Canada-United States Law Journal

Volume 10 | Issue | Article 20

January 1988

External U.S. Commitments Affecting Possible Additional Products for Sectoral Integration

Donald E. deKieffer

External U.S. Commitments Affecting Possible Additional Products for Sectoral Integration**

*by Donald E. deKieffer**

It became apparent during the Tokyo Round (1973-79) that serious obstacles were developing to the multilateral trade liberalization process. The European Economic Community has increasingly looked inward to its problems of economic integration. Japan has become a major international trade power, with seemingly impenetrable markets for foreign manufactured products. And, the advanced LDCs (e.g. Brazil and Korea) have brought a totally different attitude toward trade policy from that held by the developed countries which established the GATT and dominated earlier negotiations.

While pressures for protectionism, and the weakening of the international political will to liberalize trade, have worsened since the end of the Tokyo Round, both the United States and Canadian governments continue to emphasize the necessity for the maintenance and expansion of an open global trading system. Neither government, however, intends to wait for a multilateral consensus before taking concrete steps to liberalize trade wherever possible. Thus, the United States welcomed the Canadian government's initiative to explore possible bilateral liberalization agreements in selected sectors, even though there may be complications in moving ahead bilaterally.

Expanding the scope of bilateral market access between the world's two largest bilateral trade partners makes a great deal of sense. Joint U.S.-Canadian working groups have already been established to consider bilateral liberalization in certain sectors, such as steel; agricultural equipment and inputs; traded computer services and other elements of the "informatics" sector; and government procurement issues, particularly urban mass transit equipment. In addition, each side plans to continue to identify additional sectors which may be appropriate for future discussions.

One of many issues which needs to be addressed is the limitation, if any, that external U.S. commitments place upon these bilateral negotiations. For example, it must be endured that any bilateral sectoral agreement is in conformity with the U.S. commitment to the GATT. Since the U.S. has always supported the GATT, and the most-favored-nation

** Paper presented at Conference.

* Member of the firm of Pillsbury, Madison & Sutro (Washington, D.C.); former General Counsel, Office of the United States Trade Representative.

(MFN) principle which is its cornerstone, it is unlikely that a free-trade agreement with Canada will obtain support if it is incompatible with this policy. Thus, forming a bilateral free-trade arrangement would have to be seen as a move to supplement rather than replace the multilateral approach.

The day the GATT was born in Geneva, to encourage multilateralism, BENELUX was launched in Brussels, to initiate the movement toward regional free-trade. Consequently, the GATT came at the intersection of two conflicting trends in international commercial relations: the determination to revive the MFN principle, and the irrepressible movement toward regional free trade.

Article XXIV of the GATT is at the locus of these two trends. It reconciles the apparent contradictions between them by setting ground rules permitting members to form discriminatory arrangements in clear violation of MFN practice, but only in compliance with requirements aimed at preventing such arrangements from becoming inward-looking, protective "trade blocks," harmful to other countries and inconsistent with the GATT objective of freer international trade.

Paragraph 4 of Article XXIV sets the tone for permission to deviate from the normal GATT rules of nondiscrimination; paragraphs 5 through 9 give the specific requirements to be met by the arrangement; and paragraph 10 provides for a waiver by the contracting parties in the event these requirements are not fully met.

While the provisions encourage freeing trade, they stipulate that measures to do so should not raise barriers to the exports of other contracting parties. Discriminatory arrangements are therefore implicitly limited to the form of either a customs union (CU), a free-trade area (FTA), or to an interim arrangement leading to one of these. Article XXIV permits waivers of its requirements, but again only when a CU or FTA is being formed. The purpose of this requirement is to prevent the proliferation of preferential arrangements which fall short of free-trade. Where members wish to create a free-trade arrangement in some other form, they must seek the special waiver provided in Article XV, which is somewhat more difficult to obtain than the normal waivers of Article XXIV.

The definitions of CU and FTA under the GATT set additional requirements. For example, duties and other restrictive regulations between the participants must be completely eliminated, rather than merely reduced. Further, the total elimination of trade restrictions must apply to "substantially all the trade" between the constituent territories when the products originate in those territories. Perhaps the most important substantive requirement for a CU, an FTA, or an interim arrangement leading to either, is that the customs duties and other restrictions imposed against imports from non-member countries are not to be made higher or more burdensome.

The importance of the GATT relation, then, seems to be primarily that it requires members to have, at least some of the time, a global focus instead of a regional one. Thus, the compatibility of any U.S.-Canadian agreement with Article XXIV will probably be decided more on pragmatic than on legal grounds, *i.e.*, according to the real rather than the nominal effect on other countries. While coverage for sectoral agreements may be found under existing GATT provisions for free trade areas, or granted by a GATT waiver, an agreement between the two countries in one or more sectors will need to be reached first. This will require agreement on such things as: the definition of sectors; the tariff and non-tariff barriers to be covered by the bilateral agreements; the role of the states and provinces; and the significance of direct investment barriers. All of these issues will have to be addressed at some future point.

As noted, the GATT requirement of a CU or an FTA is to prevent the further proliferation of preferential trading arrangements which fall short of free-trade. One such arrangement, designed to aid developing countries, is the generalized system of preferences (GSP). In 1976 the U.S. became the nineteenth developed market-economy country to implement a national GSP program, and the recent GSP Renewal Act of 1984 extended this program for another eight years, until July, 1993.

The GSP is a program whereby duties on a range of products imported into the U.S. from developing countries (LDCs) are eliminated. The President has designated 114 countries and 26 dependent territories as eligible suppliers under the GSP. By eliminating U.S. import duties on about 3,000 product categories, LDC products are more competitive in the U.S. market, thereby enabling economic development via trade rather than aid.

Included in the GSP product categories are selected agricultural items; most wood and paper products; certain chemicals; and a broad range of manufactured and semi-manufactured articles. Certain products are statutorily excluded, such as: textile and apparel articles subject to textile agreements; import sensitive electronic, glass, iron, and steel articles; watches; and certain footwear. The President may also exclude other products determined to be import sensitive. The continued commitment of the United States to the GSP, and its efforts to achieve further integration of developing countries into the international trading system, may inhibit enhanced sectoral integration to the extent that the GSP provides preferential treatment and a competitive advantage to LDCs in certain articles that Canada may also wish to export to the U.S.

Another U.S. development program, the Caribbean Basin Initiative (CBI), seeks to use trade and tax measures to revitalize the economies of twenty-seven Caribbean Basin countries. The economies of this region are fragile and have been seriously affected by escalating costs for imported oil, declining prices for major exports, and shrinking export markets due to worldwide recession. In combination, these trends have led to increased political violence in the area, and the CBI is being implemented in the hope of restoring stability and prosperity to the region.

At the center of the U.S. program is a temporary extension of one-way, duty-free access to the U.S. market for the Caribbean nations. Duty-free access will be uninterrupted for twelve years, and will be extended to all products with the exception of textiles, footwear, petroleum products, leather goods, and canned tuna. Again, the CBI could inhibit enhanced sectoral integration to the extent that it provides a competitive advantage to Caribbean nations in sectors which Canada may wish to integrate with the U.S.

As a member of OECD, the U.S. has committed itself to pursue development policies beyond those which deal with the immediate requirements of economic recovery. In particular, OECD members have emphasized the importance of working with developing countries to help them strengthen and achieve greater stability in their export earnings. The GSP and CBI programs attempt to do precisely this. In addition to the GSP and the CBI, the United States concluded negotiations with Israel in February, 1985, on the establishment of a bilateral FTA. Ambassador Brock has proposed that an FTA also be negotiated between the U.S. and the ASEAN countries.

Israel has already concluded negotiations with the United States on its accession to the Government Procurement Code, and was formally accepted as a party to the Code in May, 1983. Accordingly, with respect to Israel, the President may waive, in whole or in part, the application of laws and regulations regarding government procurement which could result in less favorable treatment to Israel in the supply of such products than that accorded to U.S. suppliers or foreign suppliers who are parties to the Code. To the extent that Canada wished to integrate trade with the U.S. in the government procurement sector, agreements on government procurement such as that with Israel may also affect additional products for sectoral integration.

The U.S. is also committed to ensure that the provisions of its Friendship, Commerce and Navigation Treaties (FCN) are observed. Under these treaties, the U.S. must accord MFN treatment to the products of the other contracting nation in all matters affecting international taxation, sale, distribution, storage and use. As a result, the citizens or subjects of the contracting parties may enjoy the privileges accorded by either party to those of its most favored nations.

While the general design of the MFN clause is to establish the principle of equality of international treatment, thus requiring that U.S. concessions to one nation be extended to all nations with FCN treaties, the U.S. commitment to its FCN partners may not affect U.S.-Canadian sectoral integration. If the advantages accorded by either Canada or the U.S. to the other is by virtue of a customs union or free-trade area, the MFN clause in the FCN treaty shall not apply. The U.S. is required, however, to inform its FCN partners of its plans, and afford them an adequate opportunity for consultation.

A particularly thorny problem for future U.S.-Canadian trade relations is that any sectorally liberalized industry has to be a "global winner" in the long term. For example, the North American auto industry looked like a winner in 1965, but by the late seventies it became evident that comparative advantage was shifting. It is now fairly obvious that the U.S. and Japan will eventually have their own "AutoPact," and that the North American Autopact could become moribund. Whatever Canada's unit cost advantage relative to the U.S. might be, it is likely to be insufficient to alter the political economy leverage of the U.S. in persuading Japanese auto manufacturers to choose to site their North American facilities in the U.S. rather than Canada.

In the future, North American sectoral agreements should be considered only for those products where the reorganized continental market emerges with a long-running global comparative advantage. This will ensure that trade expansion effects are paramount, and that trade diversion effects are minimal. If agreements are concluded in those sectors where global advantage does not exist, or soon falls prey to the impact of new producers or products, than the agreement will surely come under both economic and political pressure.

Efforts to find ways to cope with a declining sector that has been liberalized across the two countries, but which retains a common set of external tariffs, are bound to lead to friction. Difficulties of this sort could easily trigger new reciprocity-type arguments; conflicting programs for industrial revitalization; and substantial dissimilarities in the future use of tariffs and other trade policy measures regarding third countries.