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North American Free Trade, Subsidies and Countervailing Duties: Issues and Options

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North American Free Trade, Subsidies and Countervailing Duties: Issues and Options

Executive Summary

The exchange of goods and services between Canada and the United States represents the most important trade relationship between two sovereign states. Canada is heavily dependent on international trade, which accounts for almost 30 percent of its GDP. Nearly 80 percent of Canadian exports are shipped to our southern neighbour. Security of access to the American market is thus fundamental for Canadian interests.

Yet, protectionist pressures are ever present in the U.S., including through the imposition of countervailing duties against imported products which are subsidized or deemed to benefit from governmental aid. This alludes to the complex mechanism of American trade legislation, formulated by the U.S. Congress and applied by administrative agencies, and through which protectionist lobbying pressures are focused. The continuing vagueness of U.S. trade remedy legislation with regard to certain important concepts ("domestic industry"; "injury") should be stressed.

In the course of the 1980s, the United States initiated 14 countervailing duty investigations against Canadian imports, five of which led to the imposition of duties. Canada considers the possibility and the frequency of such remedies as harassment of its exports by U.S. authorities. This is also highly detrimental to Canadian interests in view of the resulting uncertainty and the unfavourable environment created for trade and investment.

It was largely to counter these problems that Canada concluded in 1987 a free trade agreement (FTA) with the United States. Although unable to secure the desired subsidies code which would have obviated the need for trade remedies, the Canadian government did obtain from the U.S. an undertaking to agree on such a code within five to seven years. This was accompanied by an interim solution whereby binational panels, with the power of binding decisions but without modifying national laws, would decide whether national authorities correctly applied national law when recommending the use of countervailing duties.

The panel mechanism, although a significant achievement, has not ended the harassment of Canadian exports. Of the six countervailing duty investigations conducted by U.S. authorities since the FTA came into force in 1989, three have involved important trade volumes and led to a decision to impose duties. Canada appealed to the panel mechanism in these three cases. Two of these disputes, concerning pork and softwood lumber, have been particularly long and serious, the American government having required the establishment of an Extraordinary Challenge Committee to review the decision of the panels.

The problems related to subsidies and countervailing duties have also been addressed under the auspices of the GATT. The delayed conclusion of the multilateral trade negotiations complicated the timing of the Canada-U.S. reform agenda related to trade remedies. The bilateral FTA negotiations were, largely as a consequence of the ongoing multilateral work, unsuccessful. In the meantime, the negotiations for a North American Free Trade Agreement (NAFTA) that concluded in 1992 (including Mexico) presented an opportunity for Canada at least to remove any ambiguity as to the permanence of the FTA panel mechanism. In November 1993, moreover, the Liberal government obtained from Washington the renewal of the undertaking to work towards trade remedy reform by the end of 1995.

The results of the Uruguay Round have in part met Canada's objectives. The multilateral Agreement on Subsidies includes in this regard: a definition of subsidy; an exemption from trade remedies for certain subsidies that benefit research and regional development; and a tightening of the provisions governing the use of countervailing duties and the multilateral settlement of disputes (the latter as part of the generic dispute settlement provisions).

These achievements could serve as a basis for further improvements to the NAFTA provisions. North American negotiations should seek in the short term to counter the harassment of our exports to the United States. If changes regarding subsidies prove necessary, as this is the main leverage that Canada has to encourage the U.S. to negotiate seriously, these could, if in the national interest and in light of severe budgetary constraints, imply a reduction of the scope and level of specific kinds of subsidies. On the subsidy side, a dynamic approach could even be adopted by Canada by putting forward to the U.S. authorities formal proposals to stop bidding wars between public authorities to attract investments.

As a first priority, Canada should make certain that the results of the multilateral negotiations are faithfully implemented into domestic law, including in the United States, and are observed. Subsequently, the Canadian government should again put forward its proposals that have not yet been adequately addressed at the multilateral level, including those related to the use of countervailing duties, that is, an increase of the de minimis level below which countervailing duties cannot be applied; the strengthening of the public interest clause; consideration of the concept of net subsidy; a clear and circumscribed definition of domestic industry; and, finally, provisions to the effect that, in order to impose a countervailing duty, the regulatory authority must determine that a subsidy constitutes the principal and not just one of the causes of injury, while strengthening the concept that the amount of a duty be no more than required to remove the injury.

We also recommend in the medium term that the mechanism of ad hoc panels give way to a permanent tribunal, which could decide on the validity of injury determinations by national authorities. If agreement on a permanent tribunal seems unlikely, then other, less ambitious, options may be considered, notably the resort to panels to provide an advisory opinion as regards whether injury has occurred. The panel mechanism under Article 1904 would still be available in case of subsequent dispute to settle the issue of whether national law has been correctly applied. The main objective is, as far as possible, to achieve common decision-making on injury issues.

Finally, in the long term and in order to ensure NAFTA's smoother functioning, North American partners should develop common principles related to competition law. This would, on the one hand, obviate the need for trade remedies which more often than not distort trading conditions and serve protectionist ends, and, on the other hand, prevent bidding wars between public authorities in different jurisdictions to attract investments.

Résumé

Les échanges de biens et services entre le Canada et les Etats-Unis représentent la plus importante relation commerciale entre deux pays souverains. Le Canada est du reste particulièrement dépendant du commerce extérieur, lequel compte pour près de 30% de son PIB, et près de 80% des exportations canadiennes sont acheminées chez nos voisins du sud. La sécurité de l'accès au marché américain est donc capitale pour les intérêts canadiens.

Or, des pressions protectionnistes se font sentir aux Etats-Unis, entre autres sous la forme de droits compensateurs contre des produits importés qui sont subventionnés ou que les autorités américaines estiment avoir bénéficié d'une aide gouvernementale. On touche ici au mécanisme complexe de la législation commerciale des Etats-Unis, formulée par le Congrès américain et appliquée par des organismes administratifs, où s'exercent par le biais du lobbying les pressions protectionnistes. Il faut souligner le caractère nébuleux de la législation américaine sur les recours commerciaux en ce qui a trait à certaines notions importantes ("branche de production nationale"; "préjudice").

Les Etats-Unis ont procédé au cours de la décennie 1980 à 14 enquêtes impliquant le Canada relatives à des droits compensateurs et 5 parmi celles-ci ont abouti à l'imposition de droits. Le Canada considère comme une tactique de harcèlement de ses exportations la possibilité et la fréquence de tels recours par les autorités américaines. Cela est du reste fortement préjudiciable aux intérêts canadiens

de par l'incertitude et le climat défavorable qui en résultent pour les conditions d'échanges et d'investissements.

C'est en bonne partie afin de contrer ces problèmes que le Canada a conclu en 1987 un accord de libre-échange avec les Etats-Unis (ALE). A défaut d'un code touchant les subventions qui aurait permis de suppléer aux recours commerciaux, le gouvernement canadien a obtenu des Etats-Unis l'engagement d'en arriver d'ici 5 à 7 ans à un tel code. Cela a été assorti d'une solution temporaire comportant l'établissement de groupes spéciaux binationaux qui, avec pouvoir exécutoire mais sans modifier les lois nationales, déterminent si les autorités nationales ont appliqué correctement la loi nationale en recommandant l'imposition de droits compensateurs.

Le mécanisme des groupes spéciaux, bien qu'il constitue un acquis non négligeable, n'a pas contré le harcèlement des exportations canadiennes. Des 6 enquêtes sur des droits compensateurs conduites par les autorités américaines depuis l'entrée en vigueur de l'ALE en 1989, 3 d'entre elles impliquent un important volume commercial et se sont soldées par une décision d'imposer des droits. Le Canada a eu recours au mécanisme des groupes spéciaux dans ces trois cas. Deux de ces différends qui touchent le porc et le bois d'oeuvre, se sont révélés particulièrement longs et sérieux, le gouvernement américain ayant même exigé la mise sur pied d'un comité de contestation extraordinaire afin de renverser le jugement des groupes spéciaux.

Les problèmes inhérents aux subventions et aux droits compensateurs ont parallèlement fait l'objet de négociations sous l'égide du GATT. Le prolongement des négociations commerciales multilatérales jusqu'à l'an dernier a posé problème, celles-ci devant servir de base aux pourparlers canado-américains qui se sont révélés infructueux. Entretemps, les négociations conclues en 1992 en vue d'un accord de libre-échange nord-américain (ALENA) incluant le Mexique ont été l'occasion pour le Canada tout au moins de supprimer toute ambiguité quant au maintien du mécanisme des groupes spéciaux. En novembre 1993, le gouvernement libéral obtenait de Washington le renouvellement de l'engagement, sans échéance dans l'ALENA, d'en arriver d'ici la fin de 1995 à des améliorations aux dispositions existantes touchant les recours commerciaux.

Les résultats de l'Uruguay Round ont satisfait en partie les objectifs du Canada. L'Accord multilatéral sur les subventions contient à cet égard: une définition du concept de subvention; une exemption des recours commerciaux pour les subventions au profit de la recherche et du développement régional; et enfin un resserrement des dispositions régissant l'application de droits compensateurs de même que le règlement

multilatéral des différends (ce dernier élément s'inscrivant dans le cadre des dispositions générales touchant le règlement des différends).

Ce sont ces acquis qui doivent servir de base pour de nécessaires améliorations aux dispositions de l'ALENA. Des négociations nord-américaines doivent essentiellement viser à court terme à contrer le harcèlement de nos exportations vers les Etats-Unis. Si des changements à propos des subventions s'avèrent nécessaires, c'est du reste le principal atout dont le Canada dispose pour inciter les Etats-Unis à négocier sérieusement, ces dernières peuvent, tout en étant dans l'intérêt national et eu égard à de fortes contraintes budgétaires, supposer une diminution de l'étendue et du niveau de certains types de subventions. Sur la question des subventions, le Canada pourrait même adopter une approche dynamique en soumettant aux autorités américaines des propositions visant avant tout à freiner la surenchère entre les pouvoirs publics afin d'attirer les investissements.

En un premier temps, le Canada doit s'assurer que les résultats des négociations multilatérales soient reflétés fidèlement dans les législations nationales, en particulier dans la législation américaine, et soient dûment observés. En un deuxième temps, le gouvernement canadien doit veiller à réitérer ses propositions sur lesquelles on ne s'est pas penché de façon adéquate au niveau multilatéral et qui se rapportent aux conditions d'application de droits compensateurs, à savoir: une hausse additionnelle du niveau minimal d'aide en deça duquel des droits compensateurs ne peuvent s'appliquer; le renforcement de la clause d'intérêt public; la considération de la seule subvention nette; une définition claire et circonscrite du concept de branche de production nationale; et finalement qu'aux fins de l'application de droits compensateurs, l'autorité compétente détermine qu'une subvention constitue la principale et non simplement l'une des causes d'un préjudice et s'assure que le montant d'un droit n'excède pas le montant requis pour remédier au préjudice.

Nous recommandons aussi qu'à moyen terme le mécanisme des groupes spéciaux ad hoc fasse place à un tribunal permanent, lui-même chargé de statuer de la validité des déterminations de préjudice par les instances nationales. A défaut d'une entente sur un tribunal permanent, d'autres avenues moins ambitieuses peuvent être explorées, notamment le recours à des groupes spéciaux afin de fournir un avis déclaratoire parallèle quant à l'existence ou la menace d'un préjudice. Le mécanisme existant des groupes spéciaux aux décisions exécutoires en vertu de l'article 1904 serait toujours disponible en cas de litige pour juger si les lois nationales ont été correctement appliquées. L'idée essentielle est dans la mesure du possible de parvenir à une prise de décision conjointe sur les questions de préjudice.

Enfin, à long terme et afin d'assurer un fonctionnement plus harmonieux de l'ALENA, les partenaires nord-américains devraient développer des principes communs touchant les lois sur la concurrence. Cela permettrait, d'une part, de suppléer aux recours commerciaux qui le plus souvent faussent les conditions des échanges et servent des fins protectionnistes, et, d'autre part, de prévenir la surenchère entre les pouvoirs publics relevant de diverses juridictions en vue d'attirer les investissements.

1. Basic Facts

The exchange of goods and services between Canada and the United States represents the most important trade relationship between two states. Each country is the other's most important trading partner. The value of Canada-U.S. trade amounted to more than C$310 billion in 1993.[1]

Canada is very dependent on international trade, which accounts for nearly 30 percent of its gross domestic product. Despite the policy in the early 1970s of diversifying markets (the Third Option[2]) in order to counter Canada's dependence on the United States, the American share of Canada's foreign trade has increased continually over the past two decades, rising for example from 67.7 percent of exports in 1973 to more than 77 percent in 1993. Canada, on the other hand, accounts only for a little less than 20 percent of American foreign trade.[3] This figure can scarcely be compared with Canada's dependence on the United States, the greatest economic power in the world.

Canada's heavy dependence on the U.S. market and the asymmetry of our relationship are two basic, inescapable facts of Canada-U.S. relations. Open American markets and a liberal American trade policy are obviously of pivotal importance to Canada. Any protectionist trends in our neighbour to the south are seen by Ottawa and the Canadian business community as possibly causing severe damage to Canadian exports. Most Canadian companies export the bulk of their production to the United States, sometimes as much as 90 percent. However, protectionist pressures in the United States have increased over the last few years, as a result of the structural adaptation problems that all Western economies are facing, in addition to the mounting deficit in the American trade balance.

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[1] Unless otherwise indicated, data come from Statistics Canada and pertain to trade in goods and services.

[2] For the Third Option, see Mitchell Sharp, "Canada-U.S. Relations: Options for the Future," *International Perspectives*, special edition (Fall 1972).

[3] U.S. Department of Commerce, *U.S. Trade Highlights 1992* (June 1993).

It was in a climate of considerable concern, then, that the previous government decided that a free trade agreement was needed in order to forestall protectionist trends in the United States and enhance Canada's security of access to the American market and the predictability of trade relations with our neighbour to the south.

The protectionist trends in the United States are most apparent in regard to exports that have benefited, or are deemed to have benefited, from subsidies. The U.S. Congress, which has authority over trade policy, has proved sensitive to pressures of this kind. The concept of "subsidy" has been expanded over the years, among other things, and successive laws have been passed to cover any government policies other than those of a general nature.[4] Members of Congress even regularly propose amendments to expand the scope of trade remedy legislation and the concept of subsidy to include not only practices aimed at particular companies or industries (specific subsidies, for instance assistance for the textile industry), but also government assistance available to all kinds of companies (general subsidies, for instance, benefits available to industry in general for research and development). This was also the case when the 1988 Omnibus Trade and Competitiveness Act was drawn up.

In addition, these pressures and lobbying have tended to influence the determinations of investigating bodies and tribunals responsible for trade issues. The most noteworthy example was the decision of the U.S. Department of Commerce in 1983 that the government stumpage fees charged to companies did not constitute a subsidy; however, another complaint from American softwood lumber producers resulted in 1986 in the same practice being judged by the same department to be an unfair subsidy liable to countervailing duties,[5] since these stumpage fees or concessions were set at lower than market prices, contrary to the practice in the United States.

American law provides for the levying of countervailing duties on all subsidies over a minimal (*de minimis*) level of 0.5 percent in net subsidies aimed at specific companies or industries, or groups of companies or industries. As a result, disputes over subsidies normally focus on whether they are general or specific. This can have serious implications, in particular for regional development subsidies offered only to

[4] See Gary Clyde Hufbauer and Joanna Shelton Erb, *Subsidies in International Trade* (Cambridge, Mass./London: MIT Press for the Institute for International Economics, 1984), pp. 90-93.

[5] Countervailing duties are defined as duties levied by a country on an imported good, the production of which was subsidized—or is deemed to have been subsidized—in the exporting country. These duties are called "countervailing" because the amount of the duties is based on an evaluation of the amount of the subsidy and they aim to offset the subsidy. An alternative to the levying of such duties is for the exporting country to undertake to eliminate or reduce the subsidy or take other measures related to it (for instance, an export tax) or for the exporting company to raise its prices.

companies that are located, or are going to locate, in economically disadvantaged regions. In addition, subsidies that are general can prove to be of greater benefit to certain kinds of companies and therefore turn out *in practice* to be specific. For instance, general subsidization of investment may favour industries with high capital ratios.

Countervailing duty investigations aim therefore to demonstrate that a subsidy is specific (the Specificity Test). In addition, in order for a countervailing duty to be levied, it is necessary after the GATT Tokyo Round to show material injury or a threat of material injury to the industry or to the competing domestic industry, or else a substantial delay in the creation of a domestic industry. The 1980 Subsidies Code that came out of the Tokyo Round[6] requires in addition that there be a *causal connection* between the subsidized imports and the alleged injury. However, there is no mention of this in the American legislation implementing the Tokyo Round (the 1979 Trade Agreements Act).[7] It is certainly not easy to show that a subsidy is causing material injury to an industry in a foreign country. First, what is meant by a "domestic industry"? Second, what is "material injury"? The GATT Subsidies Code does not have a lot to say in this respect.

Other factors, such as productivity or changes in supply and demand may explain the problems that a company or a domestic industry is experiencing. As Gary Horlick points out, it is basically a judgment call.[8] Article 6:4 of the Subsidies Code stipulates in this regard that "it must be demonstrated that the subsidized imports are, through the *effects* of the subsidy, causing injury." Once again, the American legislation does not mention this. The result is that the United States tends to interpret the concept of injury quite broadly and to associate it with any increase in subsidized imports, even if factors other than subsidies may explain the increase, and therefore, the injury suffered.[9] Rodney Grey, for his part, emphasized that the concept

[6] The General Agreement on Tariffs and Trade (GATT), *Agreement on the Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade* (Geneva, 1979). Referred to hereafter as the GATT Subsidies Code.

[7] We are referring under Title VII of this legislation to Section 701(a) regarding the general rules for levying countervailing duties.

[8] Gary Horlick, "Analysis of the Dispute Settlement Provisions: A U.S. Perspective," in Murray G. Smith and Frank Stone (eds.), *Assessing the Canada-U.S. Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1987), p. 104.

[9] See Alan M. Rugman and Andrew Anderson, *Administered Protection in America* (London/New York: Croom Helm, Routledge/St. Martin's Press, 1987); Ronald A. Cass, "Economics in the Administration of U.S. International Trade Law," doc. no. 16, Ontario Centre for International Business (Toronto, July 1989). For an evaluation of American provisions and practices in determining injury, see Ronald A. Cass and Warren F. Schwartz, "Causality, Coherence and Transparency in the Implementation of International Trade Laws," in Michael J. Trebilcock and Robert C. York (eds.), *Fair Exchange: Reforming Trade Remedy Laws* (Policy Study 11) (Toronto/Calgary: C.D. Howe Institute, 1990), pp. 24-90. For a comparison of the

of injury, as ratified by GATT, was adopted in countries like the United States essentially as a legal concept, not an economic one, which in actual practice has reinforced the protectionist effect of the trade remedy mechanism.[10]

Finally, we should mention that the Uruguay Round did not result in any appreciable changes to the multilateral provisions governing the definition of "domestic industry" or the concept of "injury" and its connection to subsidization. We will return to these issues in the final part of this paper.

Returning to the American legislation, we find that the executive branch cannot intervene in the process and take discretionary action regarding the way in which trade remedy legislation is being used. If a company or a group of producers submits a request for countervailing duties, the procedure must be followed, even if the executive would prefer not to contest particular assistance practices of other countries, for diplomatic or other reasons.[11]

During the 1980s, Canada was subjected to 14 countervailing duty investigations by the U.S. government. These investigations covered products such as softwood lumber, pork and fish. Five of them resulted in the levying of duties, in particular on pork and Atlantic groundfish, and one investigation ended with Canada adopting a 15% export tax on softwood lumber headed for the United States.[12] Even though such investigations do not necessarily end in the levying of definitive duties[13], they nevertheless have a harmful effect on trade and investment because of the

injury criterion as applied in Canada and the United States, see Robert Bertrand, "Role of the Canadian Import Tribunal," *Canada-United States Law Journal*, vol. XII (1987), pp. 195-207.

[10] Rodney C. Grey, "A Note on U.S. Trade Practices," in William R. Cline (ed.), *Trade Policy in the 1980s* (Washington: Institute for International Economics, 1980), p. 250.

[11] For an interesting summary of the main features of American laws and practices in the area of countervailing duties, see Michael Hart, *The Canada-United States Working Group on Subsidies: Problem, Opportunity or Solution?* (Ottawa, Ontario Centre for Trade Policy and Law, 1989), pp. 24-32. For a broader summary of trade remedies see: Canada, Department of Foreign Affairs and International Trade, United States Trade Relations Division, *U.S. Trade Remedy Law. A Ten Year Experience* (Ottawa, December 1993), pp. 1-83; Thomas M. Boddez and Michael J. Trebilcock, *Unfinished Business. Reforming Trade Remedy Laws in North America* (Policy Study 17) (Toronto: C.D. Howe Institute, 1993), pp. 1-68. For an extended discussion of American trade legislation, see I.M. Destler, *American Trade Politics*, 2nd edition (Washington/New York: Institute for International Economics/Twentieth Century Fund, 1992); and for the Canadian trade legislation, Robert K. Paterson, *Canadian Regulation of International Trade and Investment* (Toronto: Carswell, 1986).

[12] Canada, *U.S. Trade Remedy Law*, pp. 30-33. The dispute over softwood lumber continues unabated in 1994. We will return to this later (p. 16) when we analyze the implementation of the provisions in the U.S.-Canada Free Trade Agreement on dispute settlement.

[13] So-called definitive duties should be distinguished from the interim duties imposed pending the results of the investigation.

uncertainty they cause and the adverse climate created by the very possibility of such measures. In fact, the trade remedy issue constituted—and still constitutes, as we will see—the main irritant in Canada-U.S. relations.

2. The Canada-U.S. Free Trade Agreement of 1987

2.1 Summary and Evaluation of the Subsidy Provisions

It is therefore very understandable that the Canadian government made reform of American trade law its main concern in the negotiations leading to the conclusion of the Canada-U.S. Free Trade Agreement (FTA) in 1987.[14] The government wanted most of all in its free trade initiative to reach an agreement with the United States on what constitutes a subsidy, on acceptable assistance to companies, and on abolishing the existing remedies, namely countervailing duties, in bilateral trade.

However, obstacles soon emerged in the course of the negotiations. From the outset, the parties' perceptions of the issue and of the solutions to it differed radically. The Americans were eager to obtain more stringent controls over Canadian subsidies, while the Canadians hoped to be exempted from U.S. trade remedies. One of the parties perceived government policies and practices as an obstacle to open, secure trade, while the other was concerned about the responses to these policies. Nevertheless, considerable efforts were made during the negotiations to hammer out a common view of the subsidy issue. The Canadian negotiators attempted to work out an agreement on subsidies that would have made it possible to settle the issue of government assistance and obviate the need for countervailing duties. The American negotiators, for their part, were eager to put a stop to most Canadian assistance programs and to maintain the countervailing duty mechanism.[15] In the end, these differences could not be ironed out and a temporary solution had to be devised. This solution, set forth in Chapter 19 of the FTA under the heading "Binational Panel Dispute Settlement in Antidumping and Countervailing Duty Cases," consists basically of four parts:

- Retention of domestic antidumping and countervailing duty law (Article 1902). It was stipulated in particular that any changes to this legislation would not

[14] Canada, External Affairs, *Free Trade Agreement Between Canada and the United States.*

[15] Michael Hart, "The Future on the Table: The Continuing Agenda under the Canada-United States Free Trade Agreement," in Richard G. Dearden, Michael M. Hart and Debra P. Steger (eds.), *Living with Free Trade: Canada, the Free Trade Agreement and the GATT* (Ottawa/Halifax: Centre for Trade Policy and Law/Institute for Research on Public Policy), pp. 85-87. See also Simon Reisman, Comments, in *Assessing the Canada-U.S. Free Trade Agreement*, pp. 112-115.

apply to the other party: unless the other party was expressly specified, thus avoiding drawing Canada into decisions aimed at other countries; unless the other party had been notified and consultations had taken place; and unless the changes were compatible with GATT and the objectives of the FTA;

- Bilateral review of any changes to domestic antidumping and countervailing duty law (Article 1903). This implies that both parties can ask a panel to review these changes and provide a declaratory opinion about whether they comply with GATT, the objectives of the FTA, or the determinations of a binational panel under Article 1904. If the panel recommends changes, the two parties will begin consultations in order to reach a solution;

- Review by a binational trade panel of final antidumping and countervailing duty determinations, instead of domestic judicial review, which was previously the case (Article 1904).

The trade panels provided for in Articles 1903 and 1904 consist of five members normally selected from a list of 50 candidates (25 of each nationality), who are experts in international trade law. They should not be affiliated with their governments and may not under any circumstances take instruction from them. The parties each appoint two members, in consultation with the other, and agree on the fifth member. If agreement cannot be reached, the fifth member is chosen by the four appointed members or, if they cannot agree, by drawing from the list.

Strict deadlines were established. In regard in particular to reviews of decisions to levy countervailing duties, the entire review must be completed within 315 days following the request for a panel, instead of the two to four years that were needed to exhaust all possible recourse to national tribunals. If the panel opposes part or all of the decision, the competent authorities in one country or the other are allowed as short a period as possible to make a new determination. We should point out here that, although the determinations of these binational panels are binding, the panels are not supposed to come to any conclusions about the legislation per se but rather to ensure that the provisions are properly applied by national authorities. The panels can uphold, quash or remand the determinations of national authorities. The binational panels are able, in particular, to remand determinations to the American authorities if they detect any errors or ambiguities or a lack of detail or justifications. These remands may or may not contain any directives in regard to applying the law.

It is only possible to challenge panel decisions under extraordinary circumstances, namely if a member is guilty of gross misconduct, bias or serious conflict of interest, or if the panel has seriously departed from a fundamental rule of procedure or manifestly exceeded its authority, and if one of these factors has materially affected the panel's decision and threatens the integrity of the binational review process. An Extraordinary Challenge Committee consisting of three judges will then be established and will render its decision, generally within 30 days (Article 1904, paragraph 3 and appendix).

- Finally, it was specified in substance that the provisions outlined above would remain in effect for a period of five to seven years, pending development by the two parties of a bilateral subsidies code to replace countervailing duties. If consensus could not be reached, one of the parties could terminate the Agreement on six-month notice (Article 1906). Article 1907 states in particular that "the Parties shall establish a Working Group that shall . . . seek to develop more effective rules and disciplines concerning the use of government subsidies [and] . . . a substitute system of rules for dealing with . . . government subsidization." It was stipulated as well that the two countries would make every effort to develop and implement this new regulatory system.[16]

As one might expect, subsidies and trade remedies were the most contentious issue during the negotiations. If a subsidies code could not be agreed upon, the problem of how to settle differences arose. This problem and, especially, the finality of the decisions made by a binational panel almost derailed the final round of negotiations on two occasions. These issues were only settled at the last minute and despite serious reservations on the part of the United States.

Even though this outcome was far from the objectives which the Canadian government had originally set for itself, namely a subsidies code to replace the system of countervailing duties, it was a considerable achievement to obtain a trade panel whose decisions were impartial, binding and final (except in extraordinary cases). For the first time, the United States agreed to accept a binational institution that would hand down final decisions on the legality of trade determinations. In the enthusiasm surrounding the end of the negotiations, the chief Canadian negotiator, Simon Reisman, spoke of a remarkable accomplishment.[17] It is indeed true that this mechanism is without parallel anywhere else in the world. However, despite these accomplishments, it is evident that, in comparison with the initial objectives, this was

[16] We will return to these provisions and to the Canada-U.S. working group, pp. 20-21, at the end of the third part.

[17] Comments in *Assessing the Canada-U.S. Free Trade Agreement*, p. 44.

a last-minute deal that enabled the two parties to save the negotiations and succeed in concluding a free trade agreement.[18]

In regard to the mechanism itself, questions were raised about whether the trade panels, composed for the most part of lawyers, should also have trade experts on them; whether the decisions of these panels would be narrow and legalistic or, as the FTA negotiators expected, broad and policy-oriented; and whether these decisions could create new law. In this regard, in accordance with the principles of international law, the U.S. legislation implementing the FTA (the U.S.-Canada Free Trade Agreement Implementation Act) specifies that the decisions of these panels do not create law. A binational review mechanism was considered especially useful in the case of complex disputes involving large trade volumes and in areas where questions remained, especially in regard to the definition and calculation of subsidies.

The ability of binational panels to make binding decisions about antidumping and countervailing duties was also seen as likely to induce the domestic investigating bodies in the United States to make more thorough, objective and consistent determinations, and hence to increase the predictability and security of access to the American market. The people who drew up the FTA and a number of commentators expected most of all that this mechanism would put an end to the harassment of Canadian exports to the United States.

In any case, Canada still had to rely in the end on the good will of American investigating bodies and hope that their conclusions reflected the general spirit and objectives of the FTA. Experts pointed out that the main accomplishment in the area of dispute settlement was the commitment on the part of both countries to agree in five to seven years on a substitute system of trade rules. It was recognized as well that a great deal of good will would be needed on the part of both parties to ensure that this substitute trade system was actually applied in a few years. The importance of developing these new rules should not be underestimated since, in their absence, there was no assurance that Canadian companies would not be victimized by trade disputes injurious to Canadian interests. Gary Horlick insisted in this regard on the importance for trade and investment of a stable or at least predictable environment. Some people thought, however, that this substitute set of common rules would become less necessary, or at least less urgent, with the implementation of the

[18] For a summary of the subsidy provisions in other agreements on economic integration, see Hart, *Canada-United States Working Group*, pp. 15-22; Debra Steger, "An Analysis of the Dispute Settlement Provisions of the Canada-U.S. Free Trade Agreement," in Earl H. Fry and Lee H. Radebaugh (eds.), *The Canada/U.S. Free Trade Agreement, The Impact on Service Industries* (Provo, Utah: Brigham Young University for the David M. Kennedy Center for International Studies, 1988), pp. 135, 136, 144.

binational review system.[19] On the other hand, a number of analysts did not think that this binational panel mechanism would necessarily result in significant changes to the administration of American trade remedies and ensure security of access to the American market for Canadian exporters.[20]

2.2 Evaluation of the Panel Mechanism

Even if it is true that the success of such a mechanism lies not in the number of disputes but in the number of investigations and protectionist determinations that it prevents, there is no denying that since they were implemented in 1989, the binational review panels have failed to meet expectations. Although, among other things, the panels have proved beneficial in forcing the reimbursement, after panel review, of duties initially imposed by American authorities, notably in the case of pork,[21] the harassment of Canadian exporters by their competitors south of the border has grown only worse. Since the FTA came into effect, the American authorities have conducted six countervailing duty investigations.[22] Half of them, involving magnesium, pork, and softwood lumber, resulted in the levying of duties. These cases also involved large trade volumes, and the Canadian government decided in these three cases to request a panel.[23]

In the dispute over pork, the countervailing duties levied by the American authorities had to be reimbursed after a trade panel determined after two remands to the U.S. International Trade Commission that the latter had failed to establish a threat of injury to the American industry. Disagreeing with these findings and under political

[19] See: Reisman, Comments, in *Assessing the Canada-U.S. Free Trade Agreement*, pp. 44, 113, 115; Debra Steger, "Analysis of the Dispute Settlement Provisions: A Canadian Perspective," in *Assessing the Canada-U.S. Free Trade Agreement*, pp. 91-98; Steger, "An Analysis of the Dispute Settlement Provisions," pp. 127-132, 139; Horlick, "Analysis of the Dispute Settlement Provisions," pp. 99-104; Shirley A. Coffield, "Dispute Settlement Provisions on Antidumping and Countervailing Duty Cases in the Canada-U.S. Free Trade Agreement," in Donald M. McRae and Debra P. Steger (eds.), *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988), pp. 82-83.

[20] This was true, among others, of John J. Quinn, "A Critical Perspective on Dispute Settlement," in Marc Gold and David Leyton-Brown (eds.), *Trade-Offs on Free Trade* (Toronto: Carswell, 1988), pp. 188-196. Quinn was the author of the recommendations on dispute settlement and a Canada-U.S. free trade zone in the Macdonald Commission report. In addition, one of the most virulent critiques of the provisions of the FTA can be found in the testimony of Mel Clark, the deputy head of the Canadian GATT delegation during the negotiation of the Tokyo Round, before the Standing Senate Committee on Foreign Affairs, December 29, 1988, section no. 3, pp. 3:28-34.

[21] A (basically favourable) evaluation of the functioning of the panel mechanism can be found in Boddez and Trebilcock, *Unfinished Business*, pp. 69-161. A critical view of the same mechanism and its functioning can be found in Scott Sinclair, "Trade Law," in Duncan Cameron and Mel Watkins (eds.), *Canada Under Free Trade* (Toronto: Lorimer, 1993), pp. 173-184.

[22] Data as of December 1993.

[23] Canada, *U.S. Trade Remedy Law*, pp. 30-33.

pressure, the U.S. government demanded an Extraordinary Challenge Committee. In the end, this committee upheld the conclusions of the panel and rejected the appeal, emphasizing that the U.S. government's claim that the panel had failed to apply American law correctly did not meet the conditions required to invoke the extraordinary challenge procedure.[24]

Insofar as the softwood lumber dispute was concerned, the most important in terms of trade volumes and procedures, the American authorities claimed in particular that the stumpage fees charged by provincial governments constituted a subsidy. The Canadian government maintained that this was a general public policy which had nothing to do with trade or subsidization. In 1991, Canada terminated the 1986 memorandum of understanding under which it had levied a 15% export tax on the value of softwood lumber headed for the United States, prompting the American authorities to take steps leading to the imposition of countervailing duties. Canada then demanded two trade panels to review the American investigations which had concluded that subsidies existed and injury had been done. The panel on injury has found so far on three occasions that there was insufficient evidence for the U.S. International Trade Commission's finding that injury had been done. The other trade panel concluded in December 1993, after one remand to the American investigating authorities, that there was no subsidization. In March 1994, the American government again requested an Extraordinary Challenge Committee to review this finding, alleging that the panel had exceeded its authority and that there was an apparent conflict of interest because two of the three Canadian members of the panel worked for legal firms that had represented Canadian softwood lumber companies in other matters.

This leads us to conclude that an important problem with the current provisions is that disputes can drag on for a long time. The softwood lumber dispute, in particular, has lasted for more than ten years, partly because several panel reviews are often needed after successive remands to the American authorities so that they can revise their decisions or spell out more reasons for them. Finally and most importantly, these problems and disputes are likely to be dragged out because, even though the outcome may be favourable to Canadian interests after review by a binational panel, all that is needed to launch another investigation process is the submission of a new complaint to the American authorities.

Under these conditions, a substitute system of regulating trade is not only necessary but urgent. Some people are eager to point out that barely two percent of

[24] For a summary of the pork dispute see Gary N. Horlick and F. Amanda DeBusk, "The Functioning of FTA Dispute Resolution Panels," in Leonard Waverman (ed.), *Negotiating and Implementing a North American Free Trade Agreement* (Vancouver/Toronto: The Fraser Institute/Centre for International Studies, 1992), pp. 15-21.

bilateral trade falls victim to disputes, but this fails to take into account the damage done as a result of the uncertainty surrounding trade and investment. Earlier this year, the Premier of Quebec attempted at the World Economic Forum in Davos, Switzerland to find partners in order to increase the capacity of Norsk Hydro Canada, a manufacturer of pure and alloyed magnesium, despite the antidumping and countervailing duties in the United States.[25]

3. The Canadian Proposals at the GATT Multilateral Negotiations and in the Canada-U.S. Working Group

Insofar as the FTA provisions were concerned, the question of subsidies and countervailing duties was supposed to be addressed, first, within the multilateral GATT negotiations initiated in 1986 and, then, on the basis of these results, in subsequent bilateral negotiations.[26]

After a mid-term review of the multilateral negotiations, conducted in Montréal in December 1988,[27] the Government of Canada submitted a proposal to the group negotiating subsidies in Geneva in June 1989. It contained the directions and provisions that Canada hoped to see adopted in its trade with the United States.[28] These proposals reflected the measures recommended within North America to reduce the scope of American trade remedy laws and practices.[29] Some people even thought that if these proposals were adopted by GATT, the objectives of the Canada-United States Working Group on subsidies would be met. The most significant of these proposals dealt with countervailing duties.

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[25] *La Presse*, January 29, 1994, pp. A1-2; *Le Devoir*, January 29, 1994, p. A6.

[26] Both the multilateral and bilateral strategies would be pursued simultaneously and were perceived by the government as complementary. See Canada, External Affairs, *Canadian Trade Negotiations* (Ottawa: Department of Supply and Services Canada, 1985) as well as an article by Germain A. Denis, the deputy head negotiator of the FTA, "Le Canada face eux négociations commerciales bilatérales et multilatérales," in *Un marché, deux sociétés?* Part One: *Libre-échange et autonomie politique*. Published under the direction of Christian Deblock and Maurice Couture, proceedings of the conference "Un marché, deux sociétés?", ACFAS congress, Université de Montréal, May 1986 (Montréal: ACFAS, 1987), pp. 57-62.

[27] In regard to subsidies, the Montréal Communique stated that the negotiations would proceed on the basis of a division of
subsidies into three categories: prohibited subsidies, subsidies that were permitted but could prompt a response (a challenge before GATT or counterveiling duties), end finally subsidies that could not prompt any response. See GATT, Doc. MTN.TNC/7(MIN) of December 9, 1988.

[28] Canadian proposal, GATT, Doc. MTN.GNG/NG10/W/25 of June 28, 1989. See as well Patrick J. McDonough, *Subsidies and Countervailing Measures* (Deventer: Kluwer, 1993), pp. 48-49.

[29] See Hart, *Canada-United States Working Group*, pp. 45-46. This mentions as well the main authors and works providing proposals to improve the trade remedy mechanism.

In regard to assistance that is grounds for action, Canada emphasized in particular that specificity and the existence of a government financial contribution should be essential in order for countervailing duties to be levied. The Canadian government was also eager to ensure that such duties were not imposed below a certain *de minimis* level of subsidization and that any assistance received by producers in the importing country was subtracted from the amount of subsidy that was calculated. Actually, international rules and national laws allow retaliatory measures against imported goods without concerning themselves with whether the domestic industry that requested countervailing duties is itself subsidized. In the case of the Canada-U.S. dispute over softwood lumber, Bence and Smith have calculated that American producers benefited in 1984 from subsidies of 11.93 percent.[30]

The Canadian proposal also suggested strengthening the rule that in order for a countervailing duty investigation to be initiated, it must be supported by producers representing a "major proportion" of national production. This would be done by establishing an actual percentage. In addition, Canada suggested that a clause be adopted stating that the public interest (and not just that of the producers) should be taken into account. There is currently no public-interest clause in the United States, as there is in the Canadian legislation. In Canada, the Special Import Measures Act stipulates in substance that the views of consumers and users should be taken into account and duties reduced as a result.

Non-actionable subsidies should be generally available or should serve such ends as regional development, general infrastructure, worker retraining, or research and development.

The multilateral negotiations that were originally supposed to end in 1990 did not actually conclude until December 1993. Despite these difficulties, the Canada-U.S. Working Group responsible for establishing a substitute system of subsidy and countervailing duty rules had been established and discussions held. However, they had not led to a successful conclusion. Once again, Canada and the United States proved unable to agree on a new system to regulate trade between the two countries. Gordon Ritchie, the deputy chief negotiator of the FTA who had returned to private enterprise, stated publicly in early 1992 that the Americans were failing to honour their commitments.

There is certainly room for doubt about the willingness of the two countries to agree on a code governing dumping and subsidies. A close reading of the provisions

[30] Jean-François Bence and Murray Smith, "Subsidies and the Trade Laws: The Canada-U.S. Dimension," *International Economic Issues*, April-May 1989 (Halifax: Institute for Research on Public Policy), pp. 19, 28.

of the FTA shows first that there was no *obligation* to reach an agreement (of the kind that the parties must reach or have agreed to reach a settlement). At the very most, there was a statement to the effect that the parties would make every effort. Furthermore, some American officials, irritated at the fact that binational panels could review and rule on decisions made by U.S. authorities, were awaiting the expiry of these provisions (seven years after the FTA came into effect) to return to the situation before the FTA, namely, the right to levy countervailing duties without any possible review by binational panels.[31]

As a result, Canada had something to gain from joining the free trade negotiations between Mexico and the United States, namely, ensuring that at least the binational trade panel mechanism did not disappear.

4, The Provisions of the North American Free Trade Agreement of 1992 and the Seattle Declaration of 1993

The North American Free Trade Agreement (NAFTA),[32] which was signed in 1992 and came into effect on January 1, 1994, strengthens the binational panel mechanism, in particular by clearly putting it on a permanent footing. Apart from permanent binational panels, Chapter 19 of NAFTA ("Review and Dispute Settlement in Antidumping and Countervailing Duty Matters") basically repeats the FTA provisions, despite the efforts of the American negotiators to reduce the scope of these provisions. Taking its inspiration from the FTA, Article 1907, paragraph 2 of NAFTA states that the parties "agree to consult on the potential to develop more effective rules and disciplines concerning the use of government subsidies, and . . . the potential for reliance on a substitute system of rules for dealing with . . . government subsidization." Here too there is no firm undertaking and still no formal obligation to agree on a substitute system for regulating trade. In addition, the NAFTA provisions, for their part, fail to establish any timetable for dealing with the issue of trade remedies.[33]

The trade remedy issue was debated during the federal election campaign of the fall of 1993, with the Liberal Party insisting in particular on maintaining the provisions of Article 1907 of the FTA, requiring the parties to seek to agree by the end of 1995

[31] Confidential interview.

[32] Canada, *North American Free Trade Agreement* (Department of Supply and Services Canada, 1992).

[33] For an analysis of the subsidy provisions in FTA and NAFTA , see Gilbert Gagné, "Le Canada et le libre-échange nord-américain: le problème des recours commerciaux," Bulletin SDIE, vol. VI, no. 2 (autumn 1993), pp. 15-17.

on a substitute system of rules to regulate trade.[34] This issue re-emerged, therefore, after the election of a Liberal government that was eager to put the agreement on a new footing. At the Asia-Pacific Economic Co-operation (APEC) summit in Seattle in November 1993, Canada obtained the "re-establishment" of a working group to make improvements in the existing domestic provisions on trade remedies by December 1995.[35] The tenor of this commitment, in the Seattle Declaration,[36] remained unchanged, however, in that the parties still have not undertaken any formal obligation to agree on a substitute system for subsidies and countervailing duties. On the other hand, the Declaration no longer speaks of relying on a "substitute system of rules" but of "seeking solutions calculated to reduce the likelihood of disputes over subsidies . . . and the operation of trade remedy legislation in these areas."

We should not dwell too much on the language of the Declaration since what matters are the proposals submitted by the parties. A formal obligation to reach a conclusion does not necessarily facilitate the negotiations or improve their chances of success. There is still a need, insofar as Canada is concerned, to agree on a subsidies code or else to review the rules governing subsidies.[37]

5. Results of the Multilateral Negotiations

Despite many delays, the multilateral GATT negotiations finally came to a successful conclusion in December 1993. These negotiations, as one might expect, proved particularly difficult in regard to subsidies and countervailing duties. The issue of agricultural subsidies was primarily responsible for prolonging the Uruguay Round,

[34] See in particular the editorial "It Ain't Broke," *The Globe and Mail*, October 5, 1993, p. A18 and the response of Gordon Ritchie, "Hold U.S. to Agreement," *The Globe and Mail*, October 12, 1993, p. A18, in addition to an article by the Liberal Party trade critic, Roy MacLaren, who has since become Minister of International Trade, "Setting New Rules for NAFTA," *The Globe and Mail*, October 12, 1993, p. A12.

[35] More precisely, this time there were two working groups, one on dumping and antidumping duties and the other on subsidies and countervailing duties. In addition, the negotiations were to be trilateral this time, including Mexico.

[36] See "Declaration by the governments of Canada, Mexico and the United States. Works to appear on antidumping duties, subsidies and countervailing duties," available from the Department of Foreign Affairs and International Trade.

[37] See the Canadian Press bulletin of February 9, 1994 quoting Minister MacLaren as well as "Le point sur le contentieux commercial Canada-Etats-Unis, 15 décembre 1993," written by the United States Trade Relations Division, Department of Foreign Affairs and International Trade, p. 6.

and for the first time there is even a specific agreement on them in the agricultural sector.[38]

Similar to the Tokyo Round during the 1970s, the negotiations were hobbled by fundamental differences of approach. For some countries, especially the United States, subsidies were the main issue, and they demanded the complete abolition of subsidies or at least a draconian toughening of the provisions governing them. For many other countries, including Canada, the main issue was what they perceived to be the abusive use of countervailing duties. These countries insisted on strengthening the disciplines governing the use of countervailing duties in order in particular to protect themselves against what they consider to be harassment tactics when measures are taken without any real proof that a subsidy exists or that injury has been suffered.[39]

The Agreement on Subsidies and Countervailing Measures, which came out of the multilateral negotiations, modifies the particulars of the issue and constitutes the foundation on which the NAFTA partners will base their analysis of subsidies and countervailing duties in the North American context. The GATT Agreement contains in this regard three major elements that reflect the main concerns of the Canadian government, as put forth in its proposals to the multilateral negotiations in 1989. The Agreement reached at the Uruguay Round contains for the first time at the multilateral level *a definition of what a subsidy is*. Subsidies are accordingly only "specific" assistance provided by public authorities (e.g. central or provincial governments), that is, they are directed, de jure or de facto and excluding objective criteria or conditions,[40] only at certain companies (Part I, Articles 1 and 2). It should be mentioned, in this regard, that during the final days of negotiations Canada demanded and obtained changes to the wording of the Agreement so that general provincial subsidies, i.e., non-specific subsidies, would not normally attract countervailing duties.

Second, *subsidies for regional research and development* can no longer attract countervailing duties, except under the conditions set forth in the Agreement (Part

[38] GATT, "Agreement on Subsidies and Countervailing Measures" (MTN/FA II-A1A-13) (hereafter the Subsidies Agreement), "Agreement on Agriculture" (MTN/FA II-A1A-3) in the *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, December 15, 1993.

[39] See GATT, *GATT Activities 1988* (Geneva, June 1989), pp. 53-54. For what went before and the course of the negotiations leading to this Agreement on Subsidies see McDonough, *Subsidies and Countervailing Measures*.

[40] Refers to neutral criteria or conditions that do not favour certain companies over others and that are economic in nature and horizontal in application, e.g. the number of employees or the size of the company.

IV).[41] Insofar as subsidies for regional development in particular are concerned, they must be largely part of a general framework for regional development and be non-specific, and the regions helped in this way must have a per-capita income of no more than 85 percent of the national average or an unemployment rate that is at least 110 percent of the national average (Article 8:2[b]). These criteria basically reflect the principles adopted in the European Union for co-ordinating regional assistance. This provision is a considerable achievement for Canada, which always feared that its measures to help disadvantaged regions would be blocked by the levying of countervailing duties, or just by the possibility that they would be levied, since most these regions are also heavily dependent on foreign trade.

The third major element, finally, is *a further refinement of the provisions governing countervailing duty investigations*. Henceforth, when an investigation is requested "by the domestic industry or in its name," it must be supported by domestic producers who, together, account for more than 50 percent of total production of the similar product produced by the part of the domestic industry expressing its support for or opposition to the request. Under no circumstances can an investigation be launched if the domestic producers expressly supporting the request account for less than 25 percent of total production of the similar product of the domestic industry (Article 11:4). The Quebec minister of international affairs pointed out recently in this regard that Magnesium Corporation of Salt Lake City, the American producer that originated the antidumping and countervailing duty investigation of the magnesium producer Norsk Hydro Canada, represented only 22 percent of the American market, since other producers of magnesium in the United States remained silent. In an even stranger twist, the binational panel responsible for making a determination of injury decided that the U.S. International Trade Commission did not have to consider the amount of support there was from the industry in making its judgment.[42] In addition, there should henceforth be at least a 1% subsidy in order for a countervailing duties investigation to be launched (Article II:9), instead of the 0.5% level that has been the case until now in American trade law.

These two conditions for launching countervailing duty investigations reflect the main recommendations of trade experts for reducing the number of investigations and limiting them to cases of significant subsidy. The Canadian government championed this approach in particular. Studies have shown that the effective level of federal subsidies for industry in Canada is one percent overall, apart from certain sectors such as fisheries and rail transportation. Taking into account public procurement and

[41] Although they are not similar in scope, we should recall that there are also provisions to ensure that certain subsidies for environmental protection do not attract countervailing duties.

[42] *La Presse*, January 28, 1994, p. B5.

military spending, this rate is lower than that prevailing in the United States.[43] It is true, however, that Canada has traditionally been more inclined to accept government intervention in the economy, while the United States has *claimed* at least to rely more on market mechanisms. In addition, Canadian subsidies tend to be quite evident, and therefore easy for American competitors to identify and condemn, while measures to provide assistance in the United States are more opaque. For instance, most assistance in Canada takes the form of direct subsidies or capital participation, while American subsidies largely take the form of tax breaks, low-interest loans, loan guarantees and public procurement, particularly in the latter case in regard to defence industries.

Finally, the GATT agreement includes a provision that now limits the applicability of definitive countervailing duties to five years (sunset), instead of the more than ten years that were often the case, unless it can be established that the subsidy and the injury will continue or will re-occur if the duties are removed (Article 21).

In regard to *other major changes* to the multilateral rules on subsidies, the Final Act of the Uruguay Round basically repeats the provisions that already existed in regard to the concept of "injury" and its connection to subsidization.[44] On the other hand, the dispute settlement mechanism, to which the NAFTA parties still have recourse, has proved more expeditious since 1989, as a result of the changes made after the midway review of the Uruguay Round, and has been strengthened by a provision in the Final Act requiring trade panel reports to be adopted no longer only if there is a consensus in favour of adopting them but unless there is a consensus in favour of not adopting them (reverse consensus).[45] The procedure should no longer be capable of being blocked by one or a few countries, which are generally the parties to a dispute whose arguments are rejected in the trade panel report.

Under the new provisions of the GATT agreement, many of the countervailing duty investigations conducted in the United States over the last few years against Canada could not have been initiated. In addition, the multilateral negotiations have appreciably improved Canada's ability to counter harassment or the abuse of trade

[43] See: Bence and Smith, "Subsidies and the Trade Laws"; James D. Gaisford and Donald L. McLachlan, "Domestic Subsidies and Countervail: The Treacherous Ground of the Level Playing Field," *Journal of World Trade* XXIV, no. 4 (August 1990), pp. 55-77.

[44] See Articles 11 and 15 of the Agreement on Subsidies.

[45] "Memorandum of agreement on dispute settlement" (MTN/FA II-A2), especially Article 16.

remedies. This is clearly likely to significantly improve the climate and the conditions under which trade is conducted under NAFTA.

6. Necessary Iprovements to the NAFTA Provisions

6.1 Adherence to the Uruguay Round agreement on subsidies and a repetition of the proposals Canada already made at the multilateral level: the short-term approach

Although the outcome of the multilateral negotiations partly reduced the need for substitute rules on subsidies in North America, it is still only a first step. Further negotiations will be needed, although their success, as we have seen, remains uncertain.

Some experts and commentators have provided us with what they think should be included in "a substitute system of rules for . . . government subsidization."[46] The optimal solution for Canada would certainly be a total exemption from American trade remedies, without any concessions on Canada's part. However, this is not realistic, since Canadian subsidies do injure American producers in some instances. Furthermore, such changes are usually the result of negotiations in which both parties reach a satisfactory agreement after mutual concessions.

The question, therefore, is to determine the second-best solution for Canada. This solution, we think, should be predicated on two basic objectives, namely limiting as much as possible harassment of our exports by American producers, while maintaining a certain latitude for Canada to subsidize economic activity. To reach a broadly based agreement in this regard would require long and complicated negotiations, which, though they may well prove satisfactory in regard to trade conditions (security of access, lack of harassment) could end up imposing more restrictions than the federal and provincial governments would like on their ability to subsidize economic activity in order to encourage development, including in disadvantaged regions. We believe that a less radical solution that changes the aspects most damaging to Canadian interests would be able, at least in good measure, to counter the harassment of Canadian exports. In contrast to a number of university professors and experts in international law who believe that a broadly based

[46] See among others: Boddez and Trebilcock, *Unfinished Business*, pp. 215-274; Gary N. Horlick and Debra P. Steger, "Subsidies and Countervailing Duties," in Peter Morici (ed.), *Making Free Trade Work: The Canada-U.S. Agreement* (New York: Council on Foreign Relations, 1990), pp. 84-101; and Keith Christie, *La mondialisation et la politique officielle au Canada. La recherche d'un paradigme*, Document no. 93/01, Policy Staff, Foreign Affairs and International Trade Canada (January 1993), pp. 44-46.

agreement is essential in the short term in order to guarantee Canadian companies security of access to American markets and to end harassment, we believe that Canada should opt for the strategy that seems most realistic, and hence most beneficial.

A key question that remains is how to prompt the United States to enter such negotiations, or, in other words: what could the American interest be in entering these negotiations? The main leverage that Canada has at its disposal to induce the United States to tighten the conditions under which trade remedies are applied is for Canada to eliminate, or at least reduce, the subsidies that irritate our American partners most and that affect investment. A number of these subsidies turn out, in actual fact, to be not very efficient or problematical because of the public deficit that is exerting mounting pressure on government budgets throughout the country. These subsidies include those to attract foreign investment through tax concessions of all kinds from various levels of government (federal, provincial [or state], regional and municipal). This even holds true for regions that could not be considered disadvantaged.

These kinds of subsidies, when used by American states, are also increasingly criticized within the United States. A recent study by the U.S. Congress pointed out that these subsidies or "incentives" had increased dramatically since the mid-1970s. In the automobile industry, the study reported on a veritable bidding war between various American states providing assistance to attract Japanese investors.[47] In the European Union, similar problems that arose in the early 1970s, involving American investments this time, resulted in the establishment of principles for co-ordinating regional assistance. Canada could refrain, in this regard, from remaining solely on the defensive by showing that it is ready to deal with the assistance measures that are most damaging to competition. Canada should take a positive approach and move forward with proposals, asking its American partners in return what proposals they are willing to make.

In regard to those subsidies that Canada believes to be essential and that affect regional development and research and development, we have seen that they cannot attract countervailing duties now, as a result of the multilateral negotiations. This outcome of the multilateral negotiations clearly cannot be called into question now. In addition, there are definite conditions for granting these types of subsidies, in order to avoid any possibility of trade remedies.

[47] See U.S. Congress, *Multinationals and the National Interest: Playing by Different Rules*, OTA-ITE-569 (Washington: U.S. Government Printing Office, September 1993), pp. 67-68.

The GATT agreement on subsidies should therefore constitute the starting point for NAFTA negotiations. As a first priority, Canada should ensure that the provisions of the GATT agreement on subsidies are fully complied with in the American legislation, especially in regard to whether *injury* has been suffered and to the need for a *causal link* between the subsidized imports and the injury to a domestic industry. As we have seen, there are some discrepancies between the GATT provisions and the American legislation in this regard. As a result, the American legislation does not always comply with the spirit of the international rules.

Second, Canada should table its proposals that were not taken up in the course of the multilateral negotiations. Basically, these deal with, first, *minimum assistance levels*, below which countervailing duties could not be applied. Most trade experts and experts in international law recommend in this regard a net subsidy level of between three and five percent in order to justify a countervailing duty investigation. Apart from agriculture and some industrial sectors, subsidy levels in Canada are clearly below this threshold. Even if agreement cannot be reached with the United States on this minimum level, any increase in the 1% threshold established at the multilateral negotiations would be of considerable benefit to Canada.

To the extent that one of the objectives of free trade is to ensure better consumer prices as a result of increased competition, the *public interest* and not just that of producers should be duly taken into account in all countervailing duty investigations. American trade law focuses almost exclusively on producer interests and neglects the interests of consumers and others who could benefit from subsidized imports. In the case, once again, of the notorious softwood lumber dispute, the American associations of homebuilders and wood suppliers sided with the Canadian producers since they knew that countervailing duties would cause prices to rise and sales to fall.[48] The Agreement on Subsidies that came out of the Uruguay Round only suggests that national bodies take into account the interests of consumers and industrial users of imported products that are being investigated (Article 19:2).

Americans have a tendency to believe that subsidies are a foreign practice and not to take into account the assistance which they themselves provide to economic activity. In addition, the countervailing duties levied by the United States are much more damaging to the interests of their trading partners, because of the number of these duties and the size of the American market, than all similar duties that these trading partners might levy. Canada should therefore emphasize equity and insist that only *net subsidies* should be considered, that is, the difference between the foreign subsidy that is being investigated and the assistance granted to the domestic industry.

[48] *The Financial Post*, February 11, 1994, p. 9.

What is meant by the "domestic industry" is also important.[49] Article 16:1 of the GATT Agreement on Subsidies repeats word for word the definition that is given in the 1980 Subsidies Code. It is defined there as:

> "the domestic producers as a whole of the like products or . . . those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products, *except* that when producers are *related*[50] to the exporters or importers or are themselves importers of the allegedly subsidized product or a like product from other countries, the term "domestic industry" *may be* interpreted as referring to the rest of the producers." (The emphasis is mine.)

In addition, a country's territory *may* be divided into two or more competitive markets, and the producers within each market *may* be regarded as a separate industry, if the producers within such market sell all or almost all of their production in that market and the demand in that market is not to any substantial degree supplied by producers located elsewhere in the territory. If there is a concentration of subsidized imports in one of these isolated markets and they are causing injury, injury *may* be found to exist, even if it does not involve a major portion of the total domestic industry (Article 16:2).

Countervailing duties should therefore be levied only on products sent to the affected part of the national territory. *However,* if the constitutional law of the importing country does not allow this, countervailing duties can only be levied for the entire territory if the exporters have been given an opportunity to cease exporting at subsidized prices to the area in question or else if such duties cannot be levied solely on the products of specific producers supplying the area in question (Article 16:3).

Although the United States has never used this provision making it possible to divide the national territory into areas for the purposes of levying countervailing duties, it is nevertheless true that the weakness and quite permissive nature of the

[49] I am indebted to Keith Christie for the following proposals about the definition of "domestic industry." See Christie, *Mondialisation et la politique officielle*, pp. 44-46.

[50] The definition of the term "related" was refined as a result of the Tokyo Round and the 1993 Agreement on Subsidies stipulates: " . . . producers shall be deemed to be related to exporters or importers only if (a) one of them directly or indirectly controls the other; or (b) both of them are directly or indirectly controlled by a third person; or (c) together they directly or indirectly control a third person, provided that there are grounds for believing or suspecting that the effect of the relationship is such as to cause the producer concerned to behave differently from non-related producers. For the purpose of this paragraph, one shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or direction over the latter."

GATT provisions allow the American authorities too much flexibility and room for manoeuvre. Too often the "domestic industry," on the basis of which the representativeness of the complainants and/or the alleged injury is determined, is a very diffuse concept that can change from one investigation to another. As a result, by taking advantage of all the ambiguities and loopholes, a "domestic industry" can end up in some cases representing only a small fraction (around 20 percent) of domestic production. Therefore, an approach like the one that has been approved in multilateral agreements leaves too much scope for unilateralism, and hence reliance on such provisions for essentially protectionist ends.

Canada should attempt therefore to have countervailing duties covered by a definition that is precise and without loopholes, like the definition of emergency measures in NAFTA. In Chapter 8, Article 805 of NAFTA, the expression "domestic industry" is defined as "the producers *as a whole* of the like or directly competitive good operating in the territory of a Party." Officials of the U.S. International Trade Commission do not seem to like definitions as clear and circumscribed as this because it does not allow them much room for manoeuvre. This has even induced them to attempt to expand the definition unilaterally in their Statement of Administrational Action that accompanies the American legislation implementing NAFTA.[51]

The NAFTA partners should finally attempt to make obligatory a GATT clause suggesting that the amount of a *countervailing duty should be less than the total value of the subsidy* if this lesser duty suffices to remedy the injury caused to the domestic industry.[52] In addition, the parties to NAFTA should agree on recognizing that the injury must be evident and demonstrable and result in a considerable distortion of trade. Furthermore, this injury should be largely due to one or more *assistance measures*, that is to say, they should be *the main cause and not just one of the causes of the injury*. In the case of the magnesium dispute, the Quebec ministry of international affairs pointed out that the financial difficulties of the American company that requested countervailing duties were due to its own inefficiency and not to exports by Norsk Hydro.[53]

[51] Confidential interview.

[52] This was stipulated, in substance, in the provisions of Article 4:1 of the 1980 Subsidies Code, which were taken over into the 1993 Agreement, Article 19:2, which came out of the Uruguay Round.

[53] *La Presse*, January 28, 1994, p. B5.

6.2 Insistence on the criterion of injury, a permanent tribunal and its features: the middle term

A number of people think that the North American negotiations on subsidies should address first and foremost the issue of the injury suffered by companies. The most promising strategy in this regard would be to start with what has been achieved in NAFTA, in particular the binational panels, and attempt to improve them. Most importantly, the ad hoc panels should be replaced by a permanent tribunal, in order to put an end to the harassment of Canadian exports to the United States.

This permanent tribunal could be responsible primarily for making final determinations of whether there has been material injury or a threat of material injury to a domestic industry. As we have seen, the injury question is especially difficult because factors other than subsidies may be mainly responsible for the problems that companies experience. Here we see, once again, the importance of a permanent tribunal to ensure a certain consistency in enforcing trade conditions, and therefore a stabile environment for investment. The decisions of a permanent North American tribunal should be binding, without appeal, and, most importantly and in a departure from international rules, able to create law.

Since NAFTA benefits most from a pragmatic approach and a minimum of institutional arrangements, injury investigations would always fall to national bodies, as is the case according to the current provisions, with the permanent tribunal providing only an appeal mechanism if a national government decides that it wants to appeal the results of an investigation. The tribunal could uphold or quash, in all or in part, decisions made by national investigating bodies. The point here is to ensure that the burden of proof rests exclusively with the national investigating bodies (in this case the U.S. International Trade Commission), and that, in the absence of sufficient proof in the view of the North American tribunal, the request for countervailing duties would fail. In the softwood lumber case, Canada decided in July 1992 to appeal the Commission's decision of the previous June 25 that imports of Canadian softwood lumber were injuring the American industry. However, the matter still had not been settled in June 1994, two years later, after being remanded for a third time to the U.S. Commission for lack of convincing evidence. Originally, as we remember, the panel mechanism established in the FTA was supposed to ensure prompt dispute settlement within one year.

In regard to American practices, Canada needs to ensure furthermore that a similar investigation cannot be launched shortly afterwards in response to another request for an investigation by the same complainants or interests (one of the most important ways in which our exports are harassed), unless these complainants or

interests can satisfy the tribunal that the situation has changed substantially and that important new factors could result in a different conclusion. If this is true, then the tribunal could give the national bodies a green light to undertake another investigation.

In all, Canada needs to ensure that national investigating bodies are bound by the decisions of the North American tribunal and that this tribunal is the sole judge of whether another similar investigation is justified. The basic idea is to avoid all unilateralism in such a difficult area and to ensure joint decision-making in questions of injury.

If the United States seems to feel that the idea of a permanent tribunal is too far-reaching, other options based on what has already been achieved in NAFTA could be considered. For instance, NAFTA panels could be called upon to provide declaratory opinions on the existence of or threat of injury. This could take place at the same time as the investigation conducted by national bodies and in co-operation with them. If differences of opinion emerge, they could be settled by a trade panel under Article 1904.

The United States is not the only country that makes determinations of injury that prove to be unfounded. In February 1992, a GATT Grants Committee panel, established at the request of the United States, found that a judgment of the Canadian International Trade Tribunal that subsidized kernels of corn from the United States were causing material injury to Canadian producers failed to comply with Article 6 of the Subsidies Code for lack of conclusive evidence. In this case, the United States did not appreciate at all the fact its exports, and by extension its agricultural policies, attracted a countervailing duty for the very first time. In other words, the Americans did not like a taste of their own medicine. However, the Canadian Department of Finance calculated that, in 1986 alone, American countervailing duty actions affected about $4.2 billion of Canadian exports, while Canada's sole similar action against kernel corn affected only C$9 million worth of American exports.[54] In addition, the association of American corn producers demanded and obtained from Washington reimbursement of half the expenses it had incurred in order to bring its case before the Canadian authorities.

It would therefore be not only in Canada's and Mexico's interest but also in the interest of the United States to replace unilateral determinations of injury. This is all the truer if one considers antidumping investigations, which require a procedure and

[54] Canada, Department of Finance, *The North American Free Trade Agreement: The Economic Assessment from a Canadian Perspective*, pp. 24-25.

conditions similar to countervailing duty investigations in order to prove injury, or threat of injury, and levy duties.

Between 1980 and 1992, Canada conducted 63 antidumping duty investigations of products from the United States, while the American authorities conducted 30 such investigations of Canadian exports.[55] In 1986 once again, there were antidumping investigations of $295 million worth of Canadian exports to the United States and of $375 million worth of U.S. exports to Canada.[56] Between July 1989 and June 1992, Canadian authorities conducted 15 investigations of U.S. exports, two of which resulted in the levying of definitive duties and one in an undertaking on price. Meanwhile, the United States conducted seven investigations, resulting in three cases in the levying of antidumping duties on Canadian exports. Over the same period, Mexico initiated 20 investigations of goods exported from the United States, of which seven ended in the levying of definitive duties and three in undertakings.[57]

It should be noted, therefore, that Canada initiated more antidumping duty investigations than the United States. This is another major factor that might induce the American authorities to accept stricter conditions, or even joint decision-making, in regard to questions of injury. Furthermore, the criticisms made of Canadian antidumping provisions and practices are similar to those made of the American system.[58] These conclusions, while all true, need to be tempered by the fact that barely 10 percent of American GDP is dependent on foreign trade and Canada and Mexico together took only 30 percent of American merchandise exports in 1992.[59]

The North American tribunal could also, if necessary, decide disputes over subsidies among the NAFTA parties. In comparison with injury, it is relatively easy to determine the existence of a subsidy, that is, an advantage or benefit conferred by public authorities, although a definition of the exact scope of the concept of "subsidy"

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[55] GATT, Annual Report of the Committee on Anti-Dumping Practices (1981-1992), *Basic Instruments and Selected Documents*, supplements no. 28 to 39.

[56] Canada, *The North American Free Trade Agreement: The Economic Assessment from a Canadian Perspective*, pp. 24-25.

[57] Annual reports of the GATT Committee on Anti-Dumping Practices.

[58] Susan Hutton and Michael Trebilcock, "An Empirical Study of the Application of Canadian Anti-Dumping Laws: A Search for Normative Rationales," *Journal of World Trade* XXIV, no. 3 (June 1990), pp. 123-146.

[59] U.S., *U.S. Trade Highlights 1992*. For dumping and the reform of antidumping systems, see Keith H. Christie, *Damned If We Don't: Some Reflections on Antidumping and Competition Policy*, Document no 94/15, Policy Staff, Foreign Affairs and International Trade Canada (July 1994).

is very difficult. In addition there can be problems, in practice, determining whether assistance measures are general or specific, as was the case in the softwood lumber dispute. Finally, the same holds true for the method of calculating the size of a subsidy and the corresponding size of the duty, as we saw in the dispute over pork. In case of disputes over subsidies, it is therefore important to have a North American tribunal to decide the issue. The tribunal would not make judgments of a general nature, such as about the validity of measures, but only about specific cases that give rise to disputes.

Bidding wars to attract investment pose another set of thorny problems which the permanent tribunal could study. Here too, if the United States rejects this option, the provisions that already exist in NAFTA for the general settlement of disputes (Chapter 20) could be used to help limit bidding wars over the assistance to be provided.

In North American negotiations on subsidies, Mexico's interests place it on Canada's side, which could lend added weight to Ottawa's proposals. Between 1980 and 1986, Mexican exports to the United States were subjected to 14 countervailing duties.[60] Like Canada, Mexico has what are called "concessions" for the exploitation of natural resources, as well as subsidies for regional development.[61] The latter have attracted most of the countervailing duties levied by American authorities.[62]

Mexico, which only became a member of GATT in 1986 and did not follow the Subsidies Code produced by the Tokyo Round, did not benefit until then from the injury criterion that the United States applied to signatories of the Code. In addition, the United States demanded that developing countries which signed the Code enter a bilateral undertaking almost always involving a reduction in subsidies. As a result, Mexico signed in 1985 a bilateral agreement on subsidies, which has been renewed and in which the Mexican authorities agreed to eliminate or reduce several subsidies, in particular those with a more direct effect on international trade, in exchange for the American authorities agreeing to determine whether injury had been done, or there was a threat of injury, before levying countervailing duties. Since then, the United States has never initiated a countervailing duty investigation of Mexican imports. What is noteworthy in all this is that the Mexican government deemed that it was in the national interest to abolish or reduce a number of subsidies in exchange for U.S.

[60] GATT, annual report of the Committee on Subsidies and Countervailing Measures (1981-92), *Basic Instruments and Selected Documents*, supplements no. 28 to 39.

[61] For an analysis of subsidies in Mexico, see the unpublished paper by Cecilia Siac written for the C.D. Howe Institute.

[62] See McDonough, *Subsidies and Countervailing Measures*, pp. 23-24.

application of the injury criterion, and that this has put an end so far to American countervailing duty investigations of Mexican goods.

The joint North American tribunal could consist of seven judges who are experts in North American and international trade law, two from each country, without any connections to national authorities, plus a seventh judge, appointed by joint agreement, who is a national either of a country that is party to NAFTA or of another country. It is likely, however, that the United States will have serious reservations about a North American tribunal consisting of an equal number of judges from each country, fearing in particular that the Canadian and Mexican members might join forces to limit American trade remedies. Nevertheless, as we have shown, joint decision-making in regard to injury issues would be in the interest of all three partners, especially if one considers injury due not only to subsidization but also to dumping.

Finally, it is essential that the NAFTA partners agree to abide by the decisions of the permanent North American tribunal. Our experience with the existing provisions has hardly been happy in this regard, with the extraordinary challenge procedure in the FTA being reduced more and more to an ordinary channel of appeal when decisions do not suit the American government.

6.3 Joint Competition Principles: the Long-Term Approach

In the more or less long term, in order to guarantee the success of this approach and even more satisfying results, we must attempt to free ourselves in North America from the hostility to subsidies and the focus on the injury suffered by competing firms, that so far has characterized our approach to subsidization, in order to embrace an approach based on healthy, profitable competition. Fundamentally, we need to address the issue of subsidies not from the point of view of trade distortion but of competition distortion. Similarly, subsidies should be viewed not as an issue of competing producers but of competition in general. This was the approach adopted in the Treaty of Rome, which established the European Economic Community. In addition, the agreement between Australia and New Zealand that antidumping measures would no longer be adopted between the partners in the free trade zone after July 1990 suggests that there is increasing support for the idea of relying on joint principles of competition rather than trade remedies.

This novel approach would finally make it possible to recognize the fact that the existing trade remedies have nothing to do with "fair" competition and instead constitute an obstacle to viable trade conditions. Trade remedy legislation in the United States and elsewhere may well distort international trade conditions more than the subsidies that they are supposed to keep in check. Producers use these remedies

against foreign subsidies basically in order to consolidate their market shares, their price-setting procedures and other oligopolistic practices.

The development of joint competition principles will require detailed and probably arduous negotiations. Joint rules should make it possible, first, as was the case in the European Union, to prevent bidding wars between public authorities in an effort to attract investment. These bidding wars can only undermine the benefits of trade liberalization, dangerously distort competitive conditions, drain the public purse, and compromise the development of disadvantaged regions, since they have fewer resources with which to attract investment.

7. Conclusion

Proposals aimed largely at tightening and strengthening the rules governing determinations of injury by domestic authorities are likely to fail. The American government's essentially hostile view of subsidies leaves little room for optimism that the proposals advanced in this paper will be adopted within NAFTA. In fact, the United States has always insisted during trade negotiations, whether multilateral or bilateral, on reducing subsidies and toughening the provisions governing them.

Despite these difficulties, the strategy recommended in this paper remains the best one and the only one, we believe, which should be pursued. Since Canada needs both to counter the harassment of its exports by American interests and to retain as much of its ability as possible to pursue objectives in the national interest, Canada should attempt in the short and medium terms to focus basically on questions of injury and making some joint decisions with its NAFTA partners in this difficult area.

Since Canada will very likely have to compromise on subsidies in order to induce the United States to negotiate and agree to results that, on the whole, are favourable to Canadian interests, Canada should attempt to reduce these compromises to a minimum and ensure above all that the results of multilateral negotiations are respected, especially the exemption from trade remedies of subsidies serving crucial objectives such as regional development. A less defensive approach could be adopted by proposing limitations on assistance measures to attract investment to regions that are not depressed.

In order to optimize, or even guarantee, the benefits that could result from effective trade liberalization, the North American partners should develop, in the more or less long term, joint principles of competition. Joint rules would, in particular, obviate the need for trade remedies and bidding wars between various public authorities trying to attract investment.

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