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The Impact of U.S. Export Controls on Trade Between Canada and the United States

*by Jonathan T. Fried**

The manner in which Canadian and American export controls converge and diverge can only be considered against a background understanding of each of the two systems. Mr. Downey admirably has outlined the complex system of U.S. export controls. Let me attempt to provide a similar overview of the Canadian regime.

The economic relationship between Canada and the United States is unique in the world. No other two trading partners approach the volume of cross-border trade between the two countries. The United States accounts for over three-quarters of Canada's exports. Canada, in turn, or more specifically Ontario, is by far the United States' largest trading partner. Despite this daily and massive flow of goods and technology across "the longest undefended border in the world," scant attention has been paid to the relationship between the respective export control regimes of Canada and the United States.

CANADIAN EXPORT CONTROL LAW AND PRACTICE: PURPOSES

Controls on the export of goods (and technology in material form) from Canada derive principally from the Export and Import Permits Act. As provided for under Section 3 of the Act, Canadian export controls serve a variety of purposes.

First, controls may be imposed to ensure that military or strategic goods will not reach a destination "wherein their use might be detrimental to the security of Canada." This "national security" basis for controls is common to Canada and our western allies. It not only allows Canada to fully implement its COCOM obligations, but provides the administrative flexibility necessary to permit the application of certain foreign policy-based controls as well, a point to which I will return shortly.

Secondly, controls may be imposed to implement an intergovernmental arrangement or commitment. This provision, in fact, provides the legislative basis for the imposition of Canadian controls over U.S.-origin goods not otherwise controlled. It has also allowed Canada to join in concerted international action, such as occurred when Canada and the European Community agreed to the imposition of limited sanctions

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against Argentina in response to its military action in the Falklands-Malvinas.

Finally, the Act permits the imposition of controls based on economic considerations, such as respecting the processing in Canada of Canadian natural resources or respecting situations of surplus supply and depressed prices. While limited controls based on these grounds are important when the subject of steel or softwood lumber is considered, I do not intend to address this aspect of the Canadian system further here.

THE ECL:

The Act authorizes the Governor in Council, that is, the Cabinet, to establish a list of goods that he deems it necessary to control for any of the purposes I have outlined. This list is known as the Export Control List, or ECL. This list is divided into ten major "Groups," within which are contained a series of more specific "Items."

Group 1 concerns animals and agricultural products. Controls over export of animals are based largely on Canada's international obligations under the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES). An additional item prohibits the export of ships and equipment used in whaling. Pancreas glands are controlled to ensure an adequate supply of insulin in Canada. Regarding agricultural products, sugar exports are controlled on the basis of an intergovernmental arrangement between Canada and the United States negotiated in 1983 in the wake of the U.S. imposition of sugar import quotas.

Group 2 concerns wood and wood products. Given shared federal and provincial jurisdiction over logs and logging, administrative procedures have been developed to ensure that only logs deemed surplus to domestic requirements are authorized for export.

Groups 3 through 8 are based principally upon International Lists established in COCOM. Based on national security considerations, Canada, along with its NATO partners (except Iceland and Spain) and Japan participates in this international arrangement, known officially as the "Coordinating Committee." COCOM's purpose is to maintain multilaterally agreed controls on the shipment of military and strategic goods and technologies to proscribed destinations.

Within the COCOM forum, International Control Lists, namely, industrial, munitions, and atomic energy lists, are established that define goods and technologies considered to be strategic. Groups 3 through 6 of the ECL are almost entirely based on the COCOM Industrial List. Exceptions include Canadian coins (controlled since the era of base metal prices that exceeded the value of the coinage), scrap steel (since World War II) and specialty steel (to ensure the orderly marketing or voluntary restraint of exports when necessary), a metal ore called cesium (in response to concern over possible Soviet stockpiling), and certain precur-

sors to chemical weapons (added after agreement with our allies over the risk of chemical warfare).

Group 7 reflects the COCOM Munitions List. Group 8 fulfills not only our COCOM Atomic Energy List obligations, but those derived from other international arrangements, such as the "Nuclear Suppliers' Guidelines," as well.

Group 9 controls U.S.-origin goods, a point to which I will return in detail.

The export from Canada of technical data in material form, including computer software (which relate to equipment or materials described in Groups 3 to 9 inclusive), require export permits unless available to the public under Group 10.

THE ACL:

In addition to the ECL authorized by Section 3 of the Act, Section 4 authorizes Cabinet to establish a list of countries, called the Area Control List or ACL, including any country to which it is deemed necessary to control the export of any goods. Thus, permits are required for the shipment of most goods, whether appearing on the ECL or not, to countries mentioned on the ACL. The ACL includes Albania, Bulgaria, Czechoslovakia, the German Democratic Republic and East Berlin, Hungary, Poland, Rumania, the USSR, Mongolia, the Democratic People's Republic of Korea and Vietnam. On January 10, 1986, Libya was added to the ACL for certain goods. Controls that apply to exports of strategic goods to Act countries with the exception of Libya and to the People's Republic of China (which was removed from the ACL in 1981) are based on national security considerations and also derive from COCOM agreement.

LICENSING:

The net effect of the Act, the ECL and the ACL is to control the export of strategic goods to all destinations (with the exception in most cases of the U.S., a point to which I will return), and to control the export of most all goods, whether or not strategic, to ACL destinations. Thus, while certain goods and destinations are not covered by the Act, there is an initial onus on a Canadian exporter to determine whether the goods to be exported are covered by one or more of the Items of the ECL or are destined for an ACL country. If so, then under Section 7 of the Act, an export permit is required.

The Act gives to the Secretary of State for External Affairs the discretion to issue or deny a permit on such terms and conditions as he sees fit. Section 10 provides the Minister with discretion to amend, suspend, cancel or reinstate any permit issued. The "Notice to Exporters, Serial No. 21," set out the procedures for applying for and obtaining an export permit. The Minister has designated the Special Trade Relations Bureau

of the Department of External Affairs as responsible for the administration and processing of permit applications.

FOREIGN POLICY CONTROLS:

Within the proper ambit of his discretion, the Minister on behalf of successive Governments has adopted a restrictive policy respecting exports of military, military-related and strategic equipment. This policy is based on the principles that such equipment should not be supplied to countries considered as representing a military threat to Canada; to countries involved in hostilities or where there is an imminent threat of hostilities; or to those countries to which United Nations resolutions forbid the export of arms.

Thus, in 1980, in the wake of the hostage taking in Iran, the government of the day passed the Iranian Economic Sanctions Act. No regulations were promulgated under this legislation; however, again pursuant to Ministerial discretion, export permits were denied on a wide range of goods under the Export and Imports Permits Act, and Iran was temporarily added to the ACL.

Again, in 1982, supported by an Exchange of Notes with the European Community, Canada imposed an arms export embargo (as well as an import ban) against Argentina in response to its action in the Falklands-Malvinas within the terms of the Act.

In addition, the Government of Canada has fully implemented the United Nations Security Council resolution calling for a mandatory arms export embargo to South Africa by denying permits for any exports of such goods to South Africa. Pursuant to the Accord of Commonwealth Heads at Nassau in October, 1985, Canada tightened its application of the embargo by restricting exports of ECL controlled goods; that is, there were restrictions of sensitive equipment, such as computers to the police, the armed forces, and other South African departments and agencies involved in the enforcement of apartheid.

Regarding Libya, while the general regime of export controls had long had the effect of prohibiting the export to Libya of all military goods and strategic goods such as civilian aircraft, on January 10, 1986, the Government decided that it had become necessary to control the export of oil drilling equipment to Libya, and to deny those exports, especially when they contain unique Western technology. This was achieved by placing Libya on the ACL in respect of specified categories of goods.

OTHER POTENTIALLY RELEVANT LEGISLATION:

While the Export and Import Permits Act is clearly the most important legislation in Canada for controlling exports, it is by no means the only one. I have already mentioned the Iranian legislation. In response to the unilateral declaration of independence in Rhodesia, the Security Council adopted a resolution which determined the situation to be a

threat to international peace and security and imposed mandatory sanctions. Canada first established the United Nations Rhodesia Regulations under the authority of the United Nations Act during February 1967, to implement restrictions on imports and exports from that country. These regulations were superseded by the United Nations Regulations of December 1968.

In addition, there are numerous acts, such as the National Energy Board Act, the Canadian Wheat Board Act, and others, which contain provisions pertaining to controls on certain categories of goods for export. These regulatory regimes do not concern us today.

THE FRAMEWORK FOR THE CANADIAN-U.S. EXPORT CONTROL RELATIONSHIP:

The framework for the Canada-U.S. export control relationship is provided at both the multilateral and bilateral level. Multilaterally, in the immediate post-war era, as disagreement and misunderstanding between East and West increased, a system of informal agreement on parallel controls was instituted amongst the allies to ensure that items of export denied to Eastern Europe by the United States could not be procured from Western Europe. In November, 1949, after adoption of the Export Control Act by the United States, a somewhat more formal strategic control system was established by seven countries organized into a "Consultative Group." Shortly thereafter, Canada and others were included, as were other NATO members. A permanent working committee of the Consultative Group was established in Paris under the name of the "Coordinating Committee," and soon the entire organization became known by the working committee's acronym, COCOM. Canada's bilateral cooperation with the United States, however, pre-dates the COCOM system.

At the conclusion of conversations held at Hyde Park, New York, on April 20, 1941, President Roosevelt and Prime Minister MacKenzie King issued a Declaration Regarding Cooperation for War Production. The general principles enunciated in what has come to be called the "Hyde Park Declaration," recognize North America as a single, integrated defense industrial base.

In fact, Canadian strategic export controls had been introduced at the beginning of World War II under the authority of the War Measures Act in order to prevent the shipment of goods to enemy countries, either directly or through third countries, and to ensure that supplies of strategic materials adequate to meet the needs of Canadian industry were retained in Canada. The Hyde Park principles effectively ensured an export license or permit free environment, to allow each country to "provide the other with the defense articles which it is best able to produce, and, above all, produce quickly . . ."

After American entry into the War, a Joint Production Committee

(later called the Joint War Production Committee) was formed. The Committee's statement of policy reaffirmed the Hyde Park principles and called for the suspension of legislative and administrative barriers which might impede the free flow of necessary munitions and supplies between the two countries.

An Exchange of Notes of November 30, 1942 constituting an Agreement Respecting Post-War Economic Settlement reaffirmed the Hyde Park principles. In May, 1945, the two Governments exchanged Notes accepting a U.S. proposal that the general principles of the Hyde Park Declaration continue to be accepted "on a fully reciprocal basis for the remainder of the war and that the same spirit of cooperation between the two countries should characterize their treatment of reconversion and other problems of mutual concern as the transition to peace time economy processes."

From 1945 onwards, first under the War Measures Act and subsequently under the first Export and Import Permits Act passed in 1947, the Canadian ECL normally contained all of the items included in the U.S. Department of Commerce Positive List. When in the late 1940's the U.S. added a larger number of items to their list, Canada decided to ensure that the export of all of these items to all sensitive destinations was covered by adding the ACL and a foreign origin goods item. By Order in Council of December 29, 1949, a new Group 9 was added to the ECL to cover all goods originating outside Canada, exported without further manufacture, except for goods in transit, in bond, or goods consigned to the U.S. and not otherwise included in the ECL.

An Exchange of Notes of October 26, 1950 gave "Formal Effect to the Statement of Principles for Economic Cooperation," i.e., the Hyde Park Declaration. And in 1954, Group 9 was revised to language similar to that of Item 9001 today.

Taken together, implementation of the principles inherent in the Hyde Park Declaration and reaffirmed and given formal effect in subsequent agreements was, as mentioned, a common external export control structure respecting strategic goods. Exports between the U.S. and Canada were to be exempted from the application of export restrictions, in recognition of the integrated defense industrial base constituted by our two countries. Each country in return would be expected to control the re-export of goods originating in the other country, to avoid one country becoming a "back door" for exports of the products of the other.

The concept of an integrated North American Defense Industrial Base, given formal effect in the 1950 Exchange of Notes, has received further affirmation in a continuing series of agreements, understandings and declarations. In 1956, the U.S. Department of Defense and the Canadian Minister of Defense Production recorded an administrative arrangement confirming joint defense production sharing arrangements. In June, 1963, a Memorandum of Understanding confirmed the Defense Production Sharing Program. And in November, 1963, a Memorandum

of Understanding on Defense Development Sharing Arrangement was signed. Most recently, at the Quebec Summit of 1985, President Reagan and Prime Minister Mulroney reaffirmed their shared and collective responsibility for the maintenance of North American Defense in a "Security Declaration," and further reaffirmed the commitment of the two countries to removing restrictions on the flow of goods between the two countries necessary for the defense of the continent.

Item 9001 implements these long-standing principles of bilateral economic cooperation. In exchange for U.S.-origin goods entering Canada without the necessity of a U.S. export license, the export of U.S.-origin goods from Canada, "except any such goods that have been further processed or manufactured outside the United States, by combining them with other goods or otherwise, so as to result in a substantial change in value, form and use of the goods or in the production new goods," require a Canadian export permit. The terms of Item 9001 specify that goods listed in another Group on ECL are to be controlled in any event. Item 9001, therefore, ensures that U.S.-origin goods not otherwise controlled by the ECL are subject to Canadian export permit requirements.

Item 10003 ensures that technical data in material form "that can be used in the design, production, operation or testing of equipment and materials described in Groups 3 through 9" is controlled. Thus, technology in material form related to U.S.-origin goods is also governed by Canadian export controls.

THE ADMINISTRATION OF THE CANADA-U.S. EXPORT CONTROL RELATIONSHIP —COOPERATION

Canada cooperates closely with the United States to ensure that our obligations pursuant to the principles inherent in the Hyde Park Declaration are fulfilled. Close working relationships pervade the administration and enforcement of strategic export controls, against a backdrop of continuing more general consultations.

Under Item 9001, Canada controls the export of 100% U.S.-origin goods and technology exported from Canada. The export of 100% U.S.-origin goods from Canada is approved or refused based on U.S. controls in effect at the time of the application for a Canadian export permit. Thereby, no transshipment or diversion of U.S.-origin goods through Canada is permitted.

In the case of Canadian produced goods using U.S.-origin components, Canadian export control officials must judge the extent to which the U.S. origin components have substantially changed "in value, form and use . . . in the production of new goods." If the percentage of U.S. content is substantial, the export will be treated as being of U.S. origin.

In the case of Canadian goods produced from 100% U.S.-origin technology, a decision to authorize exports to third countries is based

solely on Canadian law and policy. However, the technology itself, that is, technical data in material form, whether strategic or not, is controlled on the basis of U.S. law and policy as a result of the net effect of Items 9001 and 10003.

Thus, in the case of U.S.-origin goods which meet the test of 9001, the test applied in granting an export permit is whether U.S. authorities would allow such a shipment if exported directly from the United States. If the U.S. would not allow the export, the permit application is refused. Canada recognizes that Canadian residents wishing to re-export U.S.-origin goods which have not yet entered Canada from the U.S. at the time of application for an export permit are required to obtain a U.S. export license through the U.S. supplier. In such a case, an export permit would not be issued without a copy of the U.S. license or a statement by the U.S. supplier that an export license is not required.

In sum, the Canadian regime respects U.S. national security and foreign policy considerations. When an application for an export permit is received for U.S.-origin goods which are present in Canada, Canadian officials first judge the proposed export on the basis of Canadian law and policy. If there are no concerns in this regard, officials then look to U.S. law and policy. They issue or refuse an export permit on the basis of U.S. export control criteria.

I understand that if Canadian officials are unsure of the U.S. Government's position on a specific export, they consult with their U.S. counterparts and make their decision on the basis of these consultations, which may take place either formally in writing or informally by telephone.

Cooperation in enforcement also pervades our bilateral export control relationship. In Canada, both Revenue Canada (Customs and Excise) and the Royal Canadian Mounted Police have investigative and enforcement responsibilities related to the Act. Both work closely with the U.S. Department of Commerce, the F.B.I. and other U.S. enforcement agencies in the investigation of specific cases and regarding more general aspects of cooperations. And of course the Canadian Department of National Defense maintains daily liaison with the U.S. Department of Defense.

To ensure that this cooperation in administration and enforcement of strategic export controls is maintained, Canadian and U.S. officials from responsible departments and agencies on both sides of the border meet semi-annually at the senior officials level to review the general state of play. These consultations play an important role in anticipating areas of concern and in improving the effective fulfillment of the Hyde Park principles for maintaining our open border while preserving our mutual security interests.

Over and above this wide range of bilateral cooperation, Canada and the United States cooperate closely through their respective participation

in and implementation of COCOM obligations. Under the COCOM system, goods enumerated in the Industrial or Atomic Energy Lists may be exported to civilian consignees if it is determined that there is no strategic risk involved. This decision is taken either by the entire COCOM Committee or by the COCOM member government concerned. If the goods in question are identified within one of the "administrative exceptions" in the COCOM lists, their export to a proscribed destination may be authorized by the COCOM member country. Should the "administrative exception" provisions not apply, the goods are classed as "general exception" and their export may only be approved following a submission to COCOM. A "general exception" request submission to COCOM must receive the unanimous approval of all COCOM members before the export may be approved by the national authority concerned.

The United States, Canada and our COCOM partners have recognized the necessity of controlling unauthorized diversions or transshipments of sensitive goods to countries which may pose a risk of diversion to proscribed destinations. To deal with this problem, a cooperative system has been instituted which requires that International Import Certificates (IC) and related Delivery Verification Certificates (DV) be provided in support of certain exports. For those countries which do not participate in the IC-DV system, End-use Certificates or Import Licenses may be required in lieu thereof.

