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Roger Phillips

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The Business Perspective: Cross Border Views

*Roger Phillips**

By way of background, let me briefly review the Free Trade Agreement in terms of what it accomplished for Canadian business.

First, it provided that all tariffs between Canada and the United States would drop progressively over nine years to zero, with many items being reduced on an accelerated basis over four years, and some immediately. This was an essential move, of course, in any Free Trade Agreement.

Other aspects of the agreement dealt with special rules which would apply to agriculture, wine and spirits, automotive trade, energy and financial services, and government procurement. In addition, Canada agreed to relax its rules with regard to review of the establishment of new businesses and the acquisition of existing businesses which had been covered under the nefarious Foreign Investment Review Act. There was relaxation with regard to the ability for temporary entry of persons on a reciprocal basis for business purposes and of course there were institutional provisions with regard to how the overall agreement would work.

In addition, it provided that a working group be established between the two parties which would negotiate, over a period of five to seven years, a substitute system of laws for antidumping and countervail duties. In the meantime it was provided that industries or companies could appeal to special bi-national panels if they believed they were being unfairly treated by an anti-dumping or countervail decision. In my subsequent analysis of how this provision has worked I shall further explain the rules which govern the operation of these panels.

The provision for such panels was necessary because agreement on two major questions was not reached during the FTA negotiations. One question was the so-called "subsidy" issue. Under the rules of GATT, the General Agreement on Tariffs and Trade, a country cannot use subsidies, broadly defined, to underwrite its exports and injure directly the domestic industry of the country receiving these exports. Further, if they are found so doing the injured parties can impose "countervail" duties on the offending products, designed to negate the effects of a GATT-illegal subsidy.

Where the problems comes, and came under the FTA discussions, related to:

- (a) What is a subsidy?

* President, C.E.O., IPSCO, Inc. (Regina).

- (b) How, if you can agree on a definition, do you determine the amount of subsidy, and whether it caused the injury?

Under existing legislation most countries have given themselves a pretty free hand in answering these questions. Many believe that, in providing its own answers, U.S. legislation permits the use of countervail as a protectionist measure. Countervail duties had been imposed by the United States on imports from Canada only six times in the ten years preceding the FTA.

And the percentages involved were not significant. *But* Canada had settled, out of court as it were, a potential countervail duty imposition on softwood lumber in late December 1986, with lots of publicity and lots of politics, even though to this day we will never know, had we let the case proceed, would any countervail duty have been imposed at all. Sensitive to capital "P" politics the Canadian government wished to get this issue resolved in the free trade negotiations and made some innovative proposals. The bottom line, since no mutually acceptable solution had been arrived at, was to provide for further negotiations on the subject. I shall return to this subject later.

I mentioned two major questions which were not resolved in the FTA negotiations. The second was what would happen to anti-dumping measures once free trade were achieved. Dumping is often lumped in with subsidies in the minds of Canadian politicians and external affairs officials and the ease with which dumping gets swept into the same bag proves to me, at least, why we need a fully separate trade department composed of trade specialists, not career diplomats.

Let me spend a few minutes giving you a layman's explanation of what dumping is, and how the concept of anti-dumping laws originated. When two countries agree on a set of mutually acceptable tariff schedules, that is what one will levy on various goods received from the other, and vice-versa (not necessarily identical schedules, please note), the idea is that the tariffs will render the goods more expensive in the receiving country, giving the domestic producers a measure of protection. But what if the selling country merely drops its prices by an amount comparable to the duty, making the protection negotiated as a tariff worthless? The answer was the development of so-called anti-dumping remedies.

Dumping was defined as selling a product in an export market at a price, netted back to the originator's factory door, below the price received in the domestic market. Let us say my F.O.B. factory price in Canada is \$100 per dozen widgets. In order not to dump in the U.S. I would have to sell at \$125/dozen made up of \$100 plus \$10 duty at 10 percent duty plus the \$15 freight it costs me to deliver to the U.S. customer. Subsequently the definition of dumping was enlarged, in what clearly seems to me to have been a protectionist move, to preclude selling below cost in another country, regardless of what the domestic practices were. In my previous widget example let's assume the cost was \$90 per

dozen plus a normal profit of \$10 making up the normal price F.O.B. factory of \$100. A new widget design has come on the market and the producer is forced to change his own design. He offers a reduced price of \$80 per dozen to move the old stock. This offer, though successfully taken up by domestic customers would constitute dumping in another country to which the widgets were sent, even though full shipping costs of \$15 and duty of \$8 were added to give an end price of \$103 per dozen. While it meets the first test to be considered a non-dumped transaction, it misses the second.

What is wrong with these concepts, especially under free trade, where no duties will apply? The first definition renders the domestic producer a degree of protection from the exporter which he does not receive from other domestic producers. Imagine two producers of widgets in the U.S., one in New York, one in Chicago. Suppose that each are relatively efficient and can make \$10 profit per dozen widgets at a selling price of \$100 per dozen, F.O.B. their respective factories. Assume the freight between New York and Chicago is \$5 per dozen. To sell in New York the Chicago company must meet the New York firm's \$100 price, absorbing \$5 per dozen in freight. Similarly the New York firm must absorb \$5 per dozen if it wishes to compete in Chicago. This is what happens in practice.

Assume now that an anti-dumping rule applied within the U.S. Each of the New York and Chicago companies would be dumping if it met the other's local prices. To avoid this one would ship only as far as a point at which freight from either location were equal and retain its sales to the geographic area between its plant and all equi-freight cost points. There would be no competition! Each company would have its geographic territory in which it, and it only, was not dumping! Of course this doesn't happen within a country, but change the example to Hamilton and Chicago and that's the rule. Under the FTA as it now stands domestic companies can compete with each other, anywhere in their own country, subject only to domestic competition law, while a company from the other country is drastically limited as to its commercial trading territory by freight costs. Hardly a level playing field!

The second definition of dumping is even more restrictive and unfair. First of all the method by which total cost is calculated, stated simplistically, is that a factory's full fixed costs (plus some assumed profit) must be allocated to the production for the period. In times of low demand this has the effect of putting up unit costs. Assume that in my widget example the normal total cost of one dozen, previously identified as \$90, was made up of \$30 of fixed costs based on a normal factory operating rate of say, 80 hours per week. Demand drops and production is cut back to 40 hours per week. The fixed cost per unit double to \$60, and total cost to \$120. Profit of \$10 per dozen, duty of \$13, plus freight of \$15 means that in order not to dump the selling price must go from \$125 to \$158. Nice if you can get it but who ever heard of putting up

one's prices in a falling market! The practical impact is that under free trade as it now stands many exporters must get out of the U.S. market every time there is a down turn in demand in order to avoid dumping. Since most industrial and commodity sales are based on a long-term relationship Canadian companies selling in the U.S. are severely hampered.

Why the dumping question remained unsolved as part of the FTA negotiations remains an official mystery. But my opinion is that because dumping is a fairly technical trade issue and difficult to explain in popular terms it was not sexy enough politically to get the attention of senior politicians or senior bureaucrats and thus slipped off the table.

I should point out that not only has this left us with an uneven playing field but that the U.S. and Canadian methods of applying anti-dumping remedies, although both legal under GATT, are very different. In simple terms if Canada finds you dumping it gives you a value for your product which it considers high enough not to be dumping. As long as you sell at that price or higher in the future there is no duty attached to future shipments. The U.S. on the other hand determines a percentage dumping margin and collects this percentage on all future shipments, regardless of price. After a period of time one can apply to have these subsequent shipments reviewed. If they are ruled not to have been dumped the dumping duties are refunded with interest. In the meantime substantial funds are tied up and even if one thinks one has adjusted one's prices so as to avoid dumping one is still subject to the vagaries of bureaucratic decision-making.

Apart from how dumping penalties are assessed after dumping has been determined each country has drastically different processes to come to that stage. I will not go into great detail as time does not permit. However let me point out that hearings before the U.S. International Trade Commission strictly limit the time available to each side. Because of a system called "Cumulation" a defendant country often shares its time with others. In addition, while an anti-dumping case is taken against the entire industry penalties are individual and as individual companies often have differing circumstances to present the time an individual defending company is allotted is further reduced—so you may have 10 or 15 minutes to defend on a multi-million dollar case! Then comes the interesting part. If you as a defendant wish to cross examine the complainant, his answer comes out of your 10 or 15 minutes. I think you get my drift. The complainant can give such a long reply as to erode all your time! Consequently you refrain from cross examination and his evidence goes on the record unchallenged. In contrast to this rather "kangaroo court" like system the Canadian Import Trade Tribunal often allots days or even a week to one case, leaving lots of room for a proper hearing with a fully effective cross examination by both sides.

Back to my main subject, what has been the impact of the FTA on Canadian business over the first twenty-one months since it came into force? If we look at the situation before free trade, Canada already ad-

mitted, duty free, some 65% of U.S. merchandise exports to this country. In contrast the Americans had been somewhat more generous, allowing entry of some 70% of our exports to them on a duty-free basis. On a strictly tariff basis we already had 70% of a free trade agreement!

As indicated earlier the start of the agreement saw each side reduce to zero further tariffs, the progressive elimination of the rest over either four or nine years.

The real point of this is to demonstrate that from a tariff point of view the FTA came in with a whimper. Accordingly the plant closings which the anti-FTA lobby and the media blamed on the agreement have no basis in fact. This is not to deny that Canada's industrial base has not been under considerable pressure over the whole period since the implementation of the agreement. While Canada's economics professionals have generally been slow to recognize that we are in a manufacturing recession I submit the evidence of the indexes of recent employment trends for goods and services. The goods employment index has dropped precipitously and continuously from a level of 101 in mid 1989 to just under 97 today. In contrast, the services index has been robustly increasing until recently.

But to find the culprit we must look elsewhere. Since the FTA came into effect the Canadian dollar, pushed up by an ever-increasing Canada-U.S. differential in interest rates, has risen from 76.5 cents U.S. to 86.3 cents this month. If one takes the estimated average duty paid on all Canadian exports (dutiable or not) immediately before free trade and compares it to that in force today one sees that the FTA has given overall Canadian exports to the U.S. a relatively small gain of about one-half of one percent. In contrast the appreciation in our dollar has not only wiped it out but forced a *de facto* new tariff of 12 percent on all our exports to the U.S!

Coupled with the impact of high interest rates on domestic industrial demand the high dollar has reduced the manufacturing sector of its ability to compete in its traditional major export market while allowing U.S. manufacturers almost *carte blanche* to increase their market share in Canada. However noble in its intentions the Bank of Canada has found the sure fire way of crippling Canadian industry in a way that will take years from which to recover.

I ask you, what other country would take its industrial sector, dependent on exports for 30 percent of its volume, and choke it by the throat? That's economic suicide!

To make matters worse, the phoney baloney "soft landing" has proven to have been just that. But the jig may not be up for the Bank. The Governor may succeed in blaming the oil shock for our oncoming official recession which, if unconfirmed reports from the recent G-7 meeting are correct, he plans to exacerbate by continuing with high interest

rates. Surely higher energy costs in a weak economy should be considered recessionary, not inflationary.

Let me now return to the balance of my analysis of the Free Trade Agreement. In addition to tariff reduction considerations most other provisions have caused nary a ripple. I mentioned very early in my speech the special interim dispute settlement mechanism through the use of bi-national panels to appeal dumping or subsidy determinations.

The agreement provided these panels should act within a restricted time period, removing the Sword of Damocles which the prior appeal remedy, resort to the courts of the country meting out the anti-dumping or countervail measures involved, since courts move at their own speed. This has worked well. But the agreement also provided that these panels were merely to determine whether the assessing country had applied its *own* laws correctly. Like any appellate mechanism they were not to retry the case and broadly speaking the facts on the record would not be challengeable.

Unfortunately, in the selling of the FTA in Canada, the impression was created that somehow these panels could reverse the protectionist bias of a decision. Canada would be freed from the vagaries of the Americans! In the event we have now seemed to have "lost" a preponderance of our appeals to bi-national panels in that they have tended to uphold the U.S. findings. While disappointing to Canadians, as I already noted, their anticipations were ill-founded. It is largely the U.S. system which is unfair, not how it is administered. Given this state of affairs one could well enquire what has happened to the working group to develop a substitute system of laws for anti-dumping and countervail duties.

To my knowledge Canada and the U.S. have not started serious discussions on these issues. The bottom line was that Canada told the U.S. it wished to wait for the end of the current GATT Round before proceeding. The apparent justification was that any treatment of subsidies and dumping under the FTA should go beyond anything negotiated under GATT; thus a wait and see attitude.

I submit to you that this is faulty logic at best, and at worst a cop-out. Why? As far as subsidies are concerned the Canada/U.S. issue is so complex that, even if discussions had started immediately after the FTA had gone into effect, they would hardly have concluded before the GATT discussions were over. While many Americans, especially congressmen, view Canadian industry as highly subsidized and the U.S. free of such practices, that is far from the truth.

U.S. industry is substantially aided by government but usually at state, county, and municipal levels. (I note parenthetically that possibly the U.S. FTA negotiators realized this and, while under U.S. law Congress could act to control, say, state level subsidization, it would be politically difficult, and therefore they shied away from the subject). In the

event, much time which could have been devoted to mutual identification of subsidy practices has been lost.

With regard to dumping the delay is even more illogical. For a fully free trade regime, with no tariffs, there is a simple, yet elegant, solution. This is to give the exporting companies the same rights in the receiving country as any domestic producer, so-called "national treatment." Under this proposal the Toronto widget maker could sell in the U.S. in competition with the Chicago company at any price it desired as long as it obeyed U.S. pricing and anti-trust law. Similarly the Chicago company could sell in Canada subject only to the same pricing and competition laws that its Canadian competitors had to follow. Under no stretch of the imagination will the current GATT Round progress this far, nor should Canada or the U.S. push for universal "national treatment" under GATT at this time, for reasons upon which I can elaborate later if you wish. The point is that Canada and the U.S. could have and should have proceeded to negotiate this route immediately after the FTA came into force.

When the outline of the agreement was first revealed in October 1987 the flawed "unfinished business" aspect, the failure to settle the treatment of dumping, was identified by many more vocally by some such as myself. When the chips were down in the 1988 Federal Election many in business publicly supported the FTA. My company was the first, for instance, to contribute financially to the Canadian Alliance for Trade and Job Opportunities. Why did we do this?

First, we believed that to fail to ratify the FTA would leave Canadian business subject to the full wrath of a protectionist U.S. Congress—the old saw about a woman spurned comes to mind. Second, we were assured privately that as soon as the FTA were in place our government would push for a solution to the dumping issue. No mention of the GATT "cop-out" was made.

My views on the subject of the need to proceed are not unique. Meeting in Kananaskis a year ago the committee on Canada—United States Relations—a joint committee of the Canadian Chamber of Commerce and the Chamber of Commerce of the United States adopted some policies on the subject. It said:

1. We encourage both Canada and the United States to pursue bilateral anti-dumping negotiations with all deliberate speed, and not be bound or delayed by discussions on subsidies;
2. Consistent with the FTA objectives, there should be no anti-dumping laws and no tariffs between our two countries by 1998;

Further I know of no major Canadian opposition to the "national treatment" solution proposed. In fact, one senior external affairs trade official told me that after country-side consultations he could find none.

Why the foot dragging? While crucial to our economic well-being, the dumping problem is too complex to become a popular political issue,

and hence the politicians have shown no interest in a solution. The Conservatives are satisfied that they will go down in history as not only having delivered on free trade but having won an election on it. That being done they are on to other parts of their political agenda. And given our adversarial political system the opposition is more interested in false claims of job losses with regard to the FTA than insisting that government complete the job.

It is my experience that given this kind of political vacuum the bureaucrats proceed with their own agenda, and at their own speed. While 80 percent or so of Canada's trade is with the U.S. our diplomats have always preferred to play out their act on the world stage, hence the concentration on GATT.

I would suggest to you a proper course of action would be for Canada to shift gears and immediately press for action on resolving the dumping issue under the FTA. (It should be noted Congress wanted fast action. While the FTA provides for a five to seven year negotiation, the President's authority to come to a "fast track" solution was limited to two and one half years).

And if initial discussions with the U.S. on the subject suggest there will be heavy sledding achieving a "national treatment" solution I have another suggestion. Canada should revise its anti-dumping regime to more closely parallel that of the U.S. While such a move would toughen it up considerably and would require consultation with the U.S. under the FTA it would be difficult for the Americans to object to the same system they themselves use.

If we can't solve the dumping issue, giving each side a level playing field on the other's territory, at least we should treat each other the same way.