TRADE NEGOCIATIONS STUDIES:

DOCUMENTS RELEASED UNDER THE ACCESS TO INFORMATION ACT,

MAY 21, 1986

STUDY NO. 15:

United States trade remedy law. (Arnold & Porter for Dept. of External Affairs. January 1986)

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CANADA-UNITED STATES TRADE INITIATIVE:
RESEARCH PAPERS

UNITED STATES TRADE REMEDY LAW

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DEPARTMENT OF EXTERNAL AFFAIRS
OTTAWA
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Executive Summary

The Canadian Government is currently considering whether to enter into discussions with the U.S. Government regarding the creation of a bilateral Free Trade Agreement. This memorandum discusses the political and legal feasibility in the United States of various proposals, which Canada might make in these discussions, to modify the way U.S. import relief laws are applied to Canadian exports.[1] In accordance with your request, we discuss in some detail (i) the legal and institutional constraints on the U.S. negotiators, (ii) the current political attitudes on trade in the Administration, Congress, and key interest groups, and (iii) the likely reaction of the U.S. Government to each of the various proposals that have been made to create a special position for Canada under the U.S. import relief laws.

The deteriorating U.S. trade position has inspired a protectionist sentiment in the Congress and public, and led to increased pressure on the Administration to limit imports and reduce foreign barriers to U.S.

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[1] Undoubtedly, special phase-in procedures will be needed in a Canada-U.S. FTA to protect domestic industries from a prospective flood of imports caused by the removal of tariffs. This memorandum does not address that transitional import relief, but rather discusses proposals to permanently modify application of the U.S. import relief laws to all Canadian exports.

experts. Consequently, although elements of a Canada-U.S. FTA may be generally welcomed, individual provisions that are perceived as weakening the U.S. import relief laws are likely to generate considerable controversy.

The President would have to submit an FTA with Canada to Congress for ratification as either a treaty or "congressional-executive agreement." In either case, Congress will be able to shape, or even block, a proposed agreement. A "congressional-executive agreement" can be submitted to Congress under a "fast-track" procedure that is the most desirable in many respects (and which may be insisted upon by Congress). To proceed under the fast-track procedure, the Administration is required to keep the relevant congressional committees closely informed on the progress of the negotiations. In practice, the fast-track procedure gives Congress a continuing and persuasive influence over the U.S. negotiators that permits it to limit significantly their discretion.

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Issue Posed

You have informed us that some analysts believe that Canada now faces a decision as to whether to attempt to preserve its domestic market from foreign competition or whether to attempt to become more integrated with the international market. In the opinion of these analysts, unilateral protection of the domestic economy through tariff and nontariff barriers would ultimately limit Canadian industry to the relatively small domestic market, while integration with the international market through the reduction of trade barriers would give Canadian industry the opportunity for much greater growth.

However, these analysts recognize that the reduction of trade barriers would also make Canadian industry more vulnerable to foreign competition in the domestic market. Therefore, before reducing barriers that serve to protect the domestic industry, it is essential to ensure that the Canadian economy is poised to experience the benefits, as well as the costs, of expanded international trade.

According to these analysts, the United States is important to the Canadian economy not only as a market for sale of Canadian products, but also as a base for

Canadian competitiveness in other foreign markets. This is because for many industries, Canada alone is not a sufficiently large market to develop the product diversity, product quality, and financial support necessary to compete successfully in the international market. These industries need a larger "home" market and the economies of scale it would provide. Therefore, assured access to the U.S. market is necessary if these industries are to be internationally competitive and Canada is to benefit fully from expanded international trade.

At present, the access of Canadian industries to the U.S. market is increasingly threatened by U.S. import relief actions. These actions -- imposed most often under the countervailing duty, antidumping, and safeguards laws -- are always costly to defend against and often unpredictable in outcome. They can result in increased duties or quotas on imports of Canadian products to the United States.

In large part because of the threat of future import relief actions, some industries that would otherwise locate in Canada are shifting their production facilities to the United States, thereby assuring themselves of guaranteed access to the U.S. market.

The elimination of tariffs through creation of a Canada-U.S. Free Trade Agreement would likely further accentuate the shift in investment, as Canadian industries would become more vulnerable to competition from U.S. exports. This shift of investment from Canada to the United States may seriously limit Canada's ability to compete in the international market.

Because of the above factors, we understand that in discussions of a possible Canada-U.S. FTA, the Canadian Government would pursue measures that would increase the predictability of the effects of the U.S. import relief laws. You have asked us to evaluate the likelihood of U.S. acceptance of various proposals to limit application of the import relief laws to Canadian exports.

I. GENERAL DESCRIPTION OF U.S. POLITICAL SETTING IN WHICH THE NEGOTIATIONS WILL TAKE PLACE

As you know, the United States is currently experiencing much difficulty with its international trade relations. Most U.S. policymakers acknowledge that the poor trade performance of the United States can, at least in part, be attributed to the unusually

strong U.S. dollar. But many of them feel that certain foreign industries have gained an important competitive advantage over U.S. industries independent of the value of the dollar. And many believe that this advantage results from barriers to foreign market access for U.S. products or from "unfair" support the foreign industries receive from their governments. These policymakers feel that the U.S. government must take action to reestablish a "level playing field" on the international market by securing a reduction in foreign barriers to U.S. products, eliminating or offsetting foreign subsidies, and/or by erecting more U.S. barriers to imports.

In the eyes of the public, increased imports are directly linked to the loss of business and jobs in the United States.[1] Consequently, protectionist measures have found broad-based support among both management and labor, and often inspire emotional support from politicians. The Reagan Administration officially favors free international trade, but has come under increasing pressure to take firm action to protect domestic industries, and in some cases has responded

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[1] See Phillips, "The Politics of Protectionism," in Public Opinion (April/May 1985) p. 41, which reviews the results of a number of recent public opinion polls.

to this pressure by imposing significant import restrictions.

In the current political atmosphere, bilateral negotiations to develop an FTA with Canada that reduces barriers to U.S. exports should be welcomed by the Administration and some key leaders in the House and Senate. Certain issues connected with a proposed FTA, however, may generate considerable controversy and opposition. One such issue would be created by an effort of the Canadian Government to increase the certainty and predictability of trade for Canadian industries by negotiating a special status for Canada under the U.S. import relief laws.

II. LEGAL AND INSTITUTIONAL CONSTRAINTS

Under the U.S. Constitution, the Congress is given the power "to regulate Commerce with foreign nations" and to "levy and collect . . . duties. . . ." Therefore, the Executive Branch can take very little effective action on this subject without specific authorization from Congress. Even though Congress has for some years delegated substantial authority to the

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Executive Branch to conduct international economic affairs, Congress has traditionally felt that it has preeminent power in this area, and has maintained tight restrictions over the President's discretion. One can confidently predict, on the basis of both the past practice of Congress in trade matters and its current distrust of the Executive Branch, that Congress will insist on playing a strong role in decisions about the terms of an FTA with Canada.

A. Types of International Agreements and Their Status Under U.S. Law

There are two principal ways in which the President may enter into an international agreement such as an FTA -- by treaty or by "congressional-executive agreement." U.S. treaties and "congressional-executive agreements" have equal status under both international and domestic law.

1. Treaties

Article II of the Constitution specifically grants the President the power to enter into treaties with the "advice and consent" of a two-thirds majority of the Senate.

2. Executive Agreements

Although the Constitution does not expressly confer authority to make international agreements other than treaties, the courts have upheld the ability of the President to enter into international "executive agreements." In fact, the vast majority of international agreements to which the United States is a party are executive agreements rather than treaties. Executive agreements can take any of several forms:

(a) An executive agreement approved by Congress through advance delegation -- in this situation, Congress enacts a statute granting authority to the President to negotiate and enter into a future international agreement.

(b) An executive agreement authorized subsequently by Congress -- in this situation, the President negotiates the agreement and then submits it to Congress for approval. Congress then passes a statute ratifying the President's action in entering the agreement, or authorizing the President to proceed to sign it.

(c) An executive agreement authorized by treaty -- sometimes the President is deemed to be granted authority, under treaties or other executive agreements, to enter into derivative executive agreements designed to carry out the purpose of the prior treaty without further submission to Congress.

(d) An executive agreement authorized by the President's "inherent powers" -- on some occasions, the President has claimed he had power to enter into international agreements without any congressional input or approval whatsoever. This power has been upheld by the courts when it was closely tied with specific Presidential authorities, such as his authority as "Commander in Chief" or his authority to "receive diplomats." However, this power is very controversial, and prior efforts by Presidents to extend it have been met with considerable opposition in Congress. A claim of presidential power to enter an executive agreement on trade would be especially weak in light of the strong power over that subject vested by the Constitution in Congress.

Executive agreements explicitly approved through (a) advance congressional delegation or (b) subsequent congressional authorization are known as "congressional-

executive agreements" and, as stated above, are equivalent to "treaties" under both U.S. and international law.

3. Status of International Agreements Under U.S. Law

Article VI of the U.S. Constitution provides that the Constitution, federal legislation, and treaties "shall be the Supreme Law of the Land." This Article has been interpreted by the courts to mean that international agreements, once implemented, have equal status with federal legislation. Consequently, international agreements must conform to the requirements of the Constitution, and take precedence over state law and prior federal legislation.

It is also well-established in U.S. law that federal legislation enacted subsequent to an international agreement supersedes the international agreement.[1] While it may seem logical that a two-thirds majority of the Senate would be required to abrogate a treaty, that is not the case. In fact, there is no legal restraint preventing Congress from enacting legislation

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[1] See Restatement of Foreign Relations Law (Tent. draft) §§ 131, 135 (1980). U.S. law includes a principle of interpretation that courts should, when possible, construe domestic laws in such a way as not to bring them into conflict with international agreements. See Murray v. Schooner Charming Betsy, 6 U.S. (2 Cranch) 64, 118 (1804).

inconsistent with either a prior treaty or congressional-executive agreement. In addition, Presidents have occasionally terminated treaties without consulting Congress at all.

At the same time, however, international law provides that a nation may not rely on provisions of its own law to justify a breach of its obligations under international laws.[4] The United States recognizes the latter principle, and acknowledges that the superseding of an international obligation of the United States by a subsequent federal law does not relieve the United States of that international obligation or the consequences of its breach of that obligation.[5]

Therefore, if Congress were to enact legislation inconsistent with the FTA at some time in the future, the U.S. courts would require the U.S. Government and individuals subject to U.S. law to implement the provisions of the subsequent legislation, even if in violation of the FTA. However, the FTA would remain binding under international law, and Canada would be entitled to invoke the dispute settlement mechanism

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[4] I. Brownlie, Principles of Public International Law 36 (1979).

[5] Restatement (Tent. draft) § 135.

of the FTA or to utilize other international enforcement mechanisms.[3]

It should also be noted that international agreements entered into by the United States are often not "self-executing" under U.S. domestic law. In such cases, the Congress must enact implementing legislation. Consequently, the task of the foreign government does not necessarily end with the conclusion of the international agreement; special care must be taken that implementing legislation does not undermine the agreement.[4]

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[3] Treaties and congressional-executive agreements always take precedence over state law, no matter when enacted. See Missouri v. Holland, 252 U.S. 416 (1920). Therefore, individual states would not be able to undermine an FTA through local legislation. For this reason, an FTA could provide very effective protection for Canada against state laws limiting the purchase of Canadian products through "buy American" provisions or restrictive product standards.

[4] Although there was extremely strong support for the U.S.-Israel FTA, Congress was somewhat reluctant to implement the required tariff reductions.

B. Congressional Ratification: The Traditional and Fast-Track Procedures

1. Traditional Procedure

Under the traditional method for obtaining congressional approval, the Executive Branch would negotiate an international economic agreement with little or no congressional input. The President would then submit it to Congress.

International economic agreements -- such as an FTA -- are normally submitted as congressional-executive agreements rather than as treaties[1] because

- the House of Representatives (especially the Ways and Means Committee) has a very strong interest in these agreements;[2] and

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[1] As previously noted, a treaty is submitted only to the Senate, where it must be approved by a two-thirds majority. A congressional-executive agreement must be approved -- before or after execution -- by a majority of a quorum in both Houses of Congress.

[2] This strong interest stems from the Constitutional requirement that "revenue measures" -- such as tariffs -- originate in the House of Representatives. The House (especially the Ways and Means Committee, which has jurisdiction over these matters) has had for years a strong involvement with international trade matters, and its cooperation is needed by the President for any significant trade program.

congressional-executive agreements permit. In practice, more advance consultation between the President and Congress and thereby give more assurance that Congress will approve the final agreement.

If the FTA were submitted as a congressional-executive agreement, the procedures applied to domestic legislation would apply. The proposed bill to authorize the agreement would first be referred to the House and Senate Committees with jurisdiction over the subject matter of the bill. (In this case, the House Ways and Means Committee and Senate Finance Committee would have primary jurisdiction, although other committees may have jurisdiction over individual elements of the bill.) Those committees could then conduct public hearings on the bill and make alterations they determined were necessary. If and when the committees felt it appropriate,[1] the bill would be referred to the full House and Senate for consideration. After referral to the "floor," the bill can be subject to virtually unlimited debate by individual Congressmen, and amendments can be made. Finally, if the House and Senate pass

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[1] Many bills are essentially "killed" by the Committees and are never referred for consideration by the full Houses.

different versions of a bill, a "conference committee" must be formed to negotiate a compromise, which itself must be voted upon by the full Houses.

Treaties are subject to a similar procedure. A treaty is first referred to the Senate Foreign Relations Committee, which may conduct hearings on the treaty. The Committee is under no obligation to refer a treaty to the full Senate for consideration, and may hold it indefinitely. Although a treaty signed by the President and submitted to the Senate for ratification technically may not be "amended," the Senate may attach "reservations" and "understandings" to the treaty that ultimately have the same effect by limiting the United States in its future compliance with or interpretation of the treaty. Unlike congressional-executive agreements, however, treaties must be approved by a two-thirds vote of the Senate only, rather than a majority vote of a quorum of both Houses.

2. Fast-Track Procedure

The traditional procedure described above has sometimes proved to be inadequate for the negotiation of international economic agreements. During the Kennedy Round in the late 1960s, the U.S.T.R. concluded a

multilateral agreement after arduous negotiations that, inter alia, required the U.S. Government to alter the way it valued certain goods for customs purposes. When the agreement was submitted to Congress under the traditional procedure for congressional-executive agreements, Congress rejected the agreement, thereby severely embarrassing the Administration.

It was then recognized that a new approval procedure was needed in order to restore the credibility of the United States negotiators. Under the special "fast-track" procedure created by Section 102 of the Trade Act of 1974, the Executive Branch was committed to extensive consultation with the relevant congressional committees, and Congress, in turn, was committed to an expedited consideration procedure. On the occasions it has been used, the fast-track procedure has virtually assured congressional ratification of negotiated agreements, thereby restoring the confidence of foreign governments in the ability of the Executive Branch to negotiate on behalf of the U.S. Government in this area.

Specifically, under the 1974 Act, the President was authorized to negotiate and enter into trade agreements to harmonize, reduce, or eliminate nontariff barriers, which could then be submitted for approval

under an expedited procedure if the President (i) gave the Congress at least 90 days prior notice of his intent to enter into the agreement, and (ii) submitted a copy of the executed agreement together with a draft implementing bill, a statement of proposed administrative action, and a statement of how the agreement served U.S. interests. The Committees would then be required to refer the bill to the floor after 45 days, and each House would have 15 days to act on the bill, with no amendments permitted and special limits on debate.

These procedures permitted the relevant congressional committees to have significant influence over the U.S. negotiators during the Tokyo Round.[11] Consequently, when the bill that became the Trade Agreements Act of 1979 was ultimately introduced using this procedure, it was passed with almost unanimous votes in both Houses.

The Trade and Tariff Act of 1984 extended the availability of the "fast-track" procedure to bilateral trade agreements that provide for elimination or reduction of duties as well as nontariff barriers.[12] Duty reduction

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[11] In fact, congressional representatives were included in the negotiations as observers.

[12] The prospective agreement with Israel was exempted from the advance consultation and 90-day prior notification requirements. At the same time, duty reduction agreements with other countries were not exempted from these requirements.

agreements, however, are subject to the following additional requirements: (i) the foreign country must request negotiation of the agreement; (ii) the President must notify and consult with the House Ways & Means and Senate Finance Committees at least 60 legislative days in advance of the 90-day notice; and (iii) the Committees must not disapprove of the negotiation during the 60-day period.[1] This provision was designed to give Congress "veto" power over trade negotiations. At the same time, the law does not prohibit the Administration from holding informal discussions with the Canadian Government and developing proposals prior to reporting to Congress.

As with the 1979 Trade Agreements Act, the fast-track procedure gave the Congress considerable input into the formulation of the U.S.-Israel FTA. The implementing legislation for that international agreement also passed both Houses with near unanimity.

The original Senate version of the 1984 Trade Act would have authorized the President to negotiate

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[1] Committee disapproval makes the bilateral agreement ineligible for the fast-track procedure, but does not invalidate the negotiations as such. Therefore, the Congress felt that this statute was not the type of legislative veto that has been declared unconstitutional by the U.S. Supreme Court.

an agreement with Canada as well as Israel under the original fast-track procedures, and with other countries subject to the added requirements described above. The final compromise legislation exempted Israel from the consultation and 90-day notification requirements and placed Canada in the same category as all other countries.

Section 406 of the Trade Act of 1984 specifically provided that the prospective U.S.-Israel FTA should not alter the U.S. import relief laws. There is no such limitation on agreements with countries other than Israel. However, the report accompanying the original Senate bill to grant authority for trade agreements with Israel and Canada states that "[t]he [trade] agreements would make clear that they will not affect the normal operation of the domestic trade laws; for example, procedures for domestic industries to seek relief from unfairly traded imports would operate without regard to such agreements."[14]

Consequently, it is essential to be prepared for congressional limitations on the Administration's negotiating discretion. Even though the negotiating authorization in the Trade Act of 1984 prohibited the

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[14] S. Rep. No. 98-510, 98th Cong., 2d Sess. 6 (1984).

Administration from modifying the trade remedy laws in an FTA only with Israel, the Finance or Ways and Means Committee could easily require an informal commitment on this issue from the Administration before approving negotiations with Canada. It should be noted, in this regard, that the Senate Finance Committee's report on the U.S.-Israel FTA implementing legislation stated:

> As the Law requires with all such agreements, the Committee expects the President, when he considers negotiating a free-trade agreement with Canada, to consult fully with the Committee regarding all fundamental aspects of the potential agreement, including the subject matter under negotiation and possible U.S. approaches.[1]

Although this statement is not binding law, it is a strong expression of the attitude of the current membership of the Finance Committee.

It is of course not necessary to negotiate a Canada-U.S. FTA under the fast-track procedure; any agreement negotiated could be submitted to Congress under its normal procedures. However, the advantages of the fast-track (automatic committee discharge, nonamendability) are substantial enough that it seems

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[1] S. Rep. No. 99-18, 99th Cong., 1st Sess. (1985).

advisable to use the fast-track if it is available.[14] As explained above, a trade agreement not considered under the fast-track procedure is subject to potential delay and modification by the Committees as well as the full House and Senate.

III. POLITICAL AND POLICY CONSTRAINTS

A. Traditional U.S. Policy Favoring Multilateral Trade Agreements

The U.S. Government has historically favored multilateral over bilateral trade agreements. In recent years, however, the United States has become frustrated with the slow, fractious nature of the multilateral process. Therefore, the U.S. Government has been more favorably disposed toward bilateral and regional arrangements, such as the U.S.-Israel FTA and the Caribbean Basin Initiative. Nonetheless, it is possible that the U.S. Government position on a Canada-U.S. FTA

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[14] The fast-track procedure is due to expire in January 1988. Many feel that renewal of the procedure by the Congress is essential for the Administration to pursue a new GATT round.

may be influenced by its progress in launching a new multilateral trade negotiation. If a new GATT Round looks likely, U.S. policymakers may view a Canada-U.S. FTA as a potential threat or impediment to a successful multilateral negotiation.

3. U.S.-Israel FTA as Precedent

There are many differences between Canada's and Israel's trade and political relations with the United States. Nonetheless, because the U.S.-Israel FTA is the first such agreement to which the United States has been a party, it will inevitably be treated as a precedent for some purposes. Therefore, it may be useful to review the elements and history of the U.S.-Israel FTA that are directly relevant to proposals to limit the application of the U.S. trade remedy laws to Canada.

The U.S.-Israel FTA itself does not mention the countervailing duty law, but Annex Four of the FTA lists several specific subsidy programs the Israeli Government has agreed to phase out. The FTA also contains an "anti-sideswipe" provision for safeguard actions, which is discussed in Section IV.C.1., below.

During the congressional hearings on the proposal for a U.S.-Israel FTA, there were several strong comments opposing any limitation on the trade relief laws. Perhaps most significantly, during the hearings before the Subcommittee on Trade of the House Ways and Means Committee, Chairman Sam Gibbons made the following statement to the Deputy U.S. Trade Representative and the Deputy Undersecretary of Agriculture for International Affairs and Commodity Programs:

> I would say to both of you that I don't expect you to negotiate anything that would tear down our laws that I generally describe as keeping the playing field level, the laws against subsidies, the laws against dumping essentially. Nor do I want you to do anything that gives any country a distinct advantage in what are the basic areas.
>
> This is a reduction of tariffs and any nontariff barriers that we have, but I don't include the countervailing duty laws and dumping laws as being nontariff barrier laws. Those are basic laws designed to keep the trade free and open.
>
> Subsidized trade, as I have said so often, is not free trade. It is the worst kind of Government intervention in the marketplace.
>
> So I don't want to see you attempting

to negotiate any of those away."[17]

The implementing legislation for the U.S.-Israel FTA clearly reaffirms the principle that the trade remedy laws were not to be affected by the FTA. It provides that in cases where the FTA conflicts with any U.S. statute, the statute will take precedence. The report accompanying the Senate bill explains that "although there is no apparent inconsistency between U.S. unfair trade laws and the agreement, section 5 makes clear that such U.S. laws are not modified by the agreement."[18]

However, it is important to note that Congressman Gibbons' statement and the Senate report quoted above focus on the unfair trade practice laws. Congress therefore may have a different, more receptive reaction to changes in the safeguards law than it would to changes in the countervailing duty and antidumping laws.

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[17] Proposed United States-Israel Free Trade Area: Hearings Before the Subcomm. on Trade of the House Comm. on Ways and Means, 98th Cong., 2d Sess. 26 (1984).

[18] S. Rep. No. 99-33, 99th Cong., 1st Sess. 8-9 (1985).

C. Attitude of Executive Branch

1. General Factors Likely To Affect Administration Reaction

The reaction of the Executive Branch to proposals to modify the trade remedy laws will likely be influenced by three general factors: (a) its recent experience with international economic policy, (b) its recent experience in negotiating international economic agreements, and (c) public perceptions of a current lack of strong leadership on trade matters.

a. Recent Experience with International Economic Policy

During the Reagan Administration, international economic policy has generally been given a subordinate position to domestic economic policy. When the Administration proposed its domestic economic program in 1981, it appeared that little consideration was given to the program's possible effect on the nation's international economic position. Indeed, the official Administration view is that trade policy is a function of domestic economic policy.

In the past three years, the impairment of the U.S. competitive position, due to the high value of

the dollar, has made it more difficult for trade policy officials to get the serious attention of Congress, business leaders, or foreign governments for trade liberalization measures. In fact, the surge of imports caused by the overvalued dollar has focused Executive Branch attention and energy on strengthening the import relief laws and administering import relief cases.

The competitiveness gap between U.S. and foreign industries now appears so wide that large segments of the U.S. business and labor communities have lost the confidence normally necessary to support significant trade liberalization negotiations, whether multilateral or bilateral. Therefore, business and labor interests will require even more reassurance than in the past that any U.S. trade concessions will yield significant U.S. export benefits and will not severely jeopardize vulnerable U.S. industries.

Most recently, trade policy has become a controversial political issue. Both Democratic and Republican Senate leaders are asserting emphatically that the Administration has no trade policy at all, and that therefore Congress must take the lead on trade issues. Many members of Congress feel that the President has created a trade crisis by refusing to confront the

consequences for U.S. competitiveness of his domestic economic program. Indeed, there is some exasperation and anger because although the members of Congress are facing negative political reactions from their constituents over the trade situation, the President has not provided them with a comprehensive trade program they can point to as a solution. This poor relationship with Congress on trade policy is likely to affect the Administration's judgment on what it can offer the Canadian Government in an FTA.[11]

b. Recent Experience with Trade Negotiations

Early in the Reagan Administration, former United States Trade Representative ("U.S.T.R.") Brock made strong efforts to foster interest in new multilateral trade negotiations. These efforts were frustrated both by Congress and foreign governments. Partly as a result, the Administration turned its attention to regional and bilateral negotiations, resulting in the Caribbean Basin Initiative and the U.S.-Israel FTA. Although the Administration continues to press for a new

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[11] It has been reported that the Administration, reacting to the criticism of Congress, is now preparing a major policy statement to be released by early September. The statement is being prepared by U.S.T.R. Yeutter and will be released only after approval by the Cabinet Economic Policy Council.

multilateral round, its recent success with bilateral negotiations is likely to encourage a receptive attitude toward some further bilateral agreements.[11] The Administration may, in particular, view a Canada-U.S. FTA as a vehicle for sending a signal to the world that the U.S. Government intends to reward its most reliable trading partners -- such as Canada -- with trade liberalization while it erects barriers to trade from unreliable countries.

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[11] It was recently reported that the U.S.T.R. would be receptive to negotiating an FTA with the ASEAN nations. ASEAN includes Thailand, Singapore, Indonesia, the Philippines, Malaysia, and Brunei. The prospects for such a negotiation are in fact probably rather remote since the ASEAN group has not yet established effective free trade among its own members.

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2. Likely Administration Reaction

Based upon the factors described above, we feel that the Administration is likely to have the following reactions to the three principal questions that will be raised during a discussion of possible modification of the trade remedy laws in an FTA:

(a) Is the proposal reasonable?

(b) Does the proposal fit in with U.S. objectives?

(c) What will be the reaction to the proposal by Congress and business and labor interests?

a. Reasonableness of Proposal

As discussed earlier, to be competitive internationally, Canadian industries need open access to the U.S. market. The threat of impediments to Canada-U.S. trade encourages industries to locate in the United States, rather than Canada, to guarantee their access to the much larger U.S. market. We feel that the Administration, in general, would recognize the validity of the above concerns of the Canadian Government and would be sympathetic to the Canadian objective of predictability.

b. Consistency with U.S. Objectives

(i) Canada is generally considered a reliable trading partner, in that it participates actively in the pursuit of an open world trading system, maintains relatively open markets for U.S. products, and does not distort trade through aggressive targeting of exports with subsidies and coordinated industry efforts.[34] Indeed, Canada is thought to have attitudes

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[34] On the other hand, Canada does have the largest trade surplus with the United States of any country except Japan, a fact which is likely to be strongly emphasized if FTA talks proceed. In addition, Canada has some programs of government support for industry which are considered objectionable in the United States and are subject to countervailing duties under U.S. law if they cause injury to a U.S. industry.

thereby building support among other nations for broader trade liberalization.

c. Influence of Congress and Public

As discussed above, Congress and business and labor interests have lost confidence in the ability of the United States to compete internationally. They have also lost confidence in the soundness of U.S. trade policy. Consequently, the Administration will have a great fear of adverse reactions from Congress and various interest groups. To avoid "frightening" these interests, it may be essential to the Administration that any proposals to modify the trade remedy laws be incorporated into a balanced trade package before release to Congress and the public. Such a package would need to offer benefits that will be appealing to U.S. industry and labor to such an extent that they will justify the costs industry and labor would be asked to bear.

C. Attitude of Congress

1. Background Factors

Certain general factors have contributed to a recent dramatic change in the political atmosphere that forms a background against which members of Congress establish their positions on trade issues:

- Trade is now a much more significant component of U.S. GNP than it has ever been (21.6% in 1984);[11]
- The U.S. trade deficit is much larger than it has ever been;
- There is a lack of confidence by the large majority of U.S. industries in their ability to compete internationally;
- In the view of many Congressmen, the dollar is greatly overvalued, making imports cheaper and exports more expensive. The Administration's economic policy is considered the principal cause of the high dollar, although the economic policies of the E.C. and Japan have been a contributing factor;

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[11] Source: Bureau of Economic Analysis, Department of Commerce.

- Many Congressmen feel that the other developed country markets that could potentially absorb much of the world's exports -- Japan and the E.C. -- are not as open as that of the United States. Consequently, the world's exporters focus on the U.S. market more than they would otherwise. In addition, the countries that profit most from exporting to the United States, such as Brazil, Taiwan, South Korea, and Japan, keep their markets closed to U.S. exports and to exports from each other. (Canada is not typically included in the list of countries with closed markets.);

- Most members of Congress now find it politically necessary to take an active role in and speak out on trade policy issues, whereas formerly only a few Congressmen paid attention to these issues;

- Congressmen that are confronted by angry import-affected constituents are unable to point to strong Administration leadership as holding out hope for policy steps that will resolve the problem;

- There has been a breakdown in the traditional bipartisan support for U.S. trade policies, as some Democratic members of Congress now see an opportunity to blame the Republicans for the trade situation. This breakdown, in turn, makes each Congressman -- whether Republican or Democrat -- more cautious about supporting trade liberalization since each feels vulnerable to a new wave of protectionist criticism that could sweep him out of office.

All of the above factors will influence the behavior of Congress and, through Congress, the Administration.

2. Recent Legislative Activity

Because of the factors identified above, congressional leaders have threatened to enact a broad series of protectionist laws. In some cases, such as with the natural resource subsidy bills, the legislation is designed essentially to impose newly devised notions of fairness upon the way foreign governments implement their national policies. Some of the major bills currently pending are as follows:

a. Import Surcharge Legislation

There have been several bills introduced that would impose a surcharge of 10% to 25% on imports from either all or selected countries. The latest, and most important, was introduced on July 17 by House Ways and Means Committee Chairman Dan Rostenkowski, Ways and Means member Richard Gephardt, and the senior Democratic member of the Senate Finance Committee, Lloyd Bentsen. The bill calls for a 25% surcharge on imports from those countries -- specifically Japan, Brazil, Taiwan, and South Korea -- whose exports to the United States are 65 percent greater than their imports from the United States, and whose exports on a global basis are 30 percent greater than imports. In addition, the U.S.T.R. would have to find that such countries impose unfair trade barriers to imports. The surcharge will not take effect if such countries reduce their surpluses by June 30, 1986 or if the U.S. trade deficit falls below 1.5 percent of the U.S. gross national product. (Currently, this bill would not apply to Canada.)

This bill reflects the loss of confidence by Congress in the U.S. import relief laws and in the good faith of certain foreign governments. The underlying theme of the bill is that, instead of dealing with import

problems on a product-by-product and country-by-country basis, the United States will apply a "wholesale" approach that places the entire burden on foreign governments to reduce their trade surpluses with the United States.

b. Textile and Apparel Trade Enforcement Act of 1985

This bill would impose a highly restrictive import quota on textile and apparel products from all sources except Canada and the B.C. The legislation would abrogate some 34 bilateral restraint agreements and would be in violation of the Multifibre Arrangement and the GATT.

c. Legislation to Restrict Lumber Imports

Bills have been introduced calling for imposition of quantitative restrictions on imports of softwood lumber from Canada.

d. Natural Resource Subsidy Legislation

Several bills have been introduced that would expand the definition of subsidies in the countervailing duty law to encompass certain foreign government policies on natural resources. At least one of these bills is aimed specifically at Canadian lumber.

e. Trade Law Modernization Act of 1985

This is a comprehensive trade bill that, among other things, would make relief from import competition more accessible for U.S. industries. Key provisions of the bill would liberalize the injury standard for safeguards relief and make industrial targeting an "unfair trade practice" under U.S. law.

3. Democratic and Republican Positions on Trade

Traditionally, trade liberalization has been an essentially bipartisan issue in the Congress. However, it now appears that the Democrats will attempt to make U.S. trade policy an issue in the next election. Therefore, although the Republicans in Congress, in many cases, are as frustrated as the Democrats with the Administration's inaction, attitudes toward trade liberalization may soon begin to split along party lines.

a. Democratic Position

At the beginning of the current Congress, a Senate Democratic working group was established under Senator Bentsen to undertake a review of the effectiveness of

the U.S. Administration's trade policy."[1] On April 25 the working group released its preliminary report, which is entitled "The New Global Economy: First Steps in a United States Trade Strategy."

The report, which is considered to reflect the opinion of most of the Congressional Democratic policymakers on trade, is highly critical of the Administration's management of trade policy and describes trade as "the weak link in U.S. economic policy." It argues that the Administration has in fact failed to develop a consistent trade strategy that is responsive to current conditions in the "new global economy." In particular, it deplores the unprecedented size of the U.S. trade deficit, the high level of U.S. government borrowing, the failure of the Administration to address exchange rate issues, and the loss of U.S. leadership in international trade. The report also argues that the GATT is no longer adequate to deal with the problems of the international economy today since existing GATT rules are not observed by many countries and many key areas of trade are not covered (e.g., trade in services

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[1] The members of the working group are Lloyd Bentsen, Robert Byrd, Russell Long, Quentin Burdick, Ernest Hollings, Thomas Eagleton, Spark Matsunaga, Max Baucus, Alan Dixon, Frank Lautenberg, Jeff Bingaman, Tom Harkin, and Donald Riegle.

and petroleum, currency exchange, barter and trade by government-owned corporations, and so on).

The main theme of the report, however, is a rather precarious balancing of support for free trade versus calls for further protectionism. The report is somewhat contradictory in this regard. It criticizes the Administration for having "imposed more trade barriers on U.S. imports than any Administration since the 1920's" and emphasizes that, rather than increasing protectionism, efforts should be directed towards opening the international trading system. At the same time, however, one of the report's key recommendations calls upon the Administration to make greater use of existing authorities, such as Section 201 of the Trade Act of 1974, to provide relief from injurious imports. It is argued that relief should be as easy to obtain as is permitted under GATT rules.

Comments by several influential Democratic leaders in the House of Representatives reinforce the sense of frustration expressed in the Senate working group report. For example, Representative Rostenkowski, the Chairman of the House Ways and Means Committee, recently stated that:

> America is fast approaching a trade crisis. The dike against sheer protectionist legislation is about to break. This [the Bentsen import surcharge bill] is a kind of last call from congressional moderates.

Representative Gephardt, who is also on the Ways and Means Committee, has said "I simply believe that the Administration's trade policy is out of touch with reality." Finally, Representative Jones, another member of the Ways and Means Committee, has commented that:

> There is frustration with the trade debt, which is costing jobs in everybody's district. There is a natural human response to blame foreigners for our problems and not ourselves.

b. Republican Position

Like the Administration, Republican Congressmen have tended to view trade policy as a function of domestic economic policy. Republican Congressmen have prepared a report on trade policy that focuses on strengthening the competitive position of the United States through education and increased productivity, rather than trade law reform.

However, Republican Congressmen are becoming increasingly sensitive to the potential role of trade policy as a destructive political issue, and some have

attempted to distance themselves from the President on this issue. For example, Representative Larry Craig, a Republican from Idaho, organized the "timber summit," a bipartisan meeting held on June 25 at which about 80 members of the Senate and House of Representatives severely criticized the Administration (represented at the meeting by Commerce Secretary Baldrige, then-Acting U.S.T.R. Smith, and White House advisor Friedersdorf) for failing to take action to limit imports of Canadian lumber. Among the participants in this meeting was Trent Lott, the second-ranking Republican in the House of Representatives, who stated that "Canada has to be made to understand that there's a freight train coming down the tracks on this issue and there's no brakeman." In addition, Senator Jeremiah Denton (R. Alabama) recently asserted that the U.S. lumber industry has lost 22,000 jobs to Canadian imports during the past five years.

E. Interest Groups

1. Interest Groups Likely To Oppose Proposals

There appear to be two categories of industries that are likely to oppose proposals to modify application of the trade remedy laws to Canada.

The first category includes those U.S. industries that are currently complaining about alleged Canadian unfair trade practices, such as those involved in the production of lumber, pork, steel, raspberries, grains fish, aircraft, and fresh vegetables. Indeed, a number of industry groups came forward during negotiation of the U.S.-Israel FTA to request exclusion from the FTA's coverage, including those involved in the production or sale of jewelry, bromine, textiles, citrus, and certain chemicals.[37] We would expect similar requests from various industries if negotiation of the Canada-U.S. FTA goes forward. In addition, there have been suggestions that certain Congressmen and the lumber industry will attempt to link a possible Canada-U.S. FTA to reduction of imports of Canadian lumber.

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[37] When the textiles industry failed to delay the reduction of duties on Israeli imports, it retaliated by demanding a "call" on Israeli cotton flannel sheets under the Multifibre Agreement.

The second category includes those industries and groups with complaints about imports from countries other than Canada, who are likely to oppose the proposals on the grounds that a precedent would be established for modifying application of the trade remedy laws to other countries. Included in this category are such groups as the Labor-Industry Coalition for International Trade (LICIT)[1] and the textiles industry.

2. Interest Groups Likely To Support Proposals

The interest groups most likely to support proposals to modify the trade remedy laws in an FTA are as follows:

- U.S. groups that support trade liberalization on principle, such as the Emergency Committee on American Trade, the American Association of Exporters and Importers, and Consumers for World Trade.

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[1] LICIT is a broad-based coalition of large manufacturing concerns and labor unions in the steel, clothing and textile, electronics and aerospace sectors. LICIT drafted and strongly supports the Trade Law Modernization Act of 1985, and can be expected to react negatively to any attempt to limit the trade remedy laws.

- U.S. industries that would benefit from limitations on the Canadian trade remedy laws.

- U.S. importers and consumers of Canadian products that are interested in preserving their access to reasonably priced Canadian goods.[11]

- U.S. industries and groups that have such a strong interest in other elements of the FTA that they will support the entire package even though they are not specifically interested in modifying the trade remedy laws.[12]

- Companies or groups that are interested in generally stronger U.S.-Canadian ties, such as the Canadian-American Committee.

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[11] In general, the political influence of U.S. importers and consumers is presently somewhat weaker than it has been in the recent past.

[12] During the hearings on the proposed U.S.-Israel FTA, the U.S.T.R. noted that there was strong interest in the United States for negotiating with Canada for trade liberalization on the following products: furniture, cosmetics, lawn mowers and snow blowers, alcoholic beverages, home appliances, and high technology items. Proposed United States-Israel Free Trade Area: Hearings Before the Subcomm. on Trade of the House Comm. on Ways and Means, 98th Cong., 2d Sess. 17 (1984).

F. Factors that May Influence Policy in the Future

Certain future events may affect the feasibility of proposals to modify the import relief laws:

1. Reduction of the U.S. Trade Deficit

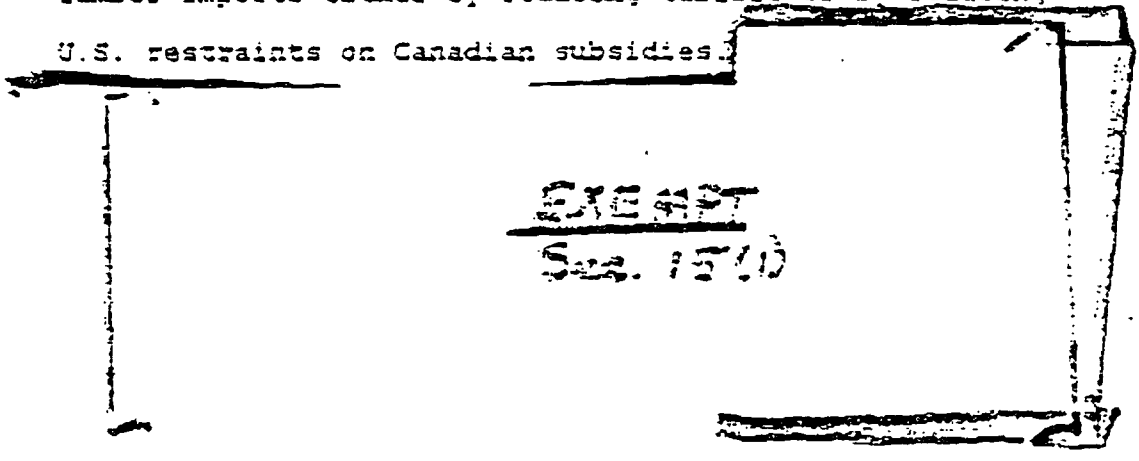
If the value of the U.S. dollar declines significantly in the near future, the trade deficit may shrink over the next few years. Trade policy might then become a less significant political issue, and the chances would improve for acceptance of significant limitations on use of the import relief laws. At the same time, however, in that situation the U.S. government (including Congress) might become significantly more interested in pursuing multilateral trade agreements than a bilateral agreement with Canada.

2. Resolution of the Dispute over Lumber Imports

The present large scale effort by some U.S. lumber companies to secure legislation limiting imports of Canadian lumber suggests that some in Congress may try to link progress on the FTA to agreement by Canada to restrain lumber exports. However, the substantive argument for making such a linkage is weak, as

- Lumber imports are already duty free and would not be facilitated by an FTA, and
- The U.S. Commerce Department in its 1982-83 investigation established that imports of lumber from Canada were not benefiting from countervailable subsidies.

Thus, the U.S. industry and its congressional supporters have little basis for arguing that an FTA would facilitate lumber imports either by reducing tariffs or by reducing U.S. restraints on Canadian subsidies.



3. Increased Application of Canadian Import Relief Measures to U.S. Exports

Several significant applications of the Canadian countervailing duty and safeguards laws to U.S. exports might make the reciprocal benefits of predictable market access more explicit for U.S. policymakers.

The future course of all the events discussed above is very difficult to predict. And, of course, other policy changes and irritants affecting U.S. and Canada are likely to occur in the future. Completing an FTA agreement may in any event take one or more years, during which time new events could impede progress. We see no advantage -- and considerable risk -- in postponing FTA discussions in the hope of finding a more propitious time for U.S. acceptance.

IV. FEASIBILITY OF MODIFICATION OF THE TRADE REMEDY LAWS IN AN FTA

We understand that in the discussions of a Canadian-U.S. FTA the Canadian Government would pursue, in addition to the elimination of duties, measures which would increase the predictability of access for Canadian products to the U.S. market. At present, the threat of U.S. countervailing duty, antidumping, and safeguards actions inhibits investment in Canadian industries that would produce for the U.S. market. Therefore, one key element of the FTA for Canada would be provisions designed

to increase the predictability of the effects of the import relief laws. The purpose of these provisions would not be to sanction dumping or unfair subsidy practices, but rather to enable investors and industries to have a greater degree of certainty as they make long-range plans about production for the U.S. market.

In this section we evaluate the feasibility of various proposals for achieving this goal. We have derived these proposals from the recent literature on the topic, suggestions from the Canadian Government, and our own analysis.

Before discussing specific proposals, we express two general conclusions with respect to this effort:

[EXEMPT
Sec. 15(b)]

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Sec 15(1)

Second, we believe the chances of achieving a satisfactory agreement will be increased if, before negotiating on specific proposals to limit the U.S. import relief laws, Canada suggests in general terms that one of the objectives of the FTA should be a balanced package of measures to enhance the predictability of access to both markets. It seems likely that U.S. officials, legislators, and business interests would have an interest in an agreement that would improve predictability of access to the Canadian market. Thus, they may be willing to acknowledge the value of negotiating reciprocal measures designed to reduce the danger of trade disruptions that would frustrate the plans of businesses operating in the newly created free trade area.

A package of such measures can potentially cover a wide range of topics, some of greater interest to one side, and some of greater interest to the other.

In addition to import relief measures, they might include provisions on:

- Government procurement.
- Local content laws.
- Regulations on investment.
- Intellectual property.
- Trans-border data flows.
- Provincial and state regulatory practices.

If both parties negotiate with the goal of improving predictability of market access, there is a reasonable chance that an agreement could be reached which includes measures of interest to Canada which reduce the threat of U.S. import relief actions.

The following paragraphs discuss specific proposals relating to the U.S. countervailing duty law, which creates the greatest threat of U.S. import relief actions affecting Canada. Thereafter, consideration is also given to the antidumping law and the safeguards law.

Each proposal is followed by an "evaluation," in which we offer our judgment on the feasibility or

desirability of the proposal. When a proposal can be implemented in more than one manner, each alternative is followed by a "comment" containing our views on that alternative.

A. Proposals To Limit U.S. Countervailing Duty Actions

In general, "subsidy" conflicts arise when the government-business relations vary in two countries that trade with each other. Many benefits available in Country A not available in Country B will be viewed as a subsidy by companies in Country B. Therefore, any program to establish open trade between the countries will, as it becomes successful, inevitably bring to the forefront "subsidy" questions. Enterprises and workers will feel that, if they are being expected to compete in a common market with enterprises and workers in another country, the benefits available to all enterprises competing in that market should be essentially the same -- or offsetting tariffs should be imposed at the border to establish a parity of competitive opportunity. It is to be expected that these questions would be especially important in trade between the United

States and Canada, in light of the advanced state of tariff reductions, the vast amount of trade between the two countries, and their rather different customs concerning government inducements for business enterprises.

The approach to further trade liberalization in the form of an FTA would be incomplete or one-sided if it did not address the question of how to resolve conflicts over "subsidies," i.e., differences in government-business relations. It would leave U.S. industries with the feeling that their home market has been opened further to competitors who have unfair government support; and it would leave Canadian industries with the feeling that the benefits of the FTA are illusory because the threat of U.S. countervailing duties would still impede their access to the U.S. market. It therefore appears appropriate that Canada raise the question of avoiding disruptive subsidy conflicts that will discourage enterprises from pursuing the full benefits of an FTA. By the same token, the United States could benefit from new limitations on subsidy programs in Canada. What is needed is a cooperative process for analyzing the trade impact of differences in governmental practices between the United States and

Canada and eliminating trade distortions in the least disruptive fashion.

Under U.S. law, exports from Canada can be subject to a countervailing duty action only if the U.S. Government finds, after extensive investigation, that there is both a countervailable subsidy and "injury" to the U.S. industry. Subsidy determinations are made by the International Trade Administration ("ITA") of the Commerce Department. Injury determinations are made by the International Trade Commission ("ITC"), an independent government agency. Potentially, modifications could be made in the standards and procedures governing both subsidy and injury determinations, as discussed below.

1. Proposals Relating to Determinations and Calculations of Subsidies

The element of the U.S. countervailing duty law that causes the most uncertainty is the discretion given to the ITA and the courts to determine what programs are countervailable subsidies and how the size of the subsidies is calculated. It is often difficult to predict how the ITA and the courts will rule on new subsidy issues.

Ideally, the FTA would bring as many subsidy decisions as possible under the "rule of law" by establishing guiding principles, specific rules where possible, and objective procedures for applying the principles and rules to individual government programs that are alleged to be subsidies. This system could be beneficial for Canada, as it would reduce the possibility of decisions based exclusively upon the U.S. view of the proper relationship between government and private industry. The system would also commend itself to the United States, however, since it is consistent with a long-range interest of the United States in promoting stability and predictability in the world economy.

As the basis for this system, the FTA could set forth comprehensive normative principles as guides for determining which economic programs would be countervailable and which would not. These principles would be based upon the objective of establishing an effective open marketplace between Canada and the United States.

The agreed-upon principles could then be implemented in several ways: by setting forth in the

FTA which existing economic programs, or types of programs, would be countervailable and which would not; by modifying domestic countervailing duty law to incorporate the principles; and/or by establishing a respected and knowledgeable Joint Committee, with members from both countries, to apply the principles in an objective and reasoned fashion to future economic programs and new subsidy issues.

The elements of such a rule of law system are discussed briefly below.

EXEMPT
See. 15(1)

a. Governing Principles or Guidelines for Determining Which Economic Programs Will Be Countervailable and Which Will Not

The ETA could state, for example, that each nation is free to adopt macroeconomic policies of its own choosing and that programs essential to the conduct of those policies would be presumptively considered not countervailable subsidies, even though they might make it more attractive to engage in a particular business in one country than in the other. This principle would include, for example, tax rates; money supply and interest rates; natural resource utilization policies; environmental regulations, etc.

The principles could also state that both countries will try to avoid programs which are not essential elements of macroeconomic policy and which confer benefits on individual industries in a way which is likely to discourage investors from establishing or pursuing business in the other country. Such programs could be presumptively considered as countervailable subsidies.

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Sec. 15(1)

b. List of Programs that Will/Will Not Be Countervailable

A somewhat more specific approach to increasing predictability for Canadian industry would be for the U.S. and Canadian Governments to evaluate all of the current economic programs of Canada and the United States and prepare a list of those programs that would be countervailable and those that would not.[11] Alternatively, the list could indicate types of programs (for example, those designed to promote research and development, or for worker retraining). This list would then be given dispositive influence in countervailing duty actions involving the listed programs.

In addition, this list could be the basis of a commitment from both governments to limit subsidy programs that affect Canada-U.S. trade.[12] Currently,

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[11] Conceivably, some economic programs exempted under this procedure might still be limited with quantitative restrictions.

[12] Such an obligation is already imposed by section 11.2 of the GATT Subsidies Code, which provides that

> Signatories recognize that [domestic] subsidies . . . cause or threaten to cause injury to a domestic industry of another signatory . . . , in particular where such subsidies would adversely affect the conditions of normal competition. Signatories shall therefore seek to avoid causing such effects through the use of subsidies.

However, this provision has not been given meaningful effect.

members of the General Agreement on Tariffs and Trade ("GATT") rely upon the GATT countervailing duty provisions that permit member countries to protect themselves from subsidies practices of other countries. It would be a logical next step for Canada and the United States to agree to exercise self-restraint over subsidy programs in exchange for new restrictions on the use of countervailing duty actions.[11]

[EXEMPT
See. 15(1)]

c. Canada-U.S. Joint Committee

The FTA could establish a Canada-U.S. Joint Committee to apply the general principles on subsidies established by the FTA in answering questions and resolving disputes over subsidy and countervailing practices. The Committee, which could have both consultative and adjudicative functions, could take

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[11] In the case of the U.S.-Israel FTA, the Israeli Government committed to eliminate certain subsidy programs without obtaining any limitations on the application of the U.S. countervailing duty law.

any one of a number of forms, but should be designed to ensure that Canada has a voice in the decisions that have a fundamental effect on the Canadian economy.[*]

Ideally, an independent Joint Committee would be formed and charged with the task of interpreting and applying the FTA. The Committee could both

- apply specific rules in the FTA (for example, determine whether an economic program was of a "type" listed in the FTA), and
- interpret the general principles on subsidies in the FTA to determine issues not covered by a specific rule.

Through its decisions in individual cases, the Committee would establish a body of interpretation that would provide the needed guidance and predictability for both

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[*] There have been several failed attempts to improve the dispute resolution mechanism in the GATT. If an effective mechanism could be created as part of a Canada-U.S. FTA, some might suggest -- and others might fear -- that it would then be viewed as a model for the GATT. However, it seems that the U.S. Government would be likely to concede more decision-making authority in the context of a bilateral agreement with a close ally such as Canada than it would in the context of a multilateral agreement. For this reason, it would probably be advisable to characterize any proposal concerning bilateral dispute resolution as a unique method to be used by the United States and Canada in light of their uniquely close relationship, and not as a possible model for wider application.

U.S. and Canadian industries.[11]

To ensure that the Joint Committee's decisions as to what is a countervailable subsidy have the requisite effect in the United States, it would need to be given a position as a replacement for or supplement to the ITA in cases involving exports from Canada. Alternatively, the Joint Committee's determinations might be deemed persuasive, but not binding, for the ITA.

The Committee could also be available to render advisory opinions when no specific dispute was pending. For example, either of the governments could consult the Committee before a new economic program was established to ensure that the program was in compliance with the FTA. In addition, private parties could raise issues with the Committee prior to initiating an expensive countervailing duty case. Presumably, such advisory opinions could help reduce conflicts over subsidy issues.

To enable the Joint Committee to function with authority and legitimacy, its members should be nonpolitical, respected experts on international trade

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[11] The FTA could contain a procedure for periodically reviewing the determinations of the Joint Committee and making necessary adjustments in the FTA or domestic law.

issues. They might be selected from the ITC and the Canadian Import Tribunal, or they could include former senior government officials or well-known scholars. In any event, the Committee should be composed of individuals known for their commitment to establishing fair rules for international trade, rather than persons who might be suspected of political partisanship.[16]

[EXEMPT
See 15(1)]

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[16] To ensure that the Joint Committee commands the respect of the public, its procedures should provide for objectivity, transparency, careful factual determinations, reasoned decisions closely linked to stated principles, and comprehensive written opinions.

[17] See, e.g., S. 2228, 98th Cong., 2d Sess. (1984) ("to authorize the President to negotiate an agreement establishing a joint Commission to resolve trade and other economic disputes between the United States and Canada"); S. Con. Res. 13, 97th Cong., 1st Sess. (1981) ("Expressing the sense of the Congress with respect to an international agreement establishing a North American Commission for Cooperation and Development").

d. Modify Domestic Law

The U.S. and Canadian Governments could agree in the FTA on some specific ways in which the general principles on subsidies would be reflected in their respective domestic laws on countervailing duties. Some of the policies proposed for consideration in this context include:

(i) A guarantee that the ITA will maintain its current practice of refusing to countervail programs formally and actually available to more than a limited number of producers or industries (the "general availability" rule).[24] For example, in the countervailing duty case involving Canadian softwood lumber, the ITA determined that, because stumpage policies made timber available on the same terms to several different industries, the alleged stumpage subsidies, even if they existed, were generally available and therefore not countervailable. (Comment: An agreement on maintaining the current application of the general availability rule may be attractive, as it would involve the classic common law method of gradually adding

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[24] This policy is based upon the statutory definition of a countervailable domestic subsidy as one granted "to a specific enterprise or industry or group of enterprises or industries." 19 U.S.C. § 1677(5).

certainty and clarity to the law by interpreting general legislative standards in individual cases and then codifying the interpretations so that they are easier to understand and apply.)

(ii) Application of the "differential subsidy" concept. Under this principle, either (1) domestic industries that are themselves subsidized would be prohibited from initiating a proceeding or (2) only the differential between the subsidies of the domestic and foreign industries could be countervailed. (Comment: The differential subsidy approach appears unrealistic, since it is novel and would involve complex two-country investigations.)

(iii) An increase in the de minimis standard. Under current ITA practice, a subsidy generally is deemed de minimis if it results in a margin of 0.5% or less. An ITA could raise the standard for Canada, requiring a de minimis finding if the margin was, for example, 2% or less. (Comment: Since raising the de minimis standard would expressly permit Canada to engage in subsidy practices to a greater extent than it may currently, that proposal would likely be unacceptable to the U.S. Government unless attractive reciprocal concessions were made.)

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Sec. 15(1)

2. Proposals Relating to Injury Determinations

As described above, exports from Canada can be subject to a countervailing duty action only if there is a countervailable subsidy and if "there is a reasonable indication that . . . an industry in the United States . . . is materially injured, or . . . is threatened with material injury . . . by reason of imports of that

merchandise. . . ."[1] There are two elements to an injury determination: the finding of injury itself and the finding that the injury was actually caused by the imports. In the U.S. countervailing duty statute, "material injury" is defined very broadly as "harm which is not inconsequential, immaterial, or unimportant."[2] The causation standard -- "by reason of" -- requires only that the imports be a contributing cause to material injury.[3] In practice, the injury standard in the countervailing duty statute is relatively easy to meet.

Determinations of injury are made by the ITC, an independent agency.[4] Although all of the decisions of the ITC cannot be predicted with absolute certainty, its discretion is limited by the relatively clear standards set forth in the law. The ITC's inquiries

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[1] 19 U.S.C. § 1671(a)(2).

[2] Id. § 1677(7).

[3] The U.S. Court of International Trade recently stated that the ITC, in applying this standard, "must rule in the affirmative [on injury] if it finds even slight contribution from imports to material injury, and . . . should not weigh that contribution against the effects associated with other factors . . . ." Gifford-Hill Cement Co. v. United States, No. 83-12-01737, slip op. 85-79 (July 31, 1985).

[4] ITC Commissioners must be nominated by the President and confirmed by the Senate. By law, no more than three of the six Commissioners may belong to the same political party.

and decisions are based primarily on the specific facts in each case, rather than on interpretations of law or exercises of discretion. Therefore, the case for improving predictability does not appear to be as compelling in the context of injury determinations as it is in the context of subsidy determinations. Nonetheless, an FTA potentially could limit application of the countervailing duty law by altering the injury standard and/or by requiring injury issues to be resolved through dispute resolution mechanisms.

a. Alterations in Injury Standard

(i) One way to limit the applicability of the countervailing duty law to Canadian exports would be to increase the level of injury required for a countervailing duty action to proceed against imports from Canada. The standard now applied in U.S. safeguards actions under section 201 of the Trade Act of 1974 might be the most logical to apply, as the ITC has extensive experience in its application. That standard requires the imports to cause "serious injury" to the domestic industry. Although "serious injury" is not defined in the statute, it is well-accepted that "serious injury" is significantly more difficult to prove than "material injury." (

Sec 15 (1)

[EXEMPT
Sec 15(1)]

(ii) Another possibility would be to require that the injury result exclusively from the countervailable subsidy, rather than the total quantities of imports. In other words, if the Canadian products undersold the U.S. products by 10%, but the subsidy only contributed a 1% benefit, the ITC would evaluate only the injury caused by the 1% benefit. This principle was formerly applied in U.S. import relief actions, but, in practice, the ITC now considers only the total volume of subsidized imports and not the amount of the subsidy.

[EXEMPT
Sec 15(1)]

(iii) Another alternative would be to create an injury threshold -- that is, prohibit a finding of injury if Canadian exports constituted less than a specified percentage of all imports or of the U.S. market. Thus, a countervailing duty action

would be terminated if imports of a product from Canada amounted to under, e.g., 3% of imports from all countries, or under 3% of the entire U.S. market for that product.

[EXEMPT Sec. 15(1)]

(iv) Finally, the FTA could eliminate cumulation for Canadian exports. Under current U.S. law, if parallel countervailing duty actions are initiated against imports of the same products from more than one country, the ITC is required to cumulate the effect of imports from all of the subject countries in determining whether the U.S. industry is injured. The Canadian Government could suggest that the ITC be required, in future cases involving Canada, to isolate Canadian imports from imports from other countries in determining whether the Canadian imports were causing injury.

[EXEMPT Sec. 15(1)]

[EXEMPT Sec. 15(1)]

b. Joint Committee for Injury Determinations

Potentially, the same Joint Committee described above for subsidy issues could also resolve disputes over injury issues.

[EXEMPT Sec. 15(1)]

3. Political and Diplomatic Resolution

It may come to pass that Canada and the United States will be unable, or unwilling, to agree on a set of general principles to govern subsidy and injury determinations. In that event, it may be advisable for the FTA to require consultations between the two governments immediately after a countervailing duty

action is initiated.[*] During the consultations, the governments would determine, based upon political and diplomatic considerations, whether the case should be allowed to proceed; should be terminated unconditionally; or should be terminated upon the imposition of quotas, added duties, voluntary price increases, or voluntary subsidy reductions. The FTA could provide either that the results of the consultations would be binding or that they would be nonbinding.

a. Binding Dispute Settlement

An example of a binding consultative mechanism is the EEC Treaty. Under the Treaty, the European Commission ("Commission") has wide discretionary power to determine whether the various types of aid granted by the member states are compatible with the Common Market. Commission control takes the form of constant review; member states are under a continuous obligation

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[*] A strong argument could be made for a provision on consultations based on the fact that the GATT Subsidies Code requires consultations with the exporting country before a countervailing duty case is initiated. Current U.S. law contains no such requirement; the Commerce Department's regulations require only that a copy of the countervailing duty petition, with confidential information deleted, be delivered to a representative in Washington, D.C. of the affected country. 19 C.F.R. § 355.26(g). On the other hand, foreign governments normally do have the opportunity to participate in the countervailing duty investigation after the case is initiated.

to report to the Commission on their subsidy practices. The Commission is empowered to initiate legal action in the European Court of Justice to enforce decisions against member states.** (Comment: The EEC model seems too extreme for both Canada and the United States, as it would require both countries to yield substantial sovereignty over these issues.)

b. Nonbinding Dispute Settlement

An example of a nonbinding dispute settlement mechanism is contained in Article 19 of the U.S.-Israel FTA. Although Article 19 expressly does not apply to the imposition of antidumping or countervailing duties, it serves as a recent example of an international dispute resolution procedure that the U.S. Government considered reasonable. Under Article 19, disputes concerning the FTA are subject to several levels of conciliation:

- First, the parties are obliged to attempt to arrive at a mutually agreeable resolution through consultations.

- Second, if the consultations fail, a joint committee is to be formed, which has 60 days to resolve the dispute.

** See Treaty Establishing the European Economic Community Art. 93 (1957); J. Cunnane & C. Stanbrook, Dumping and Subsidies 16 (1983).

- Third, if the joint committee fails, a three-member conciliation panel is to be formed; each party selects one member and those two members select the third. If the panel fails to reach a resolution within three months, it is to present the parties with a report containing findings of fact, determinations, and proposals for settlement. The report is non-binding.

- After the panel has presented its report, the affected party is entitled to take any appropriate measure.

EXEMPT
Sec. 15(1)

[EXEMPT
Sec. 15(1)]

B. Proposals To Limit Antidumping Actions

Under U.S. law, Canadian exports to the United States are subject to antidumping duties if Canadian companies sell their products at a lower price (after appropriate adjustments) in the United States than in Canada and the imports are causing injury to the U.S. industry. The dumping determinations are made by the ITA, while the injury determinations are made by the ITC.

Theoretically, elimination of tariffs may reduce, if not completely remove, the impetus to dump. An industry whose domestic market is protected by a high tariff can sell at one price in its home market and at a lower price in a foreign market because its home market price cannot be undercut by imports of its own or others' lower-priced goods. If the high tariff is

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[1] As discussed in section IV.A.1.d. above, joint decisionmaking through an impartial Joint Committee that applied legal standards, rather than political and diplomatic considerations, might be acceptable. For example, the Committee might screen cases at their outset to determine whether the alleged subsidy, if proven, would be countervailable.

removed, competition in the home market is enhanced and prices in the home and foreign markets will tend to equalize.

[EXEMPT Sec. 15(1)]

1. Proposals Relating to Determinations of Dumping and Calculations of Dumping Margins

a. Governing Principles for Determining Dumping

As with government economic programs (see section IV.A.1.a above), the ITA could set forth principles and guidelines to govern findings of dumping.

** The principal uncertainty in antidumping cases arises from choices of alternative accounting techniques for calculating the various adjustments which the statute provides should be made before U.S. prices are compared with foreign prices, and in "constructing" a foreign value when foreign market prices are not available. These uncertainties are similar to those involved in general accounting practice, and can be reduced through the building of a body of precedent through the published decisions of the ITA.

[redacted] EXEMPT Sec. 15(1) [redacted]

b. Canada-U.S. Joint Committee

As discussed for countervailing duty cases (see section IV.A.1.c. above), the ITA could establish a Canada-U.S. Joint Committee to resolve new dumping issues.

[redacted] EXEMPT Sec. 15(1) [redacted]

c. Modify Below-Cost-Sales Rule

As part of its determination of the U.S. and foreign prices of the products in question, the ITA makes adjustments for a number of factors, including commissions, marketing costs, packing costs, transportation costs, taxes, etc. As noted above, the principles applied by the ITA in this determination are relatively straightforward and predictable.

However, one of the required adjustments -- for below-cost sales -- may no longer be appropriate after the elimination of tariffs. Currently, the antidumping

law requires that the ITA, when calculating the foreign market prices that will be compared with U.S. market prices, completely disregard foreign market sales that have been made below the cost of production "over an extended period of time and in substantial quantities."[*] In practice, when such sales are disregarded, the average foreign market price is higher than it would be otherwise, thereby increasing the chances of a finding of dumping. The ITA could possibly eliminate application of the below-cost-sales rule in antidumping cases involving Canadian exports. This modification could be justified on the grounds that currently

- Companies located in the United States could sell their products in the U.S. at below the cost of production without penalty,[**] and
- Canadian companies that make sales below cost in both markets could potentially be subject to antidumping duties even though they had not engaged in price discrimination.

[EXEMPT sec. 15(1)]

[*] 19 U.S.C. § 1677b(b).

[**] Such sales, of course, would be subject to the U.S. law prohibiting "predatory pricing."

[redacted]

EXEMPT
Sec. 15(1)

2. Proposals Relating to Injury Determinations

The same injury standard is applied in antidumping cases as in countervailing duty cases: there must be "a reasonable indication that . . . an industry in the United States . . . is materially injured, or . . . is threatened with material injury . . . by reason of imports of that merchandise . . . ."[1] Also as in countervailing duty cases, injury determinations are made by the independent ITC.

a. Alterations in Injury Standard

The proposals relating to modification of the injury standard in countervailing duty cases are also applicable in the antidumping context:

- The ITA could raise the level of injury needed for imposition of antidumping duties by requiring "serious injury" rather than "material injury" to the U.S. industry;

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[1] 19 U.S.C. § 1673(2).

- The FTA could require that the injury result from the dumping margin, rather than the total quantities of imports;

- The FTA could create an injury threshold that would prohibit imposition of antidumping duties if Canadian exports constituted less than, e.g., 5% of U.S. imports from all countries, or less than 5% of the entire U.S. market for that product;

- The FTA could prohibit cumulation of Canadian exports with exports from other countries when the ITC makes injury determinations in parallel cases.

[EXEMPT Sec. 15(1)]

b. Joint Committee for Injury Determinations

Also as discussed for countervailing duty actions (see section IV.A.2.b. above), the FTA could bestow

authority to make injury determinations on an impartial Joint Committee composed of respected experts on international trade issues.

[EXEMPT Sec. 15(1)]

3. Political and Diplomatic Resolution

The FTA could provide for early consultation and a bilateral process for resolving dumping cases on a political or diplomatic basis (see section IV.A.3. above).

[EXEMPT Sec. 15(1)]

C. Proposals to Limit Safeguards Actions

GATT Art. XIX ("the escape clause") permits member countries to impose import relief on products being

imported in such increased quantities as to cause serious injury to competing domestic producers. Under U.S. law, such safeguards relief may be imposed only after a two-stage process:

First, the ITC must find that "an article is being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or the threat thereof, to the domestic industry,"[13] and must recommend a specific form of import relief to the President. In safeguards actions, the ITC considers the effect on the domestic industry of imports from all countries; it is not necessary, as it is in countervailing duty and antidumping actions, for the petitioners to identify a specific country as the source of injury. In addition, it is not necessary to allege that the imports are subsidized or dumped.

Second, the President may provide for import relief for the domestic industry "unless he determines that provision of such relief is not in the national economic interest of the United States."[14] The forms of import relief available to the President include:

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[13] 19 U.S. § 2251(b)(1).

[14] 19 U.S.C. § 2252(a)(1)(A).

- an increase in, or imposition of, any duty;
- a tariff-rate quota;
- imposition of quantitative restrictions on imports;
- orderly marketing agreements with foreign countries; or
- any combination of the above.

In practice, if the ITC has found injury, the President has enormous discretion in deciding whether to impose relief and what form the relief should take.

The various options for modifying application of the safeguards law are as follows[1]:

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[1] Some might complain that any modifications of the safeguards law to benefit Canada would be "selectivity" and a violation of the GATT. The concept of "selectivity" is normally used to describe a situation in which a country applies safeguards measures to imports from only a small minority of the countries that export the subject product. Selectivity is thought to violate GATT Art. 1, which requires member countries to extend equal treatment to all other members. However, since (i) GATT Art. 24 expressly permits the formation of free trade areas and customs unions (subject to certain conditions) and (ii) an exemption of Canada from safeguards relief would be an integral part of the Canada-U.S. FTA, our preliminary view is that exemption of Canada from U.S. safeguard actions would not violate the GATT. (U.S. law does not prohibit selectivity.)

1. Complete Elimination of Safeguards Actions

Because the ultimate goal of an FTA is to eliminate all barriers to fair trade, it is arguable that safeguards actions should not be permitted at all after an initial transition period. Alternatively, the FTA could require the governments to consider elimination of safeguards actions after a specified period.

[EXEMPT Sec. 15(1)]

2. Proposals Relating to Injury Determinations

As described above, safeguards relief can be granted only if imports are "a substantial cause of serious injury" and the President decides that relief is appropriate. The degree of injury required in a safeguards action -- "serious injury" -- is more difficult to establish than that required in countervailing duty and antidumping actions -- "material injury." "Substantial cause" is defined as "a cause which is

important and not less than any other cause."[11]

a. Alterations in Injury Standard

The ITA could make one or both of the following modifications in the injury standard for safeguards actions:

(i) The ITA could require that in safeguards actions, the ITC would always consider the effect of Canadian exports in isolation, rather than including them with the exports of all other countries, as is now done.[12] Then, unless the Canadian exports themselves were the cause of injury, the ITC's recommendations to the President for relief would exclude Canada. (Comment: This proposal could also be implemented at the Presidential determination stage, as discussed below.)

(ii) The ITA could impose a stricter causation standard for safeguards cases involving Canadian exports. Instead of the current requirement that imports be at least as important a cause of the injury as any

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[11] 19 U.S.C. § 2251(b)(4).

[12] To this end, the ITA could create a percentage threshold (e.g., 3%) of total imports under which Canadian exports would automatically be excluded from the injury determination.

other cause, the FTA could require that imports be the principal cause of injury.

EXEMPT
Sec. 15(1)

b. Joint Committee for <u>Injury Determinations</u>

The FTA could confer the authority to make injury determinations in safeguards cases on the impartial Joint Committee of respected trade experts described in section IV.A.1.c. above.

EXEMPT
Sec. 15(1)

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[55] The recently proposed Trade Law Modernization Act of 1985 would ease this standard to conform to the more liberal standard of the GATT: "in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers." Under this standard, it would be sufficient for imports to be even the <u>least</u> important cause of injury

[redacted] EXEMPT Sec. 15(1) [redacted]

3. Proposals Relating to Presidential Determination of Relief

The Presidential determination of relief is highly discretionary and subject to influence by a wide variety of political factors. Nonetheless, the FTA could provide guidelines for Presidential determinations involving Canadian exports. Setting forth such guidelines would not require an amendment to the U.S. statute.

Specifically, the FTA could include an "anti-sideswipe" provision encouraging the President to exclude Canadian exports from relief measures when the Canadian exports at issue are themselves not a substantial cause of the injury to the U.S. market. The U.S.-Israel FTA contains such a provision, which provides:

> "3. When, in the view of the importing Party, the importation of a product from the other party is not a substantial cause of the serious injury or threat thereof . . . , the importing Party may except the product of the other Party from any import relief that may be imposed with respect to imports of that product from third countries, taking into account the objective of achieving bilateral free trade as embodied in this Agreement, the domestic laws and international

obligations of the Parties."[44]

[EXEMPT
Sec. 15(1)]

4. Political/Diplomatic Resolution

Because the Presidential decision on whether to grant import relief in safeguards cases is highly discretionary -- as well as political -- it is vital that the exporting countries be able to present their views on the proposed relief. Indeed, GATT Art. XIX requires a country contemplating the imposition of safeguards relief to consult with the exporting countries at the earliest possible stage. This principle was reaffirmed in the U.S.-Israel FTA, which provides:

> "1. When a product is being imported in such increased quantities as to be a substantial cause of serious injury or the threat thereof to domestic producers of like or directly competitive products, the importing Party shall consult with the other party in accordance with

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[44] U.S.-Israel FTA Art. 5.

Article 18 before taking any action affecting the trade of the other Party."[11]

The Canada-U.S. FTA could contain a similar commitment.

EXEMPT
Sec. 15 (1)

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[11] U.S.-Israel FTA Art. 5.

[12] The nonpolitical Joint Committee discussed earlier would not serve a useful role at the Presidential determination stage, as the decision is a highly political one that does not involve the application of neutral legal principles. In addition, we feel it is highly unlikely that the U.S. Government would forfeit its discretion in these matters by submitting to binding dispute resolution by any type of bilateral committee.

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