate exporters on the pretext that they have violated intellectual property rights. Mexico shall use its best efforts to implement the requirements of this article as soon as possible, and shall do so no later than four years from the date of entry into force of the NAFTA (article 1718).

Part Seven
Administrative and Institutional Provisions

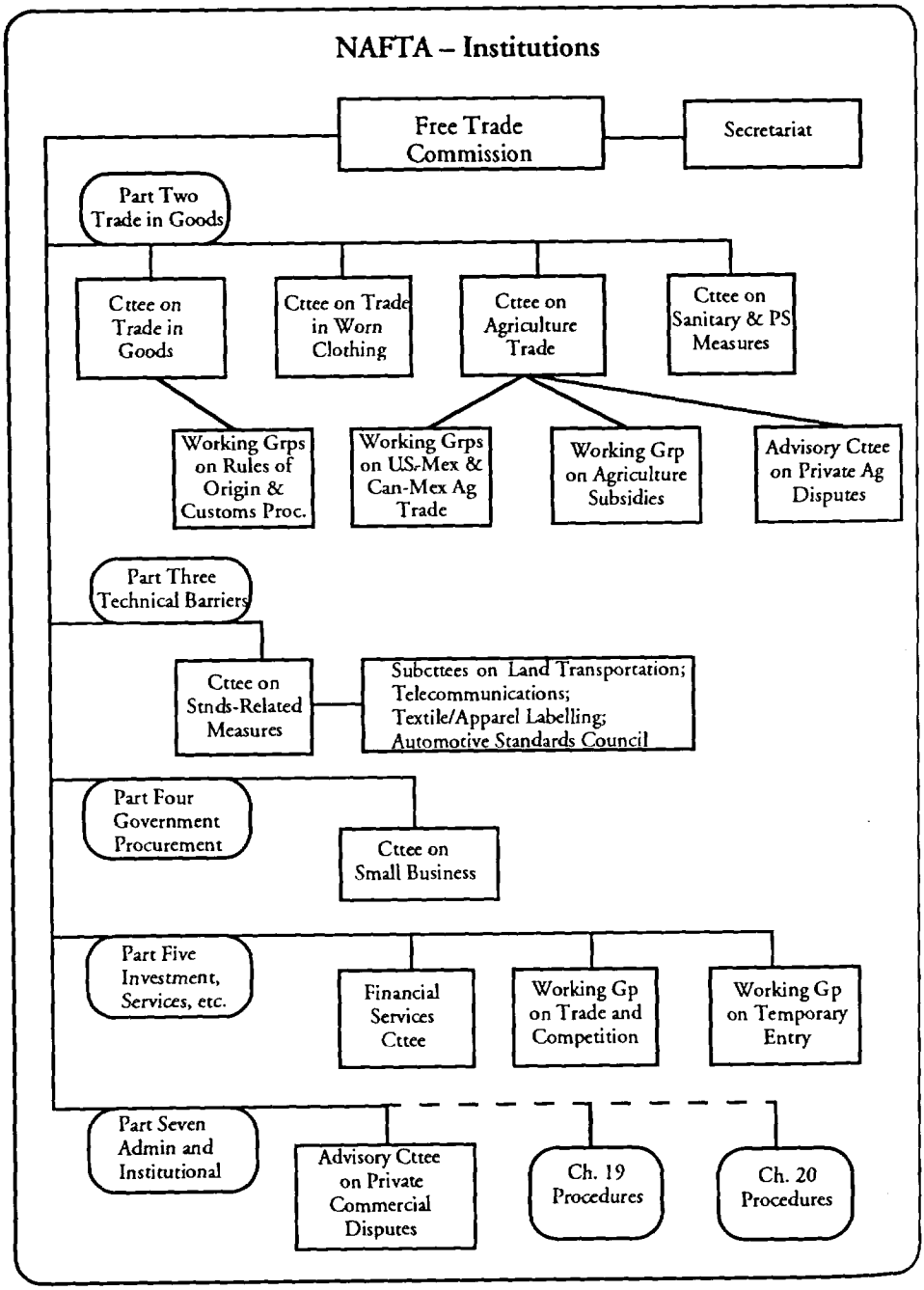
The three chapters in this part provide the basis for the administration and implementation of the complex of rules set out in the rest of the Agreement. While the rules provide the rights and obligations that ensure that the three countries will pursue their trade and economic policies on the basis of the objectives of non-discrimination and transparency announced in Chapter One, this part sets out the procedures that will ensure that these rules are implemented. Without the guaranty furnished by these provisions, business would not have the confidence to undertake the restructuring necessary for the growth and prosperity that is the ultimate goal of the Agreement. The nub of this section is found in the two chapters on the settlement of disputes. Dispute settlement in the NAFTA rests on four pillars:

1. comprehensive procedures for government-to-government dispute settlement. Building on the GATT and the FTA experience, it comprises three stages: consultations, referral to the Free Trade Commission and panel proceedings.

2. binational panel review and dispute settlement regarding antidumping and countervailing duty matters. Like the FTA, the NAFTA places binational panels in the position of domestic courts to exercise judicial oversight of domestic determinations of dumping, subsidization and injury in countervailing and antidumping duty cases.

3. a regime of mixed, or investor-state, arbitration for the enforcement of obligations under the investment chapter of the NAFTA. These build on provisions found in Canadian Foreign Investment Protection Agreements (FIPAs). Investment obligations include national treatment, and most-favoured-nation treatment as well as disciplines on performance requirements, rules against transfers and expropriation without compensation.

4. dispute avoidance achieved through "transparency" or, more simply, procedural due process. The Agreement must be administered and implemented in a "consistent, impartial and reasonable manner." The NAFTA encourages the use of private commercial arbitration and establishes a special advisory committee on arbitration.


NAFTA – Institutions
Free Trade Commission
Secretariat
Part Two Trade in Goods
Cttee on Trade in Goods
Cttee on Trade in Worn Clothing
Cttee on Agriculture Trade
Cttee on Sanitary & PS Measures
Working Grps on Rules of Origin & Customs Proc.
Working Grps on US-Mex & Can-Mex Ag Trade
Working Grp on Agriculture Subsidies
Advisory Cttee on Private Ag Disputes
Part Three Technical Barriers
Cttee on Stnds-Related Measures
Subcttees on Land Transportation; Telecommunications; Textile/Apparel Labelling; Automotive Standards Council
Part Four Government Procurement
Cttee on Small Business
Part Five Investment, Services, etc.
Financial Services Cttee
Working Gp on Trade and Competition
Working Gp on Temporary Entry
Part Seven Admin and Institutional
Advisory Cttee on Private Commercial Disputes
Ch. 19 Procedures
Ch. 20 Procedures

Chapter Eighteen
Publication, Notification and Administration of Laws

Effective administration, prompt and frequent sharing of information, a commitment to the avoidance of conflict, and quick and equitable settlement of disputes are essential to the long-term success of any agreement.

This chapter sets out the framework for administering the NAFTA. It includes an assurance that laws, regulations and other procedures are promptly published and that due process is followed when making decisions (articles 1802, 1804-5). An opportunity is given to all interested parties to comment on measures that might affect the operation of the Agreement (articles 1802-3).

> *The challenge for Canada is somehow to hold onto the best of the political culture that we have and yet take hold of the economic future. The cost of hanging too far back will be a decline into genteel poverty. That of hurrying too fast would be social polarization. To magnify the challenges, every Canadian will be able to look south and measure, by the widening gap, between what is being achieved here and there. This is the ultimate challenge for Canadians: to keep in step with the United States economically and still march to our own very different cultural drummer.*
>
> Richard Gwyn, *The 49th Paradox*

Chapter Nineteen
Review and Dispute Settlement in Antidumping and Countervailing Duty Matters

One of the main reasons Canada sought a free trade agreement with the United States was to achieve secure and predictable access to the U.S. market.

In the years prior to the FTA, actions under U.S. trade remedy laws, particularly countervailing duty investigations alleging the injurious effect of Canadian federal and provincial subsidies for fish, hog and softwood lumber exports, chilled investment decisions. This affected employment in Canada. Until such time as nations could resolve the subsidy issue, the solution lay in the creation of binational panels to review countervailing and antidumping duty determinations. These provisions are carried forward in the NAFTA. U.S. trade-remedy practices will continue, therefore, to be subjected to review by binational panels to ensure that U.S. law has been applied fairly and properly.

In the FTA, Canada and the United States agreed on a three-track set of obligations to promote fair competition. They are:

- bilateral review of any changes in existing countervailing or antidumping laws and regulations for consistency with the GATT and the FTA;
- the replacement of judicial review by domestic courts of countervailing and antidumping final orders by binational panels; and
- the development over a five- to seven-year period of mutually advantageous rules governing government subsidies and private anticompetitive pricing practices, such as dumping, which are now controlled through the unilateral application of countervailing and antidumping duties;

The NAFTA builds on these obligations and adds several new elements in order to extend them to Mexico. Mexico, for example, will draft new legislation governing countervailing and antidumping procedures. They will incorporate the kinds of procedural safeguards common to Canada and the United States. These will also be subject to review by binational panels.

The definition of what constitutes a subsidy and the problem of dumping remains a challenge. Recognizing that the issue would benefit from a multinational approach, the time-limit provision for a solution in the FTA has been dropped in the NAFTA. While no satisfactory substitute system of rules to address problems of dumping and subsidies has as yet

been devised, significant progress has been made in the GATT Uruguay Round. Improvements to the GATT Antidumping Code as well as a wholly recast Subsidies Code have been developed in the Uruguay Round. The NAFTA working group on competition policy (article 1504), which is to make a report to the Commission within five years, will continue consideration of how competition rules can address the issue of cross-border price discrimination in place of antidumping measures. Experience under the new Subsidies Code will determine the extent to which that issue will need to be revisited in the future.

Experience over the past four years has demonstrated that the review process can act as a powerful deterrent to political interference in the decision-making process. While U.S. — as well as Canadian and Mexican — private-sector interests retain the right to trigger investigations to determine whether they are being materially injured by dumped or subsidized goods, the panel procedures will maintain pressure to keep the system honest.

U.S. Trade-Remedy Legislation
Countervailing Duty Action

Section 303 of the Tariff Act of 1930, originally enacted in 1897 and amended in 1974, provides that, whenever a "bounty or grant" (i.e., a subsidy) is paid or bestowed in a foreign country "upon the manufacture or production for export of any article or merchandise manufactured or produced in such country," a countervailing duty equal to the net amount of the subsidy is to be levied upon the importation of such articles into the United States.

The purpose of this provision is to offset any alleged unfair competitive advantage that foreign manufacturers or exporters might gain over U.S. producers because of foreign subsidies.

A material injury test was added to the U.S. law as a result of the Subsidy/Countervailing Duty Code negotiated during the Tokyo Round of GATT negotiations. Before 1980, when the new law went into effect, the countervailing duty law operated without regard to injury in any case in which dutiable merchandise benefiting from a bounty or grant was imported into the United States.

In addition to an injury test, the law also contains a number of provisions designed to ensure that, where subsidized imports are causing material injury to a domestic industry producing a like product, effective relief is available. For example, provisional relief is available, the time for an investigation is set out, an illustrative list of subsidy practices is contained in the law and all parties are given an opportunity to participate in the process. Final decisions in either the determination of subsidization by the Department of Commerce or material injury by the International Trade Commission are subject to review by binational panels, which will consider whether the law was properly applied and remand any decision for consideration by the original tribunal where necessary.

Any of the three governments may seek a review, by a panel with binding powers, of an antidumping or countervailing duty determination made by an agency of another government. The panels will in all cases be binational. If, for example, an antidumping determination is made by Canada against identical goods from both Mexico and the United States, two panels will be established, one for the order against Mexican goods and the other for the order against U.S. goods.

Should a 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; the Department of National Revenue or the Canadian International Trade Tribunal in Canada; the Secretariat of Trade and Industrial Development in Mexico) 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. Like the FTA, the NAFTA spells out the relevant standard of review that applies.

Panellists who will review antidumping and countervailing duty decisions will continue to be chosen from a roster of individuals who have previously agreed to act as panellists. Because of the judicial nature of the review, the majority of panellists will be lawyers. Nevertheless, the procedures allow for up to two non-lawyers who can bring other expertise to bear on any panel decision, such as business experience or economic expertise.

U.S. Trade-Remedy Legislation: Antidumping Action

The U.S. Antidumping Act, first enacted in 1921, is intended to offset material injury created by price discrimination or by below-cost pricing.

Dumping duties are imposed when the Department of Commerce determines that a class or kind of foreign merchandise is being, or is likely to be, sold in the United States at "less than its fair value" and the USITC determines that, because of imports of that merchandise, an industry in the United States is materially injured, threatened with material injury, or its establishment is materially retarded. The dumping duty is calculated as the amount by which the foreign market value exceeds the U.S. price for the merchandise.Sales at less than fair value exist whenever the price of goods exported to the United States is less than the price at which such or similar goods are sold in the market of the exporting country for home consumption.

If too few sales have been made at the home market price, sales made for export to countries other than the United States are used instead. If these two types of "price inquiries" fail to produce a "fair value" or if a significant percentage of home market sales are found also to be below the calculated cost of production, the "constructed value" of the merchandise is used. Constructed value is defined in the Act as the sum of the cost of producing the merchandise plus statutory minimum additions for overhead and profit.

Panels must be acceptable to both governments involved in the dispute. Annex 1901.2 spells out the procedures for establishing binational panels. Each government will choose two panellists and jointly choose the fifth; if they cannot agree, the fifth panellist will be chosen by lot. Each government will be able to exercise four peremptory challenges of panellists chosen by the other side.

Decisions will continue to be rendered quickly based on the strict time limits (unchanged for the binational panels) built into the procedures. Revisions to the extraordinary challenge procedure time limits (from 30 days to 90 days) were made to accommodate the length of time required (62 days) to conclude the pork case in 1991, the first extraordinary challenge.

These limits are sufficiently generous to allow each party an opportunity to develop arguments and to challenge the arguments of the other side. While only the federal governments can seek the establishment of an Extraordinary Challenge Committee panel, many of the issues will involve private parties, and these will be allowed to make representations before the panel. Governments are obliged to invoke the panel procedure if petitioned by private parties.

To ensure the fairness and integrity of the process, either government can invoke an extraordinary challenge procedure involving a panel of three former judges (annex 1904.13) who will determine whether the grounds for such a review have been met (for example, an impropriety or gross-panel error has occurred) and whether or not a new panel will be required to review the issues.

A new innovation (article 1905) allows for review by a panel of retired judges (established under procedures outlined in annex 1904.13) should it appear that the operation of a government's domestic law has interfered with the full and effective application of the panel-review process. Failure to remedy the situation could lead to either a suspension of the application of the chapter or some other offsetting suspension of benefits as may be determined by the review panel.

A Secretariat (established in article 2002) will administer these review procedures and give aggrieved parties ready access to information. In addition, they will make available the detailed rules of procedures for panels, as well as a code of conduct for panelists.

Changes to existing antidumping and countervailing duty legislation will only apply to NAFTA members following consultation and if specifically provided for in the new legislation. Moreover, any government may seek a bilateral panel review of such changes in light of the object and purpose of the Agreement, its rights and obligations under the GATT Antidumping and Subsidies Codes and previous panel decisions. Should a panel recommend modifications, the countries will consult to agree on such modifications. Failure to reach agreement gives the other member country the right to take comparable legislative or equivalent executive action or suspend equivalent concessions.

Principal U.S. Trade-Remedy Laws

Statute	Focus	Criteria	Available Remedies	Admin. Authorities
Sec. 201 ("escape clause")	injurious imports	increasing imports are a substantial cause of serious injury	duties, quotas, tariff-rate quotas, adjustment assistance, orderly marketing arrangements	USITC President[a]
Sec. 701	subsidized imports	material injury[b]	countervailing duties	USITC ITA
Sec. 731	dumping (selling at less than fair value)	material injury	antidumping duties	USITC ITA
Sec. 301	violations of trade Agreements	actions are unreasonable, unjustified or discriminatory	"all appropriate and feasible action"	USTR President
Sec. 337	unfair trade practices (for example, trademark or patent infringement)	actions destroy or substantially injure an industry	exclusion orders; cease and desist orders	USITC President
Sec. 338	foreign country discrimination	burden or disadvantage U.S. commerce	increase duties, exclusion	President
Sec. 22	agricultural imports below U.S. prices	material interference with price support programs	import fees, quotas	USITC USDA President
Sec. 406	disruptive imports from communist countries	significant cause of material injury	duties, quotas	USITC President
Sec. 332	any trade irritant	effect on U.S. industry	investigation	USITC
Sec. 232	increasing imports	threat to national security	investigation range of restrictive measures	Commerce President

ITA: International Trade Administration of the U.S. Department of Commerce
USDA: U.S. Department of Agriculture
USTR: Office of the U.S. Trade Representative
USITC: U.S. International Trade Commission
a. The Congress may override the president.
b. The material injury test is only extended to countries that fulfill certain conditions.

Michael Hart, *Trade – Why Bother?*

FTA Chapter Nineteen – Summary of Canadian Cases

Eight cases have been filed reviewing Canadian agencies' decisions: two were completed — Small Induction Motors and Beer (dumping); one was terminated — Large Induction Motors (Dumping); and five are active — Beer (injury), Carpets (dumping and injury) and Gypsum Board (dumping and injury).

A binational panel affirmed the agency's decision in the Small Induction Motors case. In Beer (dumping), the panel affirmed the agency in part and remanded in part for it to consider its determination of a preponderant price for Heileman's sales in the home market and the inclusion of interest expenses in the calculation of Stroh's cost of production. Determination on remand was filed September 25, 1992. Virtually no change in duty resulted from the remand determination. No request was made to review the remand determination.

In Beer (injury), the panel affirmed the agency's determinations that an isolated market for beer and a concentration of dumped beer originating in the United States exists in British Columbia. The panel remanded the agency to determine whether the dumping of beer originating in the United States, rather than the presence of dumped beer originating in the United States, has caused and is causing material injury to the producers of all or almost all beer production in British Columbia. The determination on remand was filed November 9, 1992. On February 8, 1993, the panel affirmed the agency's determination on remand.

The approach to development that seems to have worked most reliably, and which seems to offer most promise, suggests a reappraisal of the respective roles for the market and the state. Put simply, governments need to do less in those areas where markets work, or can be made to work, reasonably well. In many countries, it would help to privatize many of the state-owned enterprises. Governments need to let domestic and international competition flourish. At the same time, governments need to do more in those areas where markets alone cannot be relied upon. Above all, this means investing in education, health, nutrition, family planning, and poverty alleviation; building social, physical, administrative, regulatory and legal infrastructure of better quality; mobilizing the resources to finance public expenditures; and providing a stable macroeconomic foundation without which little can be achieved.

World Bank, *The Challenge of Development: World Development Report, 1991*

FTA Chapter Nineteen — Summary of U.S. Cases

Twenty-five cases have been filed reviewing U.S. decisions. Of these, three panels rendered final decisions, and 10 cases were completed (One of the completed cases was appealed to an Extraordinary Challenge Committee (ECC)); three were consolidated; six were terminated; eight are currently active (Replacement Parts, 2 Live Swine, 2 Softwood Lumber and 3 Magnesium);

Binational panels affirmed U.S. agencies' decisions in 4 cases:

Replacement Parts (Scope Determination and AD cases);
New Steel Rails (AD and Injury).

Binational panels affirmed in part and remanded* in part decisions in 5 cases :

In Red Raspberries (dumping), the agency's decision was affirmed against one exporter and remanded for reconsideration for two others. After two remands, the agency eliminated duties for the two exporters.

In Pork (CVD), the panel remanded twice to the agency, which reduced the overall duty from C$0.08 to $0.03/kg.

In New Steel Rail (CVD), the agency reduced the overall CVD deposit rate from 112.34 per cent to 94.57 per cent ad valorem.

In Replacement Parts (dumping), the agency's decision was challenged by both the Canadian manufacturer and the original U.S. petitioner. For the third time, the panel remanded in part to the agency. The determination on remand was filed November 27, 1992.

In Live Swine four(CVD), the panel remanded in part twice to the agency for a reconsideration of government programs. The determination on remand was filed November 19, 1992, and it has since been referred to an ECC.

In Live Swine five(CVD), the panel has remanded once, so far, to the agency.

Upon remand by the Binational Panel, the U.S. agency reversed its decision in one case:

In Pork (Injury), the panel remanded the agency's determination twice. The United States appealed the second panel decision to an ECC. The ECC dismissed the request for failure to meet the standards of an extraordinary challenge set forth under the FTA article 1904.13 and affirmed the panel decision. Due to the reversal of the injury determination, no CVD on Pork was applied.

* remand — to send back to the original tribunal for reconsideration on the basis of the decision of a superior court or panel.

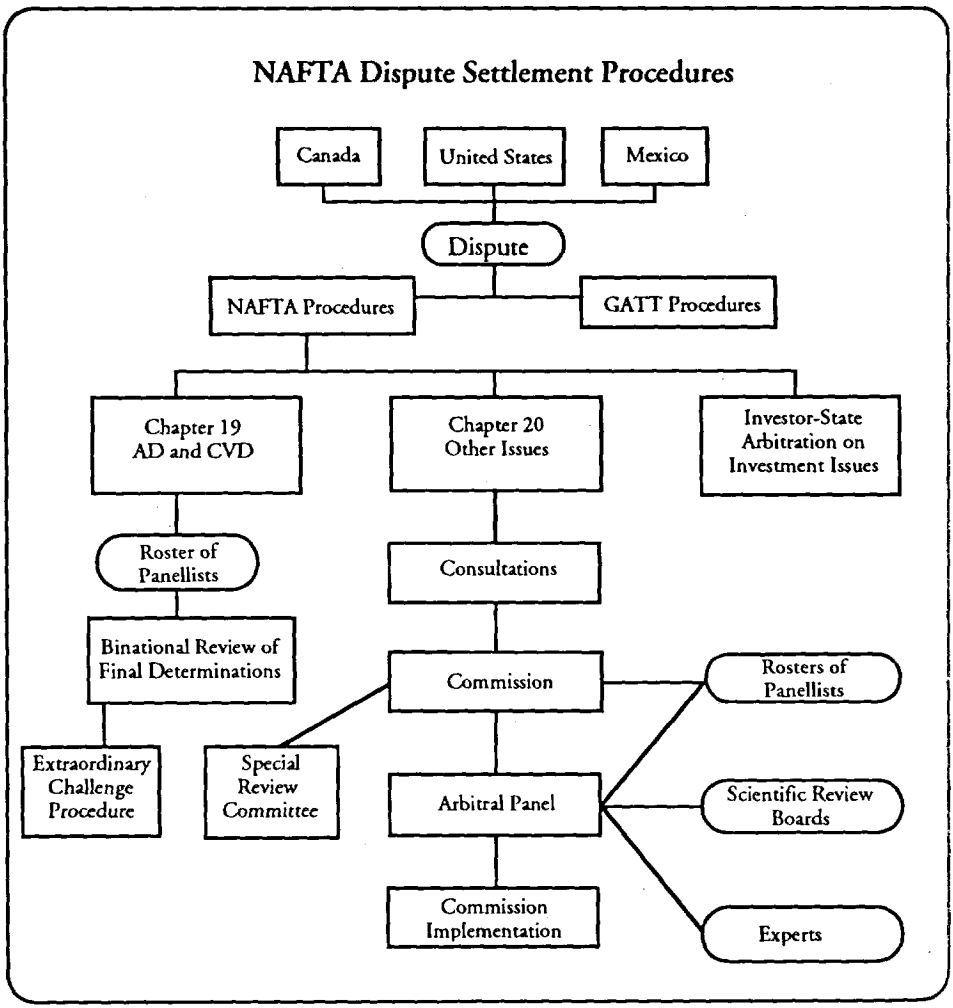
Chapter Twenty
Institutional Arrangements and Dispute Settlement

In drafting the institutional arrangements, the negotiators aimed at economy, joint decision making and effective dispute resolution. The basic objective is to promote fairness, predictability and security by giving each partner an equal voice in resolving problems through ready access to objective panels to resolve disputes and authoritative interpretations of the Agreement.

The Free Trade Commission is the central institution of the NAFTA. It comprises cabinet-level representatives (in practice the Minister for International Trade in Canada, the United States Trade Representative and the Mexican Secretary of Commerce and Industrial Development) or their designees. Regular Commission meetings are held at least once a year, alternating between member countries. As a practical matter, the day-to-day work of the Commission will be carried out by the officials of the member governments participating in the various committees and working groups mandated by the Commission.

The NAFTA establishes a Secretariat to serve the Commission and its dispute-settlement panels, committees and working groups. (In the FTA, the small Secretariat's duties were largely limited to assisting dispute-settlement panels.) There will be a permanent office in each country with the costs for each being borne by the host nation. The economy of these provisions reflects the judgment of all three partners that only experience will determine the extent to which a secretariat is required. If experience indicates the need for a large and active secretariat, the provisions are sufficiently flexible to establish it; otherwise, a smaller and more service-oriented institution is likely to evolve.

As with the rest of the Agreement, the dispute-settlement provisions build on those of the GATT and the FTA. Their objective is to ensure expeditious and effective means for both the avoidance and resolution of disputes. The NAFTA places priority on reaching an amicable settlement through consultations; indeed, the section on dispute settlement begins (article 2003) with a general exhortation at all times to "agree on the interpretation and application of the Agreement and ... make every attempt through co-operation and consultations to arrive at a mutually satisfactory resolution of any matter."



If consultations fail to resolve a conflict, a meeting of the Commission may be called, with all three nations present. Again, the emphasis is on reaching a settlement, and the NAFTA directs the Commission to consider using good offices, mediation, conciliation (article 2007), or other means of alternative dispute resolution to this end. For example, Canada could call for a meeting of regulatory experts in the United States on areas like meat inspection or health requirements for potatoes. If the Commission is unable to resolve a dispute, the next available option is to call for the creation of an arbitral panel.

NAFTA members can request a binding arbitration panel (article 2008). Arbitral panels will typically be charged with determining whether or not the action taken by the defending

country is consistent with its obligations under the NAFTA. In addition, arbitral panels will make recommendations for resolution of the dispute.

If a dispute can be brought under either the GATT or the NAFTA, the complainant country makes their choice. If another NAFTA-member country wants to bring the same case in the other forum, the complainants will consult with a view to agreeing on a single forum. If they cannot agree, the issue will usually be heard under the NAFTA. Once selected, the chosen forum must normally be used to the exclusion of the other (article 2005).

Cases under FTA Chapter Eighteen Interpretation of the Agreement

Five cases have been filed to date, two at the request of Canada. Four of the panels have issued final reports

In October 1989, the first panel concluded that a Canadian landing requirement for salmon and herring was a legitimate conservation measure but suggested that the direct export of up to 20 per cent of the catch would be in keeping with the spirit of the landing requirement. Canada subsequently adopted the report and developed a plan of implementation in consulation with the United States, industry and the B.C. government.

The second panel held that a U.S. minimum size requirement for imported lobsters was an "internal measure" not a restriction on importation as Canada had argued.

In June 1992, the third panel ruled unanimously in Canada's favour that bona fide interest costs on production facilities, whether or not secured by a mortgage, are to be included as a cost of production for the purposes of determining the origin of goods for FTA tariff treatment.

In February 1993, the fourth panel unanimously agreed with Canada's interpretation of the FTA article 701.3 respecting sales by the Canadian Wheat Board (CWB) of durum wheat for export to the United States. The panel ruled, in part, that the acquisition price is the CWB's initial payment, and that the Western Grain Transportation Act freight rate payments are not included within this provision. The panel also recommended that the information necessary to determine compliance with the FTA be reviewed by an independent auditor in accordance with an information-sharing procedure suggested by Canada.

Canada recently requested the establishment of a panel to consider whether new technical standards for ulta-high temperature (UHT) milk adopted by Puerto Rico are consistent with the FTA.

It is remarkable that Canada and the United States found it necessary to seek panel rulings in only five cases over the course of four years in what is the largest bilateral trading relationship in the world. While a number of issues have preoccupied the two governments, either in consultations between officials or in more formal discussions at the Commission, the majority of these were resolved on a basis other than panel proceedings. In short, not only are the dispute-settlement provisions of the FTA working, so are the dispute-avoidance mechanisms.

If there are only two countries involved in the proceeding, panels are composed of five members. They are chosen from a trilaterally agreed roster through a process of "reverse selection" to ensure impartiality: two from the complaining country are selected by the defending country, two from the defending country are selected by the complaining country. The chair, who may be from a non-disputing country, is selected by agreement. Panellists are normally drawn from a trilaterally agreed roster of eminent trade, legal and other experts.

If all three countries are involved, the panel will be chosen in similar fashion. The two complainant countries would select two panellists from the defending country, while the defendant country in turn would choose one panellist from each of the complainant countries. The chair is chosen by agreement.

Panel procedures provide for written submissions, rebuttals and at least one oral hearing. There are strict time limits to ensure prompt resolution. Unlike the FTA, there are special procedures that permit scientific boards to provide expert advice to panels on matters related to the environment, technical standards and related matters (article 2015).

Panel recommendations and findings should form the basis of agreed solutions. What if there is no mutually satisfactory result? If the dispute involves a measure that the panel has found impairs the fundamental rights or anticipated benefits of the aggrieved nation under the NAFTA, that country may suspend the application of equivalent benefits until the issue is resolved.

Building on the GATT and the FTA, the dispute-settlement procedures effectively limit the possibility of unilateral action by any of the countries to make their own determination of a violation. A country which "wins" a dispute may impose trade measures only to the extent authorized by the panel. However, if the other country considers this retaliation to be excessive, it may obtain a ruling on the trade measures by a binding arbitral panel.

I was brought up to believe that the trade-and-immigration controls on the border were an unnatural abrasion of the rights of man – and woman. They should be kept at a minimum or not exist. It is a feeling I have never escaped.

Once, a smaller, higher-cost production and, perhaps, lesser competence caused Canada to protect its factories from the competition of U.S. firms. Perhaps there was a case for this at one time. Now no longer. I applaud the combination of improved efficiency and self-confidence, along with the intelligently cheaper dollar, that now causes the Canadian government –Tory no less – to press for free trade.

Canadians are concerned that free trade will impair their sovereignty and bring Canada ever more dangerously under U.S. influence. This is nonsense. The U.S. influence is there, no one can doubt it, but it is a fact of geography, not of trade.

John Kenneth Galbraith

Part Eight — Other Provisions

Chapter Twenty-one — Exceptions

While the Canadian, U.S. and Mexican governments were earnest in their objective to reduce the range of barriers to the greatest extent possible, sovereignty and the national interest means that there will always be exceptions.

Exceptions constitute a buffer zone without which binding international agreements could not be concluded between sovereign nations. To that end, the three governments have agreed to incorporate the provisions of the GATT article XX. Additionally, article 2101 clarifies that the exemption for human, animal, plant life or health includes measures necessary to protect the environment. The provisions of article XX are not absolute. They are subject to the requirement that they not be applied so as to constitute an arbitrary, unjustifiable or disguised restriction on trade. By virtue of their incorporation in the NAFTA, any future dispute about the application of any measure on trilateral trade justified under this article would be subject to the dispute-resolution mechanism of the NAFTA.

A second broad exception responds to each nation's need to protect its essential security requirements. The GATT article XXI provides such an exception. The NAFTA essentially reproduces its provisions but in slightly amended language to take account of the much broader subject matter covered by the Agreement, and to confine the exception for fissionable material to military uses (article 2102). It thus ensures that each party can take such measures as necessary to protect its essential security interests, while circumscribing the potential for abuse. Somewhat tighter provisions covering the national security exception are found for trade in energy goods (article 607) and for government procurement (article 1018).

Not surprisingly, each country has ensured that its ability to tax its citizens and corporations is not impaired by the Agreement (article 2103). Given the complexity and breadth of the Agreement, however, this general exemption needed to be qualified to take account of various places where the Agreement overlaps with fiscal issues, such as the obligation to extend national treatment (article 301) and the prohibition against export taxes (articles 314 and 604). Article 2103 thus clarifies the extent of the countries' obligations where there is potential for conflict.

When the GATT was first negotiated, it was designed to complement the International Monetary Fund (IMF) to ensure an effective, international trade and payments regime. An important feature of that regime was that currencies were pegged and exchange rates could

only be adjusted with the permission of the IMF. As a result, it was essential that countries have the capacity to use trade measures to shield their balance of payments (BOPs). The GATT articles XII through XV spelled out the obligations relating to such measures, as well as the extent of the relationship between the GATT and the IMF. With the change to a system of floating exchange rates and the consequent adjustments in the IMF rules, trade measures to keep safe the balance of payments have virtually disappeared among OECD countries but have remained important elements in the economic policies of developing countries. The GATT includes a specific provision dealing with BOPs measures for developing countries (article XVIII). Unfortunately, the potential for abuse can be substantial. As a result, the NAFTA parties have agreed to a strict BOPs regime (article 2104) that is consistent with their obligations under the IMF, as well as the broader range of measures covered by the Agreement, such as trade in financial services and investment.

Article 2106 ensures that the exemption for cultural industries included in the Canada-U.S. FTA is carried over into and made a part of the NAFTA.

GATT Article XX

GATT's General Exceptions provide that nothing in the Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

- necessary to protect public morals (such as prohibitions on trade in pornographic material);
- necessary to protect human, animal or plant life or health (such as measures to protect the environment or endangered species);
- relating to the importation or exportation of gold or silver;
- necessary to secure compliance with laws or regulations, such as those relating to customs enforcement, the protection of patents, trade marks and copyrights or the enforcement of product standards;
- relating to the products of prison labour (Producers should not have to compete with goods produced with prison labour.);
- imposed for the protection of national treasures of artistic, historic or archeological value;
- relating to the conservation of exhaustible natural resources;
- undertaken in pursuance of obligations under any intergovernmental commodity agreement, such as an international wheat or tin agreement;
- involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic producing industry during periods when the domestic price of such materials is below the world price as part of a government stabilization plan; (See also Chapter Four on market access in the context of obligations relating to export measures and Chapter Seven for energy goods.); and
- essential to the acquisition or distribution of products in general or local short supply.

Chapter Twenty-two — Final Provisions

This chapter lays out the legal language necessary to bring the Agreement into force including provisions for annexes and amendments to the Agreement. The Agreement will remain in effect indeterminately. It also permits any party to withdraw from the Agreement on six-months' notice, as in the FTA.

It states that the Agreement will enter into force when domestic approval has been obtained. In Canada, the necessary implementing legislation was presented to Parliament in late February. In the United States, legislation and a Statement of Administrative Action require Congressional approval under "fast-track" procedures. In Mexico, the NAFTA is a treaty that can take effect when the Mexican Senate provides its advice and consent to ratification. The Agreement may enter into force for two of the parties upon an exchange of instruments of ratification between them.

A key part of this chapter is the clause on accession (article 2204), which will permit other countries to seek admission into the free trade area upon meeting such conditions as may be determined by the parties to the Agreement, including:

- Canada and the other governments must agree to enter into negotiations; and
- The country seeking admission will have to negotiate its price of admission; i.e., to offer commitments to eliminate tariff and other barriers and bring its trade and related economic practices into line with the rules and procedures set out in the NAFTA.

In this way, Canada and the other founding countries will have a full opportunity to assess whether the applicant is prepared to live up to the obligations of the Agreement. This "docking" provision ensures that Canada will not have to renegotiate its terms of trade with the United States and Mexico every time a new country seeks freer access with the NAFTA countries, since future negotiations will be limited to the conditions on which another country will be admitted into the free trade area.