Chapter Eleven — Investment

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

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

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

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

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

Foreign Investment in Canada

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

What They Do – Investment Dispute-Settlement Organizations

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

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

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

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

Chapter Twelve — Cross-Border Trade in Services

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

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

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

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

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

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

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

The Service Economy

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

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

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

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

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

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

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

Market Opportunities: Forestry Equipment and Services

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

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

Market Opportunities: Environment Equipment and Services

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

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

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

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

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

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

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

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

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

Market Opportunities: Transport Equipment and Services

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

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

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

Chapter Thirteen — Telecommunications

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

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

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

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

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

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

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

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

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

Market Opportunities: Telecommunications

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

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

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

The Canadian Telecommunications Industry

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

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

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

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

Donald S. Macdonald

Chapter Fourteen — Financial Services

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

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

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

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

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

Financial Services Reform in Canada

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

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

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

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

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

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

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

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

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

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

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

Market Opportunities: Financial Services

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

Chapter Fifteen
Competition Policy, Monopolies and State Enterprises

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

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

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

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

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

Competition Policy in Canada and in the NAFTA

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

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

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

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

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

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

Chapter Sixteen — Temporary Entry

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

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

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

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

Business Visitors under the FTA Provisions for Temporary Entry

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

CEIC International Services Group

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

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

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

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

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

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

Part Six — Intellectual Property

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

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

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

Chapter Seventeen — Intellectual Property

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

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

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

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

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

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

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

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

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

Section 337 in U.S. Trade Law

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

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

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

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

Part Seven
Administrative and Institutional Provisions

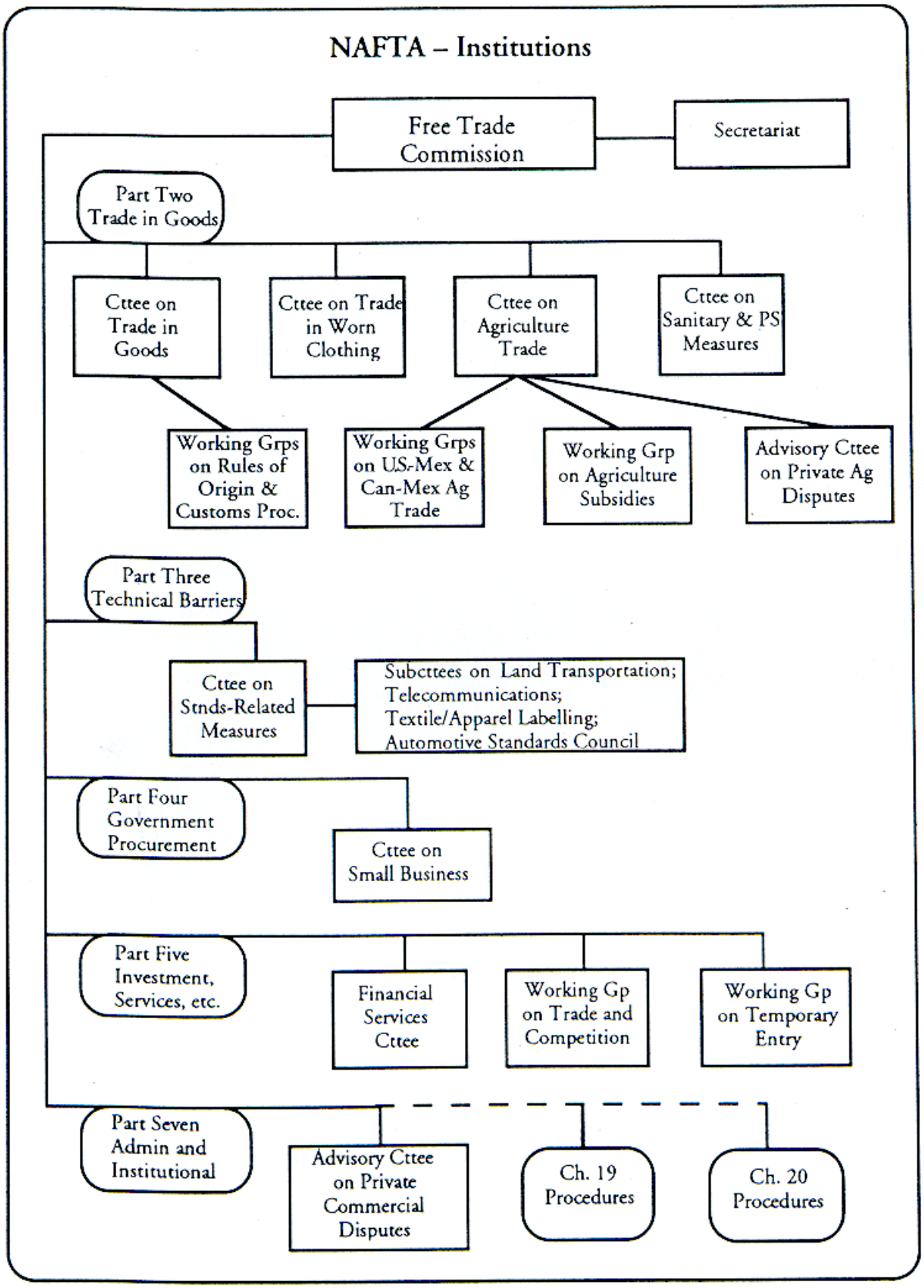
The three chapters in this part provide the basis for the administration and implementation of the complex of rules set out in the rest of the Agreement. While the rules provide the rights and obligations that ensure that the three countries will pursue their trade and economic policies on the basis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

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

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

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

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


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

Chapter Eighteen
Publication, Notification and Administration of Laws

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

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

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

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

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

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

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

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

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

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

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

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

U.S. Trade-Remedy Legislation
Countervailing Duty Action

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

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

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

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

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

Should a panel determine that the law was properly applied, the matter is closed. If it finds that the administering authority (the Department of Commerce or the International Trade Commission in the United States; the Department of National Revenue or the Canadian International Trade Tribunal in Canada; the Secretariat of Trade and Industrial Development in Mexico) erred on the basis of the same standards as would be applied by a domestic court, it can send the issue back to the administering authority to correct the error and make a new determination. Like the FTA, the NAFTA spells out the relevant standard of review that applies.

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

U.S. Trade-Remedy Legislation: Antidumping Action

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

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

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

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

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

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

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

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

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

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

Principal U.S. Trade-Remedy Laws

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

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

Michael Hart, *Trade – Why Bother?*

FTA Chapter Nineteen – Summary of Canadian Cases

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

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

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

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

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

FTA Chapter Nineteen — Summary of U.S. Cases

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

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

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

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

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

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

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

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

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

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

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

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

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

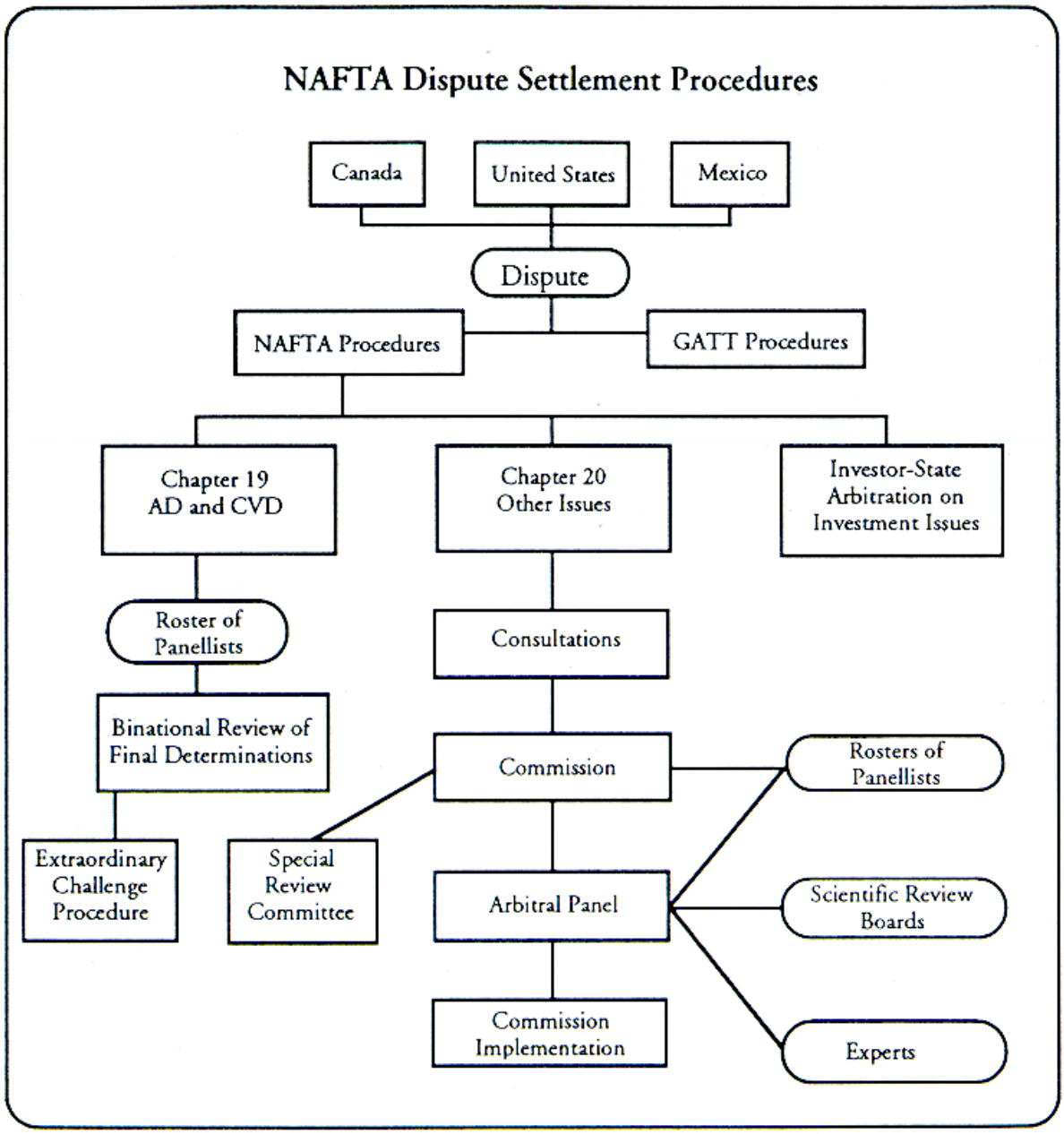
Chapter Twenty
Institutional Arrangements and Dispute Settlement

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

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

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

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



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

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

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

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

Cases under FTA Chapter Eighteen Interpretation of the Agreement

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

John Kenneth Galbraith

Part Eight — Other Provisions

Chapter Twenty-one — Exceptions

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

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

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

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

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

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

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

GATT Article XX

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

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

Chapter Twenty-two — Final Provisions

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

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

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

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

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

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