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STATES, PROVINCES, AND CROSS-BORDER INTERNATIONAL TRADE

*Carl Grenier**

Since I met Matt Schaefer a few years ago, I knew that he would do a very good job covering the whole ground and the theoretical aspects of this topic. I am not a lawyer. He did that much better than I could ever do it. So I have decided to focus on the Canadian angle and a practical approach to involvement by provinces in dispute settlement of trade disputes. I want to cover several points. How did Canadian provinces become involved in trade policies? Is it really a new phenomenon? It did not happen through disputes at first. It happened through trade negotiations. We have had at least two periods, the pre-FTA, pre-NAFTA period, and the period since. I am going to use the *Softwood Lumber*¹ dispute as an illustration, and provide some prescriptions for the future.

Matt did mention that the Canadian situation regarding the involvement of provinces is different from the U.S. situation, and indeed it is. But something that is very clear in the Canadian constitution is the fact that international trade is a federal matter. There was no ambiguity about this. I do not think any provinces have ever really contested that. There is also a celebrated case, the *Labour Conventions Case*² that goes back to 1937 which basically said that, in matters international, the provincial jurisdiction also carried. That is why, for instance, when Canadian delegations go to the International Labor Organization (ILO) in Geneva every year, there are provinces along. They have been along for quite a while. The same is true with education, for instance, and the Organization for Economic Cooperation and Development (OECD). So this is a well-established thing.

But in trade, usually the federal government has exclusive jurisdiction. In the pre-FTA, pre-NAFTA period, not only was it a federal jurisdiction, it was virtually a Minister of Finance monopoly, because we are talking about tariffs and quotas. So the Minister of Finance really dealt with this. This started to change in the early 1970s with the launch of the Tokyo Round. The Tokyo Round was launched in September of 1973. But in April of that year,

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¹ In the Matter of Certain Softwood Lumber Products from Canada, ECC-94-1904-01 USA; Memorandum Opinions and Order, 3 Aug. 1994.

² See Attorney Gen. Can. v. Attorney Gen. Ont. [1937] 1 D.L.R. 673 (P.C.)(Labour Conventions case).

the Quebec Minister for Trade, Pierre Pettigrew, and a bit later his counterpart in Alberta, called for the federal government to involve the provinces in the preparation for the upcoming multi-lateral trade negotiations.

Why did they suddenly do that? It was essentially because on the menu of the multi-lateral trade negotiations, there were non-tariff barriers for the first time. These non-tariff barriers included subsidies, non-technical barriers to trade, the standards, and the provincial procurement side. These, of course, were the sole purview of the central government, but they are also very much the business of provincial or state governments. And so this was the basic idea behind the call for provincial involvement in the preparations for the multi-lateral trade negotiations.

What the federal government did in answer to this call was to set up a deputy minister's committee which met twice a year to review the agenda of the negotiations, the progress of the negotiations, and to have a general exchange of views. This worked pretty well until 1985 beyond the multi-lateral trade negotiation, and since the Tokyo Round, which ended in 1979. It worked well because since this was the first time that these non-tariff barriers were being negotiated, the obligations did not go very far. So the provinces, which were constrained in some instances, notably in the subsidy area, did not mind much.

In that period, there were a few cases that I am going to mention. There was the Ontario sales tax rebate on cars made in Canada. Of course, most cars made in Canada are made in Ontario. And there was a five percent tax at the time. It stayed in place for about three months before Ontario desisted after the federal government intervened. A similar case occurred a few years later regarding gold coins. We were discriminating. And this, again, was an Ontario initiative, quickly followed by Quebec again, not to apply the sales tax to the Canadian gold coin. We were discriminating against South Africa, but this did not raise a lot of emotions in Canada, because South Africa was still a pariah state at that time.

Another case, which went to the dispute settlement phase, regarded wine mark-ups.³ In Canada, as in quite a few of your states, we have state monopolies on the sale of liquor and wine. The mark-ups are pretty steep. They were increased sharply in 1983. The European Community complained quickly, and we wound up at the GATT, and we lost. Not only did we lose on wine, but it also spread to beer.⁴

³ Canada-Import, Distribution, and Sale of Alcoholic Drinks by the Canadian Provincial Marketing Agencies, (1987-88) 35S B.I.S.D. 37 (Panel Report adopted Mar. 22, 1988).

⁴ United States - Measures Affecting Alcoholic and Malt Beverages (1991-92), 39S B.I.S.D. 206.

Things started to change in the mid-1980s. The reason it started to change was that the mid-1980s were a very fertile period for trade policy and trade negotiations in general. In 1983, the federal government came out with a trade policy review, the first one in many years which, among other things, called for the opening of negotiations with U.S. sectoral free trade negotiations. It was quite timid, but it was the beginning. And there were consultations with the U.S. government, which expressed interest during 1984, just prior to the election. Then, of course, we changed governments, and the new government was even more interested. You are familiar with the Shamrock Summit in Quebec and Mr. Mulroney and his letter to President Reagan in September of that year, which basically launched the free trade negotiations.⁵

To prepare for this within Canada, there were a couple of important meetings. Both took place in Halifax. First there was a ministerial meeting in September, and then in November there was a first minister's meeting. This was where the Mulroney doctrine of full provincial participation in trade negotiations, and education for settlement of trade disputes was enunciated. What was meant by full provincial participation? This first minister's meeting was really unprecedented. There were twelve of them over a two-year period. Also, there were supposed to be *ad hoc* ministerial meetings although only one was actually held. The Prime Minister and the premiers assumed control of this process. More importantly, in my view because I was a bureaucrat at that time, was Mr. Eastman's federal provincial committee monthly meetings, which went through the whole gamut of trade negotiations and subjects seeking provincial views. Most of the provinces were not shy to tell the federal government about their views on the federal approach. There were over twenty of these meetings and they were quite interesting.

The provinces recruited former federal trade negotiators and various senior officials. Quebec, for instance, recruited Jake Warren, who was a former Ambassador to the United States, a former Trade Commissioner, a former High Commissioner to Britain and a long-time trade negotiator himself. Ontario had Bob Latimer, who was former Assistant Deputy Minister of Trade for the federal government. Thomas Shoyama worked for Saskatchewan, and so on. So the provinces were well equipped to deal with the federal government, but not all of them used these consultants.

For instance, Ontario opposed the notion of free trade with the United States. It waited until the very last few weeks before making its position

⁵ See James Holbein, *The Administration of Chapter 19 Binational Proceedings Under NAFTA*, 5 U.S.-MEX. L. J., 57 (describing how the Shamrock Summit came about). See also Louis F. DeDuca, *Teachings of the European Community Experience for Developing Regional Organizations*, 11 DICK. J. INT'L L. 485.

known in these meetings. After the negotiations were over, the federal provincial meetings continued at the official level. Some provinces felt that the mechanisms that had been put in place by the federal government allowing provincial participation in the trade negotiations ought to be reflected in the implementation phase of these agreements. Of course, dispute settlement is very much a part of this.

So, in 1991, provinces met together without the federal government to codify the practices that had been put in place by the federal government. We came up with a document after approximately eleven months. Unfortunately, at the political level, that document did not go very far. The Minister of Fisheries, John Crosby did not want to accept that document. He did not want this document to become some sort of federal provincial agreement. An appeal was made to the Prime Minister, who turned it down. So this attempt at codifying federal provincial cooperation in the matter of trade negotiations and trade dispute settlements did not succeed.

After a few years and many attempts by the provinces, a best practices document was tabled at a Federal Provincial Meeting with officials in September 1998. This looked quite a bit like the initial document, but it came this time from the federal government. What it does is set out a series of practices. For instance, the federal provincial meetings, and there are many of them, hold an annual meeting of ministers responsible for trade. This is usually chaired by a province. There is an annual deputy minister's meeting. This is still going on. And there are quarterly meetings of a committee called C-trade. C is for Canada. This meets four or five times a year to discuss technical matters related to trade. An Internet trade policy has been set up to speed information exchanges. There are also provisions for trade negotiations. I will not go into this, but they are very similar to what I have already described.

Let us turn to the matter of trade disputes and see what is provided for here. The provinces are apprised as soon as a complaint has been lodged against Canada or by Canada. There are three territories now that are not provinces but are participants in these meetings. These views, therefore, are sought in a timely manner on an on going basis regarding the conduct of any proceeding. The federal government shares relevant documentation, such as submissions, interim reports, notices of appeal, and facility cooperation. This means that as a province or a territory you are in the next room. You are not at the table.

On a case-by-case basis, if a provincial or territorial measure is the focus of a dispute, which is often the case because of the importance of non-tariff barriers, the representatives of provinces and territories will be invited to participate in proceedings as a member of the Canadian delegation in the role

of technical advisors, observers and advisors who act in a silent capacity unless otherwise specifically requested by the head of the Canadian delegation. Circumstances may require limits on delegation size. And these provisions have been tested and have been used. Again, there are some weasel words that could be used to really restrict provincial participation. But by and large, they have not been used to that effect.

Next I would like to turn to the *Softwood Lumber* case as an illustration of provincial involvement in dispute settlement. It was mentioned yesterday by a couple of people that there are very old roots to this so-called problem. We came very near to a shooting war in 1832 over softwood lumber. Militia and regular troops were massed along the Aroostook River in Maine and New Brunswick. They did not shoot, but they came close. There have been disputes on and off about softwood lumber, but basically, starting from 1913, the stuff was going into the United States duty-free. The reason was clear. The United States has not been self-sufficient in softwood lumber production for over a century. There was an exception, of course, in the 1930s with the Smoot-Hawley Tariff where every tariff was hiked quite substantially, but then it came down again.⁶ Canada was one of the first countries to take advantage of the new legislation for bilateral agreements in 1935. So there was an agreement in 1935 and 1938, and the duties came down to zero very quickly.

We did not have much of a problem in the trade of softwood lumber for the ensuing decades. A very important change occurred in the United States, which helps explain why we started having problems in the early 1980s. The Department of Commerce took over from the Department of Treasury the settlement and oversight of trade relations between the United States and other countries. Of course, the reason is clear; the Department of Commerce is looking after U.S. industry the world over.

So in 1981 and 1982 there was a big recession, and a section 322 investigation of the Tariff Act was requested by some lumber producers of the Pacific Northwest. They were mostly smaller producers, dependent upon lumber from public land. When the price of lumber went up, they could not afford it. They could not cut it, and had to watch all those Canadian trucks of softwood lumber coming across the border. Of course, the trucks were coming because the lumber was needed. There was no way U.S. production could have been sufficient for U.S. needs.

The section 332 investigation did not conclude that there was a problem, but it did not stop the first coalition from bringing a complaint in 1983 and 1984. As you know, Canada won. The provincial involvement in that first

⁶ Pub. L. No. 71-361, 49 Stat. 590 (codified as amended as scattered sections of 14 U.S.C.).

case was quite different from how it is handled today. For instance, Quebec was sharing lawyers with British Columbia. The same lawyer was working for the industry and the government. This is no longer the case. We won the case in 1984, but it was not the end of the problem. It came back in 1986 under very different circumstances, even though U.S. legislation had not really changed. Canadian practices were virtually the same. The second investigation came when we were right at the beginning of the Free Trade Agreement negotiations. This played a large role in Canada's decision to settle out of court. We had the Memorandum of Understanding (MOU), which set an export tax of fifteen percent on Canadian lumber going into the United States – fifteen percent, which could vary province by province if stumpage rates were increased, or obligations on the company were generally increased.

This happened, for instance, in British Columbia less than a year after the MOU came into force. British Columbia raised stump rates by something like 600 million dollars overnight and went to zero export tax. Quebec did it in stages and was back to something like three percent when the MOU was terminated in 1991. Terminating the MOU in 1991 was perceived as a hostile act here, even though it was fully legal for Canada to do so, and less than five percent of lumber trade was still being held under the MOU. There was a letter signed by sixty senators. The United States and the U.S. Trade Representative (USTR) in particular, took very vigorous action.

We won this one essentially because of the new dispute settlement mechanism of the NAFTA. We won, and then we sat down a year and a half later and negotiated the *Softwood Lumber Agreement*. Why did we do that? For quite a few reasons: to include a billion dollars worth of leverage, for want of a better word, by the Department of Commerce. They were dragging their feet in reimbursing the money that was owed Canadian companies that had been paid during the countervailing duty investigation and appeal, a renewed threat of countervailing duty (CVD) by the Coalition for Fair Lumber Imports, a constitutional challenge of Chapter 19 in the United States by the coalition, and a very sharp case of battle fatigue in Canada. We had been fighting this battle for quite a while already.

I should have told you right from the beginning, of course, that I was not representing the Quebec government view here. I no longer work for the Quebec government.

What has this done? There have been a number of consequences to the *Softwood Lumber Agreement*. First, and this is what the home builders are really complaining about here in the United States, lumber prices no longer follow trends in the housing market. You can see before the case was settled in 1994, and just before the *Softwood Lumber Agreement* was negotiated, that

the trends in the price of lumber tracked the trends in the price of housing. This is no longer the case. The spikes are produced by the quota itself. There are quarterly quotas within the yearly quota. This is not good for anyone using lumber in the United States. We have lost a lot of business because of this. We estimate that, for the last four years, we would have sold upwards of 4.1 billion dollars worth of lumber. Our market share now would probably be somewhere around forty percent instead of the current share of less than thirty-four percent.

There has been a lot of money made because of this agreement, and this is why we think the problem will continue for quite a while. Just look at the estimated profit flowing from the *Softwood Lumber Agreement*. The five known members of the Coalition for Fair Lumber Imports in the United States have made a lot of money from a very modest investment. We estimate that they put in something like two to three million dollars a year on the average on this issue, and they are reaping profits of more than 300 million dollars a year because of the agreement. So there is no way that they are going to let go, and we assume that they will not let go.

Another result of the higher cost of wood, is increased integration of substitutes. For wood-based products, it is accelerating. For other products such as steel and concrete, it is also dramatic. In three or four years, we lost ten percent of the market share, and this includes U.S., and Canadian producers.

There has also been a shift in export production within Canada, because only four provinces are under constraint by the *Softwood Lumber Agreement*. The non-quota provinces were exporting about 1.6 billion board feet before the agreement, and only sixty percent of that was going to the United States. Now they are probably exporting 2.5 billion board feet, and just about everything is going to the United States, and why not? The price spread between Canada and the United States has widened. In 1995, just before the agreement, it was under \$20.00. Right now it is nearly \$100.00.

What we are aiming for here is a consensus between the lumber industry and the governments of Canada. This is not easy, a return to free trade at the expiry of the *Softwood Lumber Agreement*. There is intensive preparation for the next U.S. trade offensive, because we are quite sure there will be one. We are not adverse to consultations, although the last time we had consultations, they quickly turned into negotiations.

The way we are proceeding this time is quite different from what we have done in the past. We are building political support in the United States to avoid unilateral U.S. solutions, to influence the terms of any future U.S. trade action, because you can influence the terms of these actions, and to deal from a position of strength if it were necessary to negotiate at some point. Our

common goal, and this is true now of five provincial associations and the Free Trade Lumber Council, is to get back to free trade. And, as far as we are concerned, the quickest and least expensive way to get there is to let the agreement expire.

Why is it better to fight than to fold? We believe that due process is more likely to produce a fairer outcome than lopsided so-called negotiations on a sectoral basis. We know we can win. We have done it before, and we are able to make these legal victories stick the next time with the help of our U.S. allies. We also believe that as an industry, we should have more regard for our U.S. customers and our U.S. competitors. Canada is always better off when we rely on a rules-based dispute settlement system with the United States because of the size and power disparity. This was underlined many times yesterday in various presentations. The dispute settlement mechanisms that we have at our disposal are better than they have ever been, both under NAFTA and under the WTO. The time to negotiate, if we have to negotiate, is at the end of the process. That is, after final adjudication, not before.

What are the lessons for the future that we can draw from this and other cases? I think the first one is that the provinces will use their standing under Chapter 19.⁷ There is a big difference, between Chapter 19 and the WTO process where we do not have standing as provinces. The provinces will act in their own interest. That seems almost to go without saying, but I think it is useful to remind ourselves that indeed we will do that.

For instance, during the last dispute, the Maritime Lumber Bureau representing the Maritime Provinces industries issued a joint press release with the coalition blaming other provinces for their subsidies; quite an extraordinary thing to do. With Quebec's request for exclusion, successfully showed at the Department of Commerce level that there were no subsidies in Quebec. It is a market-based system.

The British Columbia log export ban was responsible for at least sixty percent of the 6.5% duty according to the Department of Commerce. But there is really no control on British Columbia, as there are regarding other provinces, to effect policy changes in that regard.

Increasingly, also, the national interest will be left to private parties to decide. The negotiation of an agreement like the *Softwood Lumber Agreement* clearly went against the general rule, which was free trade. Because the industry appeared solid in its support of that solution, the federal government negotiated it. Also, I think we have to remember that there is really nobody at the helm. That is, there is no one that looks after either the

⁷ North American Free Trade Agreement Between the government of Canada, the government of Mexico, and the government of the U.S., Dec. 17, 1992, Can. T.S. 1994 No. 2.32 I.L.M. 298 (entered into force Jan. 1, 1994). Ch. 19.

national interest in the United States or in Canada. So you better be prepared yourself to deal with this.

Our view of things is that you should litigate, not negotiate, on a sectoral basis. The only really useful negotiations that can happen between Canada and the United States on trade matters are negotiating on rules, either in the WTO or bilaterally, if we can do it. We should not step into the ring alone. We should know our friends and seek common action, common goals. This is what we are doing with the alliance that we have identified in the United States.

Finally, we should be prepared to live with the results of litigation, that is, pay the duty or cease and desist; change the policies in question. This is probably the hardest part and certainly seems to be the hardest part for the U.S. side, as well. I think we will have continuing complaints about softwood lumber. It is the same in other fields. Wheat was mentioned yesterday. They had eight investigations in ten years. This is not conscionable, but, as I said, I do not think anyone really is in charge of the process.

