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# External Commitments of Canada Affecting Possible Additional Sectoral Integration\*\*

by *Frank Stone\**

## I. INTRODUCTION

I shall discuss four major points in these remarks. The first will be a review of certain relative aspects of Canada-U.S. trade relations. The second is the Quebec Declaration and where that may lead. The third is the GATT and constraints outside of the GATT which will bear upon a new Canada-U.S. trade arrangement. And the fourth is how to proceed, within the context of our international obligations, in putting a new bilateral arrangement into place.

## II. CANADA-U.S. TRADE RELATIONS

What are the important elements of the Canada-U.S. trade relationship as it has developed, particularly since World War II? We see a blend of multilateral and bilateral elements. Multilaterally, there is the GATT, the General Agreement on Tariffs and Trade, which is not only a multilateral set of obligations for both Canada and the United States, but is also the main Canada-U.S. trade agreement in a bilateral sense. The GATT rules were originally designed (and to some extent elaborated and refined, during the Tokyo Round) partly in the light of a number of Canada-U.S. problems. The rules on antidumping, and those on countervailing duties, were partly developed because of Canada-U.S. issues. To an extent, then, the GATT rules and the Tokyo Round Codes are rules which govern bilateral trade.

There are other elements in the GATT beyond the rules. It has been a framework for reducing and removing trade barriers not only on a global basis, but also on a bilateral Canada-U.S. basis. The Canada-U.S. negotiations at successive GATT rounds have been very important parts of those discussions. The GATT has, in part, been a major means by which Canada and the United States have reduced tariffs on cross border trade since World War II.

Other elements in the GATT are of interest in a bilateral sense. The GATT embodies procedures and rules for the resolution of disputes aris-

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\*\* Remarks given at Conference.

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ing out of the GATT system. Canada and the United States have used those procedures to deal with and settle a number of bilateral trade disputes. The GATT also has a framework for committees, where Canadian and American trade policy officials meet regularly. Canadians and Americans are talking to each other not only in the meeting rooms, but in the corridors, dealing with bilateral problems. It has been a very important framework for Canada-U.S. consultations over the years.

Finally, the GATT has a certain capacity for doing research, assembling information and publishing reports. Now, these are not often on the subject of Canada-U.S. trade issues; they are more often on the subject of global trade issues. Nevertheless, the work in the area of research and analysis provides a useful, global framework within which the two countries can see and deal with their bilateral issues.

What are some of the strictly bilateral elements? After the great Reciprocity Treaty came to an end in the middle of the nineteenth century, there was the curious situation that for seventy years there was no trade arrangement between Canada and the United States. There was no formal, legal trade agreement at all. Although they each had MFN treaties with a number of other countries, when it came to bilateral trade they charged each other the highest possible tariffs. And these were very high indeed, especially during the 1920's and 1930's.

That situation was turned around after the Reciprocal Trade Agreements Act of 1934. The two countries then concluded two trade agreements which established, for the first time, an MFN relationship, made rules governing bilateral trade, and lowered tariff barriers. Those trade agreements were incorporated into the GATT. It has been the main trade agreement between Canada and the U.S., though not the only one.

There are a few other bilateral agreements, or arrangements, between the U.S. and Canada. There is a less structured agreement, covering the procurement of defense goods—a defense sharing arrangement—which has evolved since the meeting at Hyde Park between President Roosevelt and Prime Minister King. And, there is an understanding on the licensing of controlled strategic exports, by which Canada is treated differently under U.S. law. And there is an understanding on safeguards, which was concluded a year ago, that elaborates on the GATT rules with respect to advanced consultation when one country takes safeguard measure that effects the imports from the other. That is about the whole list and it's not very long. It is curious how few bilateral arrangements there are between two countries with such an enormous and complex pattern of trading relationships.

The relationships between Canada and the United States are perhaps unique in trade related areas. They are wide open; they are informal; they are continuous. They involve the federal governments, the state governments and the provincial governments. They involve private sector interests of all kinds, manifested through diplomatic channels—or on the telephone between departments in Washington and Ottawa.

There is a curious absence of any kind of formal arrangement for consultation or for resolution of disputes. There is the Canada-United States Ministerial Committee on Trade and Economic Affairs. It was operative for a number of years from the mid 1950's through 1970, but has not met since. And no one seems to regard its inactivity with any particular concern—business goes on as usual, perhaps even better. But the question of these institutional relationships will undoubtedly be looked at again and considered in the context of a new and more comprehensive bilateral trading relationship.

There are, in addition, a few special trading relationships which both Canada and the U.S. have. The U.S. has special relationships with the Caribbean countries, Israel, and some developing countries. Canada has essentially the same arrangements for tariff preferences for developing countries. It also has a few other special relationships such as the agreements with Australia and New Zealand. We have a separate trade agreement with the Soviet Union, with China, with Mexico and a few other countries that are outside of the GATT. These could not be entirely ignored and will have to be looked at in the context of negotiating a new and broader bilateral arrangement with the United States.

### III. THE QUEBEC DECLARATION

What will a new and broader bilateral relationship with the United States look like? We do not know. We have an indication in the declaration that was signed by the President and the Prime Minister at their meeting in Quebec City on March 17-18, 1985. The two leaders agreed on the objective of removing, or at least reducing, tariffs and other barriers to cross-border trade. They called for a report in six months on all possible methods to achieve this.

They have also committed themselves to halting protectionism in cross-border trade in goods and services. But it seems to me that, even since then, there have been a few elements of protectionism that have crept into the relationship and, of course, there were quite a few on the books already. We do not know to what extent that commitment will be held. Our leaders over the past few years have become very well accustomed to halting protectionism in the GATT, in the Summit meetings, etc., but protectionism seems to grow nevertheless.

Two other things came out of Quebec. They announced a commitment to find measures of resolving a certain number of particular bilateral irritants. And they said that over the next year action would be taken to liberalize and facilitate mutual trade in a number of very important areas: government procurement, air travel, tariffs, energy products, high technology goods, intellectual property rights, and some others.

Although they announced this very impressive and ambitious program for dealing with bilateral trade issues, it should be remembered that they are going to go forward with these bilateral efforts in a manner con-

sistent with their international obligations, and consistent with the respective legislative requirements. There was no suggestion that these bilateral efforts would lead to a free-trade area or customs union or even a comprehensive Canada-U.S. trade arrangement. We really do not know what the two governments have in mind. We will have to wait for the report and, on the Canadian side, until the current process of consultations with the provinces is completed.

It seems, however, that many questions can be asked about accommodating any new bilateral arrangement. We do not know yet, for example, how the bilateral negotiations are going to be structured. Will they be blended with another GATT round? Hopefully, they will go forward on a bilateral basis and get started without waiting for any new GATT round, which can be fairly slow going—it took seven years to get through the Tokyo Round.

#### IV. THE GATT AND CANADA-U.S. TRADE

We do not know whether we are going to end up with a broad, comprehensive Canada-U.S. trade arrangement; or whether this would have to be embodied in trade agreement supplementary to the GATT. We cannot yet foresee the problems of accommodating a new Canada-U.S. trade relationship within the GATT rules. Nor will concern be only with the GATT rules; there are other relationships, both within the GATT and outside of it, with other countries, which go beyond the formal rules.

The GATT has been able to accommodate, or tolerate, quite a large variety of regional and preferential trade arrangements. The basic principle is most-favored-nation. This is called unconditional but, of course, it is unconditional only among the GATT countries, it is not unconditional when it comes, for example, to Mexico. And there have been all kinds of exceptions. There is an exception written into the GATT itself: the Article XIX provisions which are in fact rights, not really exceptions to the GATT at all.

Member countries of the GATT have the right to form customs unions, free-trade areas. Other countries do not have the right to retaliate, or even to object, if the arrangements concluded by two or more countries conform to the Article XIX criteria. Of course, of the ones that have been made, few of them have been found to conform to the strict letter of the Article XIX rules. The GATT contracting parties looked at the European Economic Community in great detail over a long period of time. They looked at a series of so-called free-trade areas or customs unions, especially among the groups of developing countries. Few, if any, were found to be fully consistent with the GATT Rules and Article XIX. Nevertheless, they have continued to operate.

The problem with the GATT is that if countries make preferential arrangements in conformity with Article XIX, outside countries find it

difficult to challenge policies which may be damaging to their interests. The Europeans, in fact, said exactly that when the United States, Canada, and Japan complained about the rules of origin, which were changed to make them more restrictive. The Europeans refused to discuss these in a legal sense within the context of the GATT. That is one effect of Article XIX: since Article XIX is a matter of right, the arrangements that are claimed to conform under Article XIX are difficult to challenge by outside countries.

Article XIX was inserted into the GATT partly to accommodate plans in Europe for some type of integration. It was extended to cover free-trade areas and customs unions, to accommodate a possible Canada-U.S. free-trade arrangement. Article XIX today has been used largely to accommodate the process of European integration. And secondly, to accommodate special arrangements between developing countries. It seems now the United States is going to tell the contracting parties that the arrangements with Israel and the Caribbean conform with Article XIX. If that happens there will be a working party in the GATT and other countries will be certain to have a close look at those arrangements.

#### V. ALTERNATIVE METHODS FOR A BILATERAL ARRANGEMENT

Since we do not know what a Canada-U.S. trade arrangement is going to be like, it is difficult to come to a conclusion now as to whether we have an Article XIX situation or not. Nor am I sure that Article XIX is exactly the model we want for a future arrangement. There are other ways of accommodating arrangements in the GATT. There is the Article XV waiver. Canada has only used that once, in a very technical way. The United States has used it to cover its position under the Canada-U.S. Automotive Agreement. It has been used to cover other arrangements between Asian countries. But these waivers are not easily obtained. First, you need the approval of a two-thirds majority of the GATT contracting parties—which is not easy to get. Also, the GATT contracting parties can attach conditions as a price for granting a waiver.

Another possible way of accommodating arrangements of a preferential kind within the GATT is through the process of a conditional MFN. This was an important legal feature of some of the Tokyo Round codes. The rights and obligations involved in an agreement are assumed only by the signatory countries, and not automatically extended to all of the GATT contracting parties. However, a good legal case can be made that, if countries do apply conditional MFN treatment under these Codes, they would be in violation of Article I of the GATT. I do not know if there has actually been a challenge on conditional MFN, but it is another possible method of concluding Canada-U.S. arrangements.

There is a newly issued report by a group of experts which was appointed by the Director-General to study the current issues involving the GATT. Among other things, it suggests that in the context of a new

round the Article XIX rules might be reviewed, with a view to making them tighter. The report states the GATT rules on customs unions and free-trade areas should be examined and redefined in order to avoid ambiguity. It states further, that they should be more strictly applied, so that this legal cover is available only to countries which genuinely use it to establish free-trade among themselves. The rules should not be undermined by grants of waivers which allow discriminatory arrangements by other means.

## VI. CONCLUSION

I do not think it should be assumed that a new Canada-U.S. trade agreement, involving important elements of preference, would have an easy ride through the GATT, even though the Europeans and the developing countries have made free-trade arrangements. For the two largest trading countries in the world to conclude an arrangement with important elements of preferences might be seen by the Europeans, the Japanese, the Latin Americans and others, as damaging their trading interests.

At the present time there is no need, indeed it would be quite unwise, for the two governments to base their strategy to create a free-trade area, or a customs union, on a model conforming to Article XIX. Those issues should await the outcome of bilateral negotiations. And if there is a new GATT round, surely there would be elements of a bilateral arrangement within the multilateral negotiations. Undoubtedly there will be elements, in any ambitious Canada-U.S. trade arrangement, which would go into areas not covered by the GATT, such as services.

Rather than proceed in the context of a legal model, I suggest it would be well to examine and analyze in more detail the uniqueness and special nature of the Canada-U.S. relationship which sets it apart from the relationships among the European countries or the Australians and New Zealanders. What are these elements? To what extent will they require unique, special bilateral arrangements? And how can these bilateral arrangements be accommodated within the broader trade system, and within the GATT, to create an agreement which will give rise to the minimum friction with our trading partners?

In making agreements with Canada, the United States, because of its larger role and authority in the world, may look without too much apprehension towards its other trading partners. I am not sure that Canadians can or should be equally relaxed. We have extremely important trade relations with the Europeans, with the Japanese, and with the developing countries. The Canadian government and Canadian businessmen will want to expand on these. We may, therefore, be more exposed to pressures from our other trading partners, who tend to be larger countries than Canada. These pressures will have to be taken into account

differently than they would be in Washington. It is at least something to think about.

Thank you.

