ECONOMIC INTEGRATION, THE GATT AND CANADA-UNITED STATES FREE TRADE

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I. INTRODUCTION

As Canada approaches the opening of free trade negotiations with the United States, more and more is heard about what matters are to be excluded from consideration and what interests must be specifically protected in any eventual agreement. Important questions about the effect of a free trade agreement on Canada's sovereignty and national identity are also being discussed. Behind all this palaver is the fear of American economic and political domination of Canada. This alarm is valid — there are indeed special Canadian interests that must be protected — but the result has been a narrowing of Canadian attitudes that does not bode well for the success of any negotiations.

This article's first aim is to bring back into focus some of the external factors that any free trade agreement must take into consideration, but which in the case of a Canada-United States agreement are in danger of being ignored — at least this side of the border. These factors are the legal ramifications of economic integration (which are examined in the light of some major integration schemes involving industrialized countries[1]) and

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[1] These are: *Convention Establishing the European Free Trade Association*, 4 January 1960, 370 U.N.T.S. 3 [hereinafter *EFTA Treaty*]; *Treaty Instituting the Benelux Economic Union*, 3 February 1958, 381 U.N.T.S. 260 [hereinafter *Benelux Treaty*]; *Treaty Establishing the European Economic Community*, 25 March 1957, 298 U.N.T.S. 4, *reprinted in* ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW, Vol. B II (European Community Treaties) K.R. Simmonds ed. (London: Sweet & Maxwell, 1974) Pt. B10 at B10001 [hereinafter *EEC Treaty*]; *Agreement Establishing a Free Trade Area*, 6 June 1966, United Kingdom and Northern Ireland-Ireland, U.K.T.S. 1966 No. 31, 565 U.N.T.S. 58, *reprinted in* 5 I.L.M. 321 [hereinafter *Eire Agreement*]; *Australia-New Zealand: Closer Economic Relations — Trade Agreement*, 28 March 1983, *reprinted in* 22 I.L.M. 945 [hereinafter *ANZCERT Treaty*]; *Israel-United States: Free Trade Area Agreement*, 22 April 1985, *reprinted in* 24 I.L.M. 653 [hereinafter *Israel Treaty*]; and the *Agreement Between the European Economic Community and the Republic of Austria*, 22 July 1972, *reprinted in* ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW, Vol. B III (European Community Treaties) K.R. Simmonds ed. (London: Sweet & Maxwell, 1974) Pt. B12 at B12369 [hereinafter *Austrian Agreement*]. The *Austrian Agreement* is practically identical to all the other free trade agreements between the EEC and the EFTA countries.

the *General Agreement on Tariffs and Trade (GATT)*[2] rules on free trade areas. The article's second aim is to examine, on the basis of these external considerations, how the main issues connected with free trade might be settled in any Canada-United States agreement. In doing this, no attempt is made to deal with the intricate constitutional problems that may confront both countries in implementing their obligations. The point of this contribution to the free trade debate is to set out what appears to be necessary to attain a workable arrangement that does not impinge unnecessarily on Canadian sovereignty. Whether or not such an arrangement will have to be adjusted to suit constitutional realities is another matter and one which will doubtless be explored by those well-versed in the intricacies of constitutional law.

II. The External Factors

A. *The Process of Economic Integration*

1. *Liberalization*

(a) *Discrimination in Law*

There are two aspects to the process of international economic integration. The first is that of liberalization, which entails the abolition of all national measures that prevent the free movement of goods, persons, services and capital.[3] Foremost among such measures are those that discriminate openly and directly in law against other Member States[4] and their nationals. In the case of free trade areas, where there is only free movement of goods, liberalization requires the removal of the following: tariffs;[5] quantitative restrictions;[6] exchange controls;[7] discriminatory

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[2] *General Agreement on Tariffs and Trade*, 30 October 1947, Can. T.S. 1947 No. 27, T.I.A.S. No. 1700, 55 U.N.T.S. 187 [hereinafter *GATT*]. The document has been modified in several respects since 1947; the current version is contained in *General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents*, Vols. I-IV, Supps. 1-31, [hereinafter B.I.S.D.].

[3] For an excellent discussion of economic integration and, more specifically, "liberalization", *see* B. Balassa, The Theory of Economic Integration (London: George Allen & Unwin, 1973) at 1 [hereinafter Balassa]; A.E. Safarian, Canadian Federalism and Economic Integration (Ottawa: Information Canada, 1974) at 2 [hereinafter Safarian].

[4] In this study, the term "Member State" is used to connote an integrating state and the term "community" denotes the area of integration.

[5] *See, e.g., ANZCERT Treaty*, art. 4(3); *EFTA Treaty*, art. 3(2), (6); *Eire Agreement*, art. I; *Israel Treaty*, Annexes 1, 2; *Austrian Agreement*, arts. 3(2), 6(2), 7, cited note 1, *supra*.

[6] *See, e.g., ANZCERT Treaty*, arts. 5(14), 8; *EFTA Treaty*, arts. 10(2), 11; *Eire Agreement*, arts. VI, VII; *Israel Treaty*, art. 3; *Austrian Agreement*, art. 13(2), cited note 1, *supra*.

[7] *See, e.g., EFTA Treaty*, art. 29; *Eire Agreement*, art. XXI; *Austrian Agreement*, art. 19, cited note 1, *supra*.

internal measures[8] (including trade discrimination by public undertakings having the same effect as tariffs or quotas[9]); and, possibly, discriminatory government procurement practices,[10] insofar as they apply to imported goods from Member States. Some free trade agreements also grant a rudimentary right of establishment to enable non-nationals[11] to set up service and distribution facilities.[12] A Canada-United States agreement is expected to extend to some free movement of services, and this will involve the elimination of national measures inconsistent with the non-national's right to enter and temporarily reside in the other Member State in order to provide these services under conditions of equality with nationals.[13]

(b) *Discrimination in Fact*

Discrimination in law is not the only form of discrimination. Indeed, many national measures that are ostensibly non-discriminatory, in that they apply equally to nationals and non-nationals alike, in fact place the latter at a disadvantage and so discriminate in fact if not in law. This may occur in one or both of two ways. The first way is for a national measure to confer a benefit on the basis of criteria that normally only nationals can fulfil. Examples are esoteric national standards that must be met before goods can be sold, or the requirement of national qualifications as a condition for the provision of a particular service. Alternatively, the national measure may impose a burden on the basis of criteria that normally only non-nationals will fulfil. An example of this type of discrimination in fact within the European Economic Community (EEC) was the high British excise tax on wine, which, given the low level of wine production within the United Kingdom, affected mainly non-national producers. The tax was successfully challenged as discrimination in fact before the European Community Court of Justice[14] and was subsequently

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[8] *See, e.g., ANZCERT Treaty*, art. 7(2); *EFTA Treaty*, art. 6; *Eire Agreement*, art. IV, cited note 1, *supra*.

[9] *See, e.g., EFTA Treaty*, art. 14(1); *Eire Agreement*, art. XIV(1), cited note 1, *supra*.

[10] This is the case in the *ANZCERT Treaty*, art. 11; *Israel Agreement*, art. 15, cited note 1, *supra*.

[11] In this study, the term "non-national" is used to connote nationals of other Member States, while the term "foreigner" is used for nationals of third countries.

[12] *See, e.g., EFTA Treaty*, art. 16(1); *Eire Agreement*, art. XVI(1), cited note 1, *supra*. Free movement of persons has existed between Australia and New Zealand since 1920.

[13] *See Israel Agreement*, Declaration on Trade in Services, point 2. *See also* the provisions on the free movement of services in *EEC Treaty*, arts. 59, 60; Benelux Treaty, arts. 2, 6, cited note 1, *supra*.

[14] *See Re Excise Duties on Wine (No. 2): E.C. Comm'n v. United Kingdom* [170/78] (1983), [1983] 3 C.M.L.R. 512 at 543-4 [hereinafter *Re Excise Duties on Wine*]. *See also* the successful challenge to an Italian law that discriminated in fact against foreign-made used buses in *Re Aged Buses: Comm'n of the European Communities v. Italy* [50/83] (1984), [1985] 1 C.M.L.R. 777 at 784 (European Ct.) [hereinafter *Re Aged Buses*].

reduced in the British budget of April 1984.

While discrimination in fact may not *directly* violate the principle of free movement, it undermines the value or feasibility of the principle through the disadvantages it imposes. To be forced to manufacture goods specifically for a non-national market increases costs and reduces the value of tariff elimination; to have to expend time and effort on re-qualifying in another Member State may well outweigh the advantage to be gained from providing services there. Clearly, liberalization must include the elimination of such national measures of general application if it is to be fully effective. There is a problem, however, for many of these measures are based on solid policy grounds with the result that Member States are loath to eliminate them. The solution is for the Member States to agree to modify their general laws in order to remove or reduce their discriminatory effects. This is done in free trade agreements just as in the more advanced schemes of economic integration.[15]

This process of modification, which will be referred to as the approximation of laws, can take three forms. Firstly, the various national laws may be harmonized so that nationals and non-nationals can conform to them on equal terms. The adoption by Member States of common industrial standards or packaging rules is an example of such harmonization. Secondly, Member States may agree to adjustments that assist non-nationals in meeting national requirements. They may, for instance, agree to recognize foreign qualifications or permit self-testing for compliance with national standards for goods. The last possibility, which is somewhat less frequently used, is to waive the application of the measure altogether in the case of non-nationals. The EEC directives on the provision of health care services do this with respect to the need to register with national social security bodies.[16]

A distinction must be made between the approximation of laws and policy harmonization. While the former may entail some modification of policy, this is not its essential purpose. Rather, it seeks to modify the way in which national policies are put into effect, without calling into question the policies themselves. To put it another way, the approximation of laws is concerned with removing the discriminatory effects of the exercise of national sovereignty, not with curtailing the exercise *per se*. This distinction is quite crucial, yet it is not always appreciated. Even the recent Royal Commission study (the *Macdonald Report*)[17] does not differentiate the

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[15] *See, e.g., ANZCERT Treaty*, arts. 12, 22(2), (3)(c); *EFTA Treaty*, arts. 31, 32(1)(c); *Eire Agreement*, art. XVIII(1), (4); *Israel Agreement*, arts. 9(2), 19(1)(a), cited note 1, *supra*.

[16] *See, e.g.*, Council Directive 78/686/EEC, [1978] O.J. no. L 233/1, art. 16.

[17] *See Report of the Royal Commission on the Economic Union and Development Prospects for Canada* (Ottawa: Minister of Supply and Services, August 1985) (Chair: D.S. Macdonald) at 309-10 [hereinafter *Macdonald Report*], where both processes are referred to as harmonization and treated as if they entailed the same obligations. This confusion in terminology is probably partly due to the fact that harmonization of national rules is one form of approximation. *See* the discusssion in section II.A.1.(b) of the text (*Discrimination in Fact*), *supra*.

two. Approximation is an integral part of the liberalization process and cannot be avoided or tackled half-heartedly if free trade is to be effective. Nor should it be baulked at as is frequently the case with policy harmonization, which is a more radical process and involves the curtailment of national sovereignty. To confuse the two processes is to raise unnecessary fears within Canada, which will in turn impede the process of approximation and impinge on the effectiveness of any free trade agreement with the United States.

There remains one additional point to deal with in connection with discrimination in fact. Not all general laws that place non-nationals at a disadvantage can be justified on the basis of the public policy goal they serve. In the case of the British excise tax on wine, for example, the European Community Court of Justice found no objective validity in the measure and dismissed it as purely discriminatory.[18] The same would also be true of a national requirement stating that goods must undergo testing procedures to meet national standards, notwithstanding that they have met equivalent standards in another Member State. A requirement that non-nationals acquire domestic qualifications even where the non-national qualifications are recognized as equivalent in merit falls into the same category. Under the *EEC Treaty* all such purely discriminatory measures, even though couched in terms of general application, stand to be eliminated.[19] Such an approach is not normally adopted in free trade agreements, although it is common practice to prohibit the type of discriminatory general tax that was at issue in the British wine case.[20] Nevertheless, bearing in mind how discrimination in fact can disrupt free movement, there is good reason to include in a free trade agreement a general prohibition on purely discriminatory measures of this type.

2. *Policy Harmonization*

The second aspect of the process of economic integration concerns the harmonization of policy in areas that bear on the economy in general.[21] Policy harmonization is a sensitive issue, for unlike approximation the essence of this process is indeed the modification of national policies. Naturally, whenever national control over policy-making is reduced, there

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[18] *See Re Excise Duties on Wine, supra*, note 14.

[19] *See, e.g., Patrick* v. *Minister of Cultural Affairs* [11/77] (1977), [1977] 2 C.M.L.R. 523 (European Ct.) [hereinafter *Patrick*]; *Ministère Public* v. *van Wesemael [110/78] (1979), [1979] 3 C.M.L.R. 87 (European Ct.) [hereinafter van Wesemael]*; *Ordre des Avocats au Barreau de Paris* v. *Klopp* [107/83] (1984), [1985] 1 C.M.L.R. 99 (European Ct.).

[20] *See, e.g., EFTA Treaty*, art. 6(11)(b); *Eire Agreement*, art. IV(1)(b); *Austrian Agreement*, art. 18, cited note 1, *supra*.

[21] *See* V. Curzon, THE ESSENTIALS OF ECONOMIC INTEGRATION: LESSONS OF EFTA EXPERIENCE (London: McMillan, 1974) at 22 [hereinafter Curzon]; M.A.G. Meerhaeghe, INTERNATIONAL ECONOMIC INSTITUTIONS (New York: John Wiley & Sons, 1966) at 77.

must perforce be a curtailment of national sovereignty. This issue is especially sensitive in Canada, because the sheer difference in size vis-à-vis the United States means that, in any free trade agreement between the two, policy harmonization will almost inevitably involve a substantial degree of policy americanization. Thus, if Canada is to safeguard its national independence, policy harmonization should be restricted to the minimum amount necessary to achieve a workable free trade arrangement.

(a) *Corrective Policy Harmonization*

Policy harmonization is not a monolithic process, although it is sometimes discussed as though it were.[22] In fact, it has various functions and can be pursued to varying degrees. Its most common use in schemes of economic integration is to correct national policies that cause distortions in the conditions of competition within a given community. Government aids, for example, can lead to the production of artificially low-priced goods that are able to compete unfairly with goods produced in other Member States.[23] In such cases, the use of aids by the Member States must be aligned or give way to community measures.

A common distortion within free trade areas is caused by the absence of a common external tariff.[24] As Member States retain control over their national tariffs against third countries, discrepancies inevitably arise in the duties payable on third country inputs into goods destined for export within the community. Where these discrepancies are significant, they will affect the export price of the finished products so as to give an advantage to producers in a Member State with low tariffs. The resulting distortion of trade in favour of the low-tariff Member State is called deflection of trade. It is dealt with in all free trade agreements by rules of origin, which determine the amount of third country materials that may be used in goods that qualify for area treatment.[25] However, these rules may not be completely effective in the case of substantial discrepancies between national tariffs, and so most free trade agreements also provide for reducing national disparities through tariff alignment.[26] Among other national policies that can similarly distort the conditions of competition are

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22 With respect, this criticism can also be made of the *Macdonald Report, supra*, note 17 at 310, 357-60.

23 This topic is discussed in more detail in the text, section III.C.2, *infra*. *See also* note 29, *infra*.

24 Free trade areas, by definition, do not have a common external tariff. *See* Balassa, *supra*, note 3; Safarian, *supra*, note 3. *See also GATT, supra*, note 2, art. XXIV(8)(b). The addition of a common external tariff to a free trade area results in a customs union.

25 *See, e.g., ANZCERT Treaty*, art. 3; *EFTA Treaty, art. 4; Eire Agreement*, art. II; *Israel Agreement*, Annex 3; *Austrian Agreement*, Protocol 3, cited note 1, *supra*.

26 *See ANZCERT Treaty*, art. 14(4)(a); *EFTA Treaty*, art. 5; *Eire Agreement*, art. III(2); *Israel Agreement*, art. 18(1)(b); *Austrian Agreement*, arts. 12, 24, cited note 1, *supra*.

those relating to customs administration, government monopolies, the environment, energy, restrictive business practices, wage and price controls, social programmes, interest rates and taxation. There may have to be some policy harmonizaton in these areas as well. Also, unforeseen distortions may arise as economic integration is put into effect, and these will have to be dealt with on an *ad hoc* basis.

This type of corrective policy harmonization is a necessary adjunct to liberalization, as it fulfils the vital function of ensuring that the benefits intended to accrue from liberalization are not frustrated. In other words, while liberalization establishes the principle of free movement, it is corrective policy harmonization that guarantees its integrity. Accordingly, policy harmonization is necessary for any workable scheme of economic integration. This fact has been well-recognized in the case of the more advanced forms of integration (such as common markets and economic unions), but its relevance for the less integrated free trade area has been downplayed.[27] Yet free trade agreements routinely provide for such harmonization and the difference is only a matter of scope and degree. Because the agreements deal solely with the free movement of goods, only policy areas relating to it, such as customs administrations,[28] government aids,[29] external tariffs,[30] restrictive business practices[31] and agricultural stabilization and support schemes,[32] are specifically covered. However, provision is often made as well for some minor harmonization of general economic and financial policies[33] and for *ad hoc* action to be taken against distortions arising from the operation of the agreement.[34] If Canadian sovereignty is to be protected, any free trade agreement between Canada and the United States should not depart any further from this traditional free trade approach than is necessary to accommodate the inclusion of free movement of services.

Another very significant point with respect to corrective policy harmonization in free trade areas is the degree to which it is pursued. Free trade areas do not aspire to the complete unification of policy that is often

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[27] *See* Balassa, *supra*, note 3 at 1-2; Safarian, *supra*, note 3.

[28] *See, e.g., ANZCERT Treaty*, art. 21; *EFTA Treaty*, art. 9, cited note 1, *supra*.

[29] *See, e.g., ANZCERT Treaty*, arts. 9, 14; *EFTA Treaty*, arts. 13, 24(2); *Eire Agreement*, art. XIII; *Israel Agreement*, Annex 4; *Austrian Agreement*, arts. 18, 23(1)(iii), cited note 1, *supra*.

[30] *See, e.g., ANZCERT Treaty*, art. 14(4)(a); *EFTA Treaty*, art. 5(2), (4); *Eire Agreement*, art. III(2); *Israel Agreement*, art. 18(1)(b); *Austrian Agreement*, arts. 12, 24, cited note 1, *supra*.

[31] *See, e.g., ANZCERT Treaty*, art. 12(1)(a); *EFTA Treaty*, art. 15; *Eire Agreement*, art. XV; *Austrian Agreement*, art. 23, cited note 1, *supra*.

[32] *See, e.g., ANZCERT Treaty*, art.10; *Eire Agreement*, art. XXIII(2); *Austrian Agreement*, art. 10(2), cited note 1, *supra*.

[33] *See ANZCERT Treaty*, art. 22(13)(c); *EFTA Treaty*, art. 30; *Eire Agreement*, art. XX, cited note 1, *supra*.

[34] *See ANZCERT Treaty*, art. 22(2); *EFTA Treaty*, art. 31; *Eire Agreement*, art. XXIII(3); *Israel Agreement*, art. 19, cited note 1, *supra*.

found in more advanced arrangements.[35] Instead, they require only an alignment of national policies that is sufficient to remove the distortion and prevent the frustration of benefits.[36] Thus, they not only limit the scope of policy harmonization, but they also restrict it within that scope to the minimum necessary. As a result, they uphold the principle of national independence as far as is consistent with achieving free trade. This is, in fact, one of the main characteristics of free trade areas and one which sets them apart from common markets and economic unions.[37] It should also characterize any Canada-United States agreement.

(b) *Integrative Policy Harmonization*

Policy harmonization may also be pursued as an end in itself. In this case, it is not undertaken merely to ensure effective liberalization, but rather to integrate the economies of the Member States *in addition to* attaining free movement. Article 2 of the *EEC Treaty*,[38] for example, sets out the establishment of a common market *and* the harmonization of the economic policies of the Member States as two separate goals to be achieved by the Community.[39] Not only does such integrative harmonization considerably expand the scope of policy harmonization, it also requires a substantial degree of policy unification to be effective.[40] Because it is not absolutely necessary to free trade, it is not found in free trade areas. Also, the severe curtailment of national sovereignty it entails runs counter to the principle of national independence that these areas seek to protect. For these reasons it should not be part of any Canada-United States agreement either.

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[35] The *EEC Treaty* provides, *inter alia*, for a common commercial policy (arts. 18-19) and common rules on restrictive business practices (arts. 85-90). *Supra*, note 1.

[36] A typical example is article 15(1) of the *EFTA Treaty*, under which the rules on restrictive business practices are applicable *only* "in so far as . . . [the practices] frustrate the benefits expected from the removal or absence of duties and quantitative restrictions on trade between Member States". *Supra*, note 1.

[37] *See* Curzon, *supra*, note 21 at 90; J.S. Lambrinidis, THE STRUCTURE, FUNCTION, AND LAW OF A FREE TRADE AREA: THE EUROPEAN FREE TRADE ASSOCIATION (New York: Praeger, 1965) at 6-7. A comparison between the preamble of the *EEC Treaty* and that of the *EFTA Treaty* well illustrates the different approaches towards economic integration taken by free trade areas and common markets. *See supra*, note 1.

[38] *See supra*, note 1.

[39] Referring to this double-headed process in the EEC, Kapteyn and van Themaat remark that here liberalization and policy harmonization "form an indissoluable unity, like two sides of the same coin". P.J.G. Kapteyn & P. V. van Themaat, INTRODUCTION TO THE LAW OF THE EUROPEAN COMMUNITIES: AFTER THE ACCESSION OF NEW MEMBER STATES (London: Sweet & Maxwell, 1973) at 51.

[40] The European common agricultural policy is a prime example. *EEC Treaty, supra*, note 1, arts. 38-47. So, too, are the joint exchange rate policies pursued by both the Benelux Economic Union (*Benelux Treaty, supra*, note 1, art. 12) and the EEC (Council Regulation 3180/78/EEC, [1978] O.J. no. L 379/1).

(c) *Positive Policy Harmonization*

Similar to integrative policy harmonization is the adoption of community policies aimed at improving living standards and social welfare throughout the community. This process has been described as "positive integration".[41] It is found particularly in the more advanced forms of integration,[42] where it is really just a sub-species of integrative harmonization. It may also occur as a separate process in free trade areas, for Member States may feel that their joint efforts in a particular matter are likely to be more productive than individual national initiatives. For example, the Australia-New Zealand agreement provides for joint rationalization of industry[43] and the joint marketing of agricultural products in third country markets.[44] Total uniformity may not be required, but there must be a close alignment of national policies, even in free trade areas, if positive policy harmonization is to attain its goal. It is a moot point whether this type of harmonization, which is in any case not necessary to secure free trade, will play a role in any Canada-United States arrangement. Fear of the loss of political sovereignty will probably restrain Canada from encouraging it, while the present political mood in the United States is firmly opposed to most forms of government intervention.

3. *Conclusion*

Bearing in mind both the limitations that Canada might reasonably place on its obligations as well as what is necessary to secure a workable agreement, economic integration for Canada should include the following undertakings: a) to eliminate national measures that conflict, either in law or in fact, with the principle of free movement of goods and services; b) to harmonize policies relating to trade in goods and services to the extent necessary to remove distortions; and c) to approximate national measures of general application that impede either liberalization or policy harmonization. To these must be added the requirements of article XXIV of the *GATT*,[45] which relate exclusively to trade liberalization.

B. *The Requirements of Article XXIV*

The multilateral nature of the obligations of the contracting parties under the *GATT* has been crucial to the agreement's success, for it has

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[41] J. Pinder, *Positive Integration and Negative Integration. Some Problems of Economic Union in the EEC*, in G.R. Denton, ed., ECONOMIC INTEGRATION IN EUROPE (London: Weidenfeld & Nicholson, 1969) at 90.

[42] Article 2 of the *EEC Treaty* sets as one of the goals of the Community an "accelerated raising of the standard of living". *Supra*, note 1. Both the EEC and the Benelux Economic Union provide for the harmonization of social policy for the specific purpose of improving social welfare. *See EEC Treaty, supra*, note 1, art. 117; *Benelux Treaty, supra*, note 1, art. 70.

[43] *ANZCERT Treaty, supra*, note 1, art. 11.

[44] *Ibid.*, art. 10(4).

[45] *Supra*, note 2.

imposed upon the parties a liberalizing give-and-take that the commercial self-interest and bilateralism of the inter-war years was never able to achieve. The most-favoured-nation (MFN) principle, which is enshrined in article I of the *GATT*,[46] may thus be seen as the cornerstone of the agreement. For this reason, some of the original contracting parties (the United States in particular) were wary about the notion of regional economic integration, which they saw as bound to undermine the MFN principle by encouraging the formation of blocs of bilateral privilege.[47] This has happened to some extent, but in the late forties regional arrangements were seen by many as a way out of the depressing cycle of protectionism and war. And so the *GATT* came to terms with them in article XXIV.

Article XXIV represents a compromise between absolute adherence to the MFN principle and automatic exemption for schemes of economic integration. In it, the Contracting Parties "recognise the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements".[48] At the same time, however, they require these agreements to represent a genuine attempt at economic integration before Member States can qualify for an exemption from their *GATT* obligations. The stipulations set out in paragraph 8(b) thus require Member States of a free trade area to eliminate duties and other restrictive regulations of trade on *substantially* all the trade between them in products originating within the area of integration. The only exceptions permitted are those contained in *GATT*, articles XI, XII, XIV, XV and XX.[49] A common external policy towards third countries is not required.

Controversy over the meaning of the phrase "substantially all the trade" has plagued the application of article XXIV(8).[50] When the EEC and the European Free Trade Association (EFTA) were set up in the late fifties, proponents of the two schemes argued for a quantitative interpretation, while many other contracting parties preferred a qualitative reading.[51] As far as the EFTA was concerned, the Member States insisted that the exclusion of agricultural and fish products from the scope of the

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[46] *Ibid.*

[47] *See* J.H. Jackson, WORLD TRADE AND THE LAW OF GATT: A LEGAL ANALYSIS OF THE GENERAL AGREEMENT OF TARIFFS AND TRADE (New York: Bobbs-Merrill, 1969) at 575-80 [hereinafter Jackson].

[48] *GATT, supra*, note 2, art. XXIV(4).

[49] *Ibid.*, art. XXIV(8)(b).

[50] *See, e.g.*, the continuing disagreement on this point with respect to the agreements between the EEC and the EFTA countries in Contracting Parties, B.I.S.D. (Supp. 20) at 147 (1974) (examination of the *Austrian Agreement*); Contracting Parties, B.I.S.D. (Supp. 20) at 159-60 (1974) (agreement with Iceland); Contracting Parties, B.I.S.D. (Supp. 20) at 172-3 (1974) (agreement with Portugal). Differences of opinion are still evident in the Report of the Working Party on the Australia-New Zealand agreement. *See* Contracting Parties, B.I.S.D. (Supp. 31) at 178 (1985).

[51] *See* Contracting Parties, B.I.S.D. (Supp. 9) at 83 (1960) (examination of the Stockholm Convention). *See also* Jackson, *supra*, note 47 at 607-10.

Stockholm Convention was not inconsistent with paragraph 8(b), as the remaining trade that fell to be liberalized between them was *quantitatively* substantial. But other contracting parties took the view that the exclusion of two such important sectors of the economy rendered trade liberalization within the proposed free trade area *qualitatively* insubstantial. No agreement on the correct interpretation of the phrase has ever been reached and in the face of its seemingly impenetrable ambiguity, the contracting parties have agreed to differ.[52] The result, as the *Macdonald Report* points out, is that key sectors of the economy may be left out of a free trade agreement without violating article XXIV.[53] The *Macdonald Report* even fixes a minimum percentage of trade — 80 percent —that must be liberalized, although it is questionable whether *GATT* practice really allows for such preciseness.

Not all customs charges or import controls have to be eliminated between Member States of a free trade area under article XXIV. Noting the context of the term "duties" in paragraph 8(b) and bearing in mind the presumption in international law in favour of sovereign rights,[54] it may safely be assumed that only charges that restrict trade are intended to be covered. This excludes revenue duties (which are fiscal charges levied at the time of importation in lieu of and equal to internal taxes on domestic goods), countervailing and anti-dumping duties imposed in conformity with *GATT* rules to combat unfair trade practices, and customs charges commensurate with the services rendered.

Among the non-tariff barriers that may be maintained between Member States are export quotas intended to forestall shortages in essential commodities,[55] import quotas imposed in order to enforce national classification, grading or marketing rules or agricultural support programmes,[56] and exchange and trade controls to combat balance-of-payments disequilibria that are applied in conformity with *GATT*[57] and International Monetary Fund (IMF) rules.[58] Measures consistent with the "General Exceptions" provisions of *GATT* article XX are also permitted, as are restrictions arising from national security considerations and government procurement practices, to which the *GATT* does not apply.[59] Government procurement practices have, of course, been partly liberalized by the Tokyo Agreement on Government Procurement, but this agreement is not capable of amending the *GATT* itself.[60] Thus, for the purposes of article

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[52] *See ibid.* for the proposals and respective positions of the contracting parties.

[53] *See supra*, note 17 at 308. A notable exception is the *Israel Agreement, supra*, note 1, which covers all commercial trade between the United States and Israel.

[54] *See, e.g., The S.S. Lotus* (1927), P.C.I.J. Reports, Series A, No. 10.

[55] *GATT, supra*, note 2, art. XI(2)(a).

[56] *Ibid.*, art. XI(2)(b), (c).

[57] *Ibid.*, arts. XII-XV. *But see* the text, section III.A.5.(c), *infra*.

[58] *See* note 172, *infra*.

[59] *See GATT, supra*, note 2, arts. III(8)(a), XVII(2), XXI.

[60] *See* J.H. Jackson, J. Louis & M. Matsushita, IMPLEMENTING THE TOKYO ROUND: NATIONAL CONSTITUTIONS AND INTERNATIONAL ECONOMIC RULES (Ann Arbor: University of Michigan Press, 1984) at 12-3.

XXIV(8)(b) these practices remain excluded. In suggesting that a Canada-United States agreement deal with them, the *Macdonald Report* goes beyond what is required in a free trade area.[61]

One exception that would not seem to be permitted by paragraph 8(b) is safeguard action against particular imports to prevent injury to domestic producers. Such action is allowed in intra-*GATT* trade pursuant to article XIX, but this article does not appear among the permitted exceptions in paragraph 8(b).[62] This does not cause problems during the transitional period permitted by article XXIV(5), as the full requirements of paragraph 8(b) do not apply at that time. However, once the free trade agreement has been implemented, the wording of paragraph 8(b) surely means that the right to take safeguard action then lapses. This was certainly the view of the Working Party on the EFTA agreement,[63] but it was challenged by some members of the Working Parties on the EEC agreements with the EFTA countries. They maintained that the non-application of safeguard measures against Member States violated the MFN principle of the *GATT*.[64] The issue is thus somewhat contentious, but it is submitted that the wording of paragraph 8(b) speaks strongly against the second view.

Whatever the correct legal position may be, it is clear that the complete elimination of the safeguard option within free trade areas will cause great problems for Member States that have not been able to adjust totally to the new regime. Accordingly, the practice in free trade agreements has been to retain this exception beyond the transitional period, but to restrict its use. The normal procedure is to require the Member State seeking to impose safeguard measures to consult with the other Member States beforehand, with a view to finding an alternative, mutually satisfying solution.[65] If no solution is found, however, unilateral action is permitted in some agreements even though this may not be compatible with paragraph 8(b).[66] An alternative procedure, adopted in both the EFTA and Australia-New Zealand agreements, has been to permit unilateral action as a last resort during the transitional period, but to replace it with action by multilateral authorization thereafter.[67] It is a moot point

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[61] *See supra*, note 17 at 316. *But see* the discussion in section III.A.3.(e) of the text (*Government Procurement*), *infra*.

[62] *See* note 49, *supra*.

[63] *See* Contracting Parties, B.I.S.D. (Supp. 9) at 79 (1961) (examination of the Stockholm Convention).

[64] *See* Contracting Parties, B.I.S.D. (Supp. 20) at 156 (1974) (examination of the *Austrian Agreement*); Contracting Parties, B.I.S.D. (Supp. 20) at 166-9 (1974) (agreement with Iceland); Contracting Parties, B.I.S.D. (Supp. 20) at 181 (1974) (agreement with Portugal). This view was disputed by the EEC and EFTA countries.

[65] *See, e.g., ANZCERT Treaty*, art. 17; *EFTA Treaty*, art. 20; *Eire Agreement*, art. XIX; *Israel Agreement*, arts. 5, 18; *Austrian Agreement*, arts. 26, 27, cited note 1, *supra*.

[66] *See, e.g., Israel Agreement*, arts. 5, 18; *Austrian Agreement*, arts. 26, 27, cited note 1, *supra*.

[67] *See ANZCERT Treaty, supra*, note 1, art. 17. The *Eire Agreement, supra*, note 1, art. XIX(4) provided for a review of unilateral action at the expiry of the transitional period in 1975. However, by that time both nations had joined the EEC and the treaty had become defunct.

whether even this latter arrangement satisfies the exigencies of paragraph 8(b),[68] but it is probably the most realistic solution. It is the one suggested by the *Macdonald Report* for Canada and the United States.[69]

A final point concerning article XXIV relates to the transitional period referred to above. Paragraph 5(c) requires any interim free trade agreement to include a plan for liberalization to be implemented "within a reasonable length of time". This requirement has become more or less meaningless since the Contracting Parties implied that the plan need not be detailed and need not even indicate when the agreement might be fully implemented. This was done in the case of the association agreement between the European Community and Turkey, where an indefinite period was considered reasonable.[70] The ten years suggested by the *Macdonald Report* for phasing in any Canada-United States agreement should not, therefore, cause any problems.[71] Nor does the *Macdonald Report's* proposal that United States' liberalization be implemented more quickly than Canada's run counter to *GATT* rules. A similar two-speed approach was taken in the Ireland-United Kingdom free trade agreement.[72]

This indulgent approach to the requirements of paragraph 5(c) is, in fact, symptomatic of the generally cavalier way in which the whole article has been treated by the Contracting Parties. No regional integration scheme that has come before them has wholly conformed to the criteria set out in article XXIV, yet none has been rejected. The normal procedure has been for objections to be aired and then for the arrangement to be tolerated. Only on rare occasions has an official waiver been asked for or thought necessary.[73] As a result, article XXIV is, in the words of Professor Jackson, "largely irrelevant".[74] Add to this the fact that nearly two-thirds of the contracting parties belong to regional arrangements that are incompatible with their *GATT* obligations and it becomes difficult to share the view of the *Macdonald Report* that Canada and the United States cannot expect to get away with an agreement that does not conform to article XXIV.[75] Nevertheless, there are sound policy reasons for Canada to

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[68] No comment on the compatibility of this multilateral approach was made in the reports of the various Working Parties.

[69] *Supra*, note 17 at 315.

[70] *See* Contracting Parties, B.I.S.D. (Supp. 13) at 61-2 (1965) (association of Turkey).

[71] *Supra*, note 17 at 308, 311, 382.

[72] *See Eire Agreement, supra*, note 1, arts. I, IV. No adverse comment was made on this practice in the Working Party Report. *See* Contracting Parties, B.I.S.D. (Supp. 14) at 122 (1966).

[73] Waivers were granted under *GATT*, art. XXV(5) for the European Coal and Steel Community (ECSC) (Contracting Parties, B.I.S.D. (Supp. 1) at 17 (1953)) and for American participation in the Canada-United States Autopact (Contracting Parties, B.I.S.D. (Supp. 14) at 37 (1966)).

[74] *Supra*, note 60 at 621.

[75] *See Macdonald Report, supra*, note 17 at 304.

comply with Article XXIV[76] and the *Macdonald Report* is right to urge such compliance in the context of Canada-United States free trade.[77]

C. *The Mechanics of Integration*

1. *Introduction*

As crucial to any scheme of economic integration as the substance of the obligations and the *GATT* rules, are the mechanisms, institutions and enforcement procedures needed to implement and operate it. The mechanics may differ from agreement to agreement, but they all have some impact on national sovereignty. At the very least certain national measures will have to be decided with community criteria in mind; in more advanced forms of integration, national law-making power may even be transferred to community institutions. The methods of enforcement can similarly range from a reliance on the Member States' good will to retaliatory sanctions or some form of judicial proceeding. This is the other dimension to the issue of national independence, so that, in addition to keeping policy harmonization to a minimum, Canada should take care to avoid the adoption of overly radical methods of implementing the agreement.

2. *Mechanisms and Institutions*

(a) *Consultation and Co-operation*

The most innocuous mechanism for implementing economic integration is *consultation*, by which is meant a process whereby a Member State is acquainted with the views of its partners on a matter of common concern and expected to take them into consideration in making its decision. It entails no binding agreement to act in a certain way; at the very most, the Member State is placed under a moral obligation to pursue a certain course of action. Consultation may occur spontaneously between the Member States or be required in certain circumstances by the agreement.[78]

Closely associated with consultation is the mechanism of *co-operation*, which occurs when Member States assume a binding obligation towards each other to act in a certain way as a result of their consultations. Community considerations now cease to be just a persuasive factor influencing the national decision, for, having given the undertaking, the Member State is now bound under the agreement and the principles of international law to perform it. Co-operation does not, however, entail any

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[76] *See* the discussion in section III.A.1 of the text, *infra*, for some of these reasons.

[77] *Macdonald Report, supra*, note 17 at 303, 381-2.

[78] A typical example of required consultations is article 5(4) of the *EFTA Treaty, supra*, note 1, which directs Member States that are contemplating a change in their national tariffs to "consider any representations by other Member States that the reduction is likely to lead to a deflection of trade".

significant abdication of national sovereignty. The substance of the obligation is determined, at least in part, by the Member State, and it is carried into effect wholly at the national level. It is a self-imposed international commitment into which the state enters into of its own sovereign choice. As with consultation, co-operation may occur pursuant to a treaty obligation to agree on a certain matter[79] or on an *ad hoc* basis where consultations lead spontaneously to the giving of an undertaking. Another, and very important, form of co-operation is the agreement itself insofar as it represents binding obligations on the part of the signatories to implement particular measures at the national level (such as eliminating tariffs or according non-nationals the right to provide services).

These two mechanisms are used in all integration schemes, but they are particularly favoured by free trade areas because they harness the normal flow of intergovernmental relations for the purposes of economic integration and thereby respect the principle of national independence.[80] In two-nation free trade areas they are used either exclusively[81] or predominantly,[82] while in multilateral arrangements like the EFTA the multiplicity of competing interests requires that they be supplemented by some *co-ordination*. Because consultation and co-operation are traditional forms of intercourse between nations, a community institution is not necessary to operate them, and in the Ireland-United Kingdom and Australia-New Zealand agreements, which use only these mechanisms, reliance is placed instead on intergovernmental meetings. Alternatively, such official interaction may be formalized within a Joint Committee of representatives of the Member States' governments, as in the Israeli-United States and EEC-Austrian agreements. In this case, the Joint Committee can also be used to play a minor co-ordinating role, although its main purpose is to provide a permanent framework for consultation and co-operation between the Member States. The Joint Committee can be considered a community institution, but it invariably acts on the basis of unanimity[83] and does not possess to any significant degree the independent status of the EEC or EFTA Councils. It could be that Canada and the United States (another two-nation grouping) will also rely mainly on consultation and co-operation and adopt either the pure intergovernmental or Joint Committee approach. Certainly this would serve to protect Canadian sovereignty. It is not, however, the most effective means of achieving free trade and it is not advocated by the *Macdonald Report*.[84]

(b) *Co-ordination*

The next stage in the mechanics of economic integration occurs when the community is given the authority to decide what measures should be

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[79] *See, e.g., ANZCERT Treaty*, art. 17(11); *EEC Treaty*, art. 220; *EFTA Treaty*, art. 9, cited note 1, *supra*.

[80] *See* Curzon, *supra*, note 21 at 90.

[81] *See generally Eire Agreement; ANZCERT Treaty*, cited note 1, *supra*.

[82] *See generally Israel Agreement; Austrian Agreement*, cited note 1, *supra*.

[83] *See Austrian Agreement, supra*, note 1, art. 30(2).

[84] *See generally* section III.D.1 of the text, infra.

adopted by the Member States in pursuance of their obligations under the agreement and the authority to co-ordinate their enactment into national law. As a mechanism of economic integration, *co-ordination* represents a significant step along the path toward the abdication of national sovereignty. Although the measures in question are still put into effect at the national level and Member States retain some discretion in determining their exact form, the substance is now determined by the community. The extent of the loss of national sovereignty depends firstly on whether the Member States are obliged to enact the measures and secondly on what the method of enforcing this obligation is. To fulfil its co-ordinating role effectively, the community requires an institution to formulate and oversee the enactment of the measures, a task that must be performed pursuant to and in conformity with the agreement.[85]

c) *Voluntary and Obligatory Co-ordination*

In the case of voluntary co-ordination the community institution empowered to undertake the co-ordination will formulate the substance of the proposed measure and invite the Member States to enact it within their jurisdictions. This community proposal may be quite detailed or it may leave much to the discretion of the Member States, but in either case the Member States are free to either adopt it or not. The normal term used in agreements for this type of proposal is *recommendation*.[86]

With voluntary co-ordination, the curtailment of sovereignty is very slight, for the Member State alone decides whether to follow the community recommendation. Obligatory co-ordination, on the other hand, entails a real loss of independence, as the community proposal must be acted upon. Where this binding proposal (or *directive* or *decision* as it is most frequently called in the agreements)[87] is very detailed, national implementation is reduced to a formality so that, in effect, legislative initiative is transferred to the community. The ensuing loss of national sovereignty is, however, attenuated somewhat by the fact that in all

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[85] *See, e.g., EEC Treaty*, art. 189; *EFTA Treaty*, art. 32; *Benelux Treaty*, art. 19, cited note 1, *supra*.

[86] *See, e.g., EFTA Treaty*, art. 32(4); *Austrian Agreement*, art. 29; *EEC Treaty*, art. 189; *Benelux Treaty*, art. 19(c), cited note 1, *supra*.

[87] *See EFTA Treaty*, art. 32(4); *Austrian Agreement*, art. 29; *EEC Treaty*, art. 189; *Benelux Treaty*, art. 19(a), cited note 1, *supra*. Exceptionally, the binding proposal is termed a recommendation in article 14 of the *Treaty Instituting the European Coal and Steel Community*, 18 April 1951, 261 U.N.T.S. 140, *reprinted in* ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW, Vol. BI (European Community Treaties), K.R. Simmonds ed. (London: Sweet & Maxwell, 1974) Pt. B2 at B200l. It should also be noted that recommendations made by the EFTA Council under article 31(3) of the *EFTA Treaty*, and non-binding reports issued by the conciliation panel under article 19(2) of the *Israel Agreement* (*supra*, note 1) may be regarded as binding on Member States, despite the terminology used, where failure to comply with them leads to sanctions being taken against the delinquent state.

functioning schemes of regional integration the main decision-making community institution is made up of representatives of the governments of the Member States.[88] Thus, there is some national input into determining the measures to be enacted by Member States. But where the community institution is empowered to formulate its binding proposal on the basis of a majority vote (which is permitted in some agreements for certain situations)[89] a Member State's input may be ignored and the Member State may even find itself having to enact something it does not want to enact.

A feature of some integration agreements is a provision for Member States to take certain action at the national level subject to an authorization from the community. This mechanism is used particularly with respect to derogations from the agreement.[90] In this case, it is not a question of the community formulating the substance of the measures and imposing them on the Member States, but of the community approving the substance of national measures on the basis of community criteria. The result is, however, the same, namely that it is the community and not the Member States that determine the substance, for if the proposed national measures do not conform to community criteria, the Member State will be instructed to modify them accordingly. For this reason, the requirement for community authorization can be viewed as a form of obligatory co-ordination.

The advantage of co-ordination over consultation and co-operation as a mechanism for implementing economic integration is that it does not rely exclusively on the Member States to act appropriately and at the right time. By endowing the community with the authority to set out how the agreement is to operate and be implemented at the national level and to see that this is done properly, co-ordination — and particularly obligatory co-ordination — can help overcome the problems of foot-dragging and the discrepancies in national performance that can arise with the other two mechanisms. These problems are particularly acute when several nations are involved in the process or where a high level of integration is the goal. For this reason co-ordination is used extensively in advanced schemes such as the European Community and the Benelux Economic Union and in multi-national free trade areas like the EFTA. It is found to a much lesser extent in two-nation free trade groupings, and it is not found at all in the Anglo-Irish and Australia-New Zealand agreements; but it would make for a more effective arrangement and is advocated by the *Macdonald Report* for Canada and the United States.[91]

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[88] This is true, *inter alia*, of the Council of the European Community. *See Treaty Establishing a Single Council and a Single Commission of the European Communities*, 8 April 1965, *reprinted in* 4 I.L.M. 776, ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW, Vol. BI (European Community Treaties), K.R. Simmonds ed. (London: Sweet & Maxwell, 1974) Pt. B8 at B8030 [hereinafter *Merger Treaty*]; the Benelux Committee of Ministers, *Benelux Treaty, supra*, note 1, art. 17; and the EFTA Council, *EFTA Treaty, supra*, note 1, art. 32(2). *See also* note 92, *infra*.

[89] *See, e.g., EEC Treaty*, art. 57(1); *EFTA Treaty*, art. 31(3), cited note 1, *supra*.

[90] *See, e.g., EEC Treaty*, art. 26; *EFTA Treaty*, art. 20, cited note 1, *supra*.

[91] *Supra*, note 17 at 318, 320-1.

It should be stressed, particularly in the context of Canadian sovereignty, that the role of the community institution with respect to voluntary and obligatory co-ordination is not a supranational one, for the community does not in these cases have the power to make laws that have any effect within the Member States.[92] This vital attribute of sovereignty remains with the Member States, for the community's proposals need to be enacted into national law in order to attain legal status within the national jurisdiction. Certainly, at times, where the community proposal is binding and very detailed, this exercise of national sovereignty may be reduced to a formality, but even here a Member State is free to refuse to act as long as it is prepared to put itself in breach of its treaty obligations and endure the consequences thereof. The principle of national independence, although compromised, is not abrogated in the case of voluntary and obligatory co-ordination.

(d) *Compulsory Co-ordination*

With both voluntary and obligatory co-ordination it is always possible, as indicated above, for Member States to refuse to play their proper role. Even if some form of sanction ensues as a result of this recalcitrance, this will not complete the process of co-ordination. In the final analysis, therefore, the community will have to rely on the sovereign good will of the Member States. This is not so in the case of compulsory co-ordination as practised in the European Community. There, failure to enact a binding Community proposal into national law simply results in the proposal itself becoming a direct source of national legal rights.[93] This deprives the Member States of the freedom to choose whether to co-operate or not in the process of co-ordination, for, even if they do not fulfil their proper role, the decision or directive will nonetheless operate as part of their national laws until the proper national measures are forthcoming. It will confer rights on individuals that can be enforced before national courts[94] and it will prevail

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92 The *Macdonald Report* distinguishes between an inter-governmental body made up of government representatives and a supranational body composed of non-governmental appointees with fixed terms. *Ibid.* at 320. This is not a very helpful distinction, for in all functioning schemes of economic integration, including the EEC and the Benelux Economic Union, the most important community decision-making body is made up of government representatives. With respect, it is suggested that the distinction should be based instead on the nature of the body's powers, so that the epithet "supranational" is applied to a community institution, like the Council of the European Community, that is capable of making laws directly for the Member States without the need for their intervention. *See* G. Mally, THE EUROPEAN COMMUNITY IN PERSPECTIVE: THE NEW EUROPE, THE UNITED STATES, AND THE WORLD (Toronto: D.C. Heath, 1973) at 244.

93 *See van Duyn* v. *Home Office* [41/74] (1974), [1975] 1 C.M.L.R. 1 at 15-6 (European Ct.) [hereinafter *van Duyn*]; *Federation of Dutch Indus.* v. *Inspector of Customs and Excise* [51/76] (1977), [1977] 1 C.M.L.R. 413 at 429 (European Ct.) [hereinafter *Dutch Indus.*]; *Pubblico Ministero* v. *Ratti* [148/78] (1979), [1980] 1 C.M.L.R. 96 at 110 (European Ct.) [hereinafter *Ratti*].

94 *See Grad* v. *Finanzamt Traunstein* [9/70] (1970), [1971] C.M.L.R. 1 at 27 (European Ct.) [hereinafter *Grad*]; *van Duyn, ibid.* at 16, 19; *Ratti, ibid.*

against all inconsistent national rules.[95] Foot-dragging and improper implementation by Member States become impossible, or at least nugatory. It should be noted, however, that not all binding proposals issued by the Commission or Council of the European Community are susceptible of direct effect in the Member States; only decisions or directives that set out unconditional and sufficiently precise rights have this attribute.[96]

Compulsory co-ordination entails a very real curtailment of national sovereignty, for it gives the community the capacity to affect the national legal order of the Member States with or without their consent. Indeed, to the extent that community proposals have the potential to operate directly as law throughout the community and to prevail over inconsistent national rules, this mechanism can be said to constitute the issuing community institution as a supranational body operating within an autonomous community legal order.[97] Under such a system the community court ceases to be an optional forum to enforce treaty obligations and becomes instead a necessary instrument for upholding the community legal order and ensuring the uniform interpretation and application of its norms.[98]

Compulsory co-ordination is only used in the European Community. It is far too radical a mechanism for free trade areas and should be avoided in any Canada-United States agreement. It is, in fact, only a step removed from *centralism*, which is the most radical mechanism for achieving economic integration.

(e) *Centralism*

Centralism means that the power to make laws and policy resides in the community, to whose institutions is transferred, for this purpose, the sovereignty of the Member States. The hallmark of centralism is direct applicability, which means that the decisions of the community are intended at the outset to take effect automatically within the jurisdictions of the Member States without the need for national intervention. Unlike co-ordination, centralism reserves both the determination of the substance *and* the implementation of the measure to the community. National sovereignty is not just curtailed, it is surrendered in order to confer supranational powers on the community institutions.[99] Like compulsory

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[95] *See Dutch Indus., supra*, note 93; *Ratti, ibid.* at 113.

[96] *See Grad, supra*, note 94 at 24.

[97] *See supra*, note 92 concerning the term "supranational". For an analysis of the concept of an autonomous community legal order, *see* P. Raworth, *Article 177 of the Treaty of Rome and the Evolution of the Doctrine of the Supremacy of Community Law* (1977) 15 CAN. Y.B. INT'L L. 276 at 278-82 [hereinafter Raworth].

[98] *See* P.S.R.F. Mathijsen, A GUIDE TO EUROPEAN COMMUNITY LAW 4th ed. (London: Sweet & Maxwell, 1985) at 54-76.

[99] *See, e.g., N.V. Algemene Transp.-En Expeditie Onderneming van Gend en Loos* v. *Nederlandse Tariefcommissie* [26/62] (1963), [1963] C.M.L.R. 105 at 129 (European Ct.) [hereinafter *van Gend en Loos*]. *See also* Raworth, *supra*, note 97 at 279-81.

co-ordination, centralism is only used in the European Community,[100] where it takes the form of regulations issued by the Community institutions[101] and the form of directly applicable treaty provisions.[102] Proper and uniform interpretation and application of the directly applicable Community rules are secured by the Community Court, and private individuals may enforce before national courts any rights devolving upon them from these rules. Centralism is unlikely to be used in any Canada-United States agreement and should be avoided if Canadian sovereignty is to be protected.

(f) *Enforcement Procedures*

All agreements for economic integration provide for some procedure for the enforcement of obligations arising under or out of the agreement. The three methods used are consultation and co-operation, retaliatory sanctions or some form of judicial proceeding. The first two methods are those most commonly found in free trade agreements.

Consultation and co-operation, either directly between the Member States[103] or through the mediation of a community institution,[104] is almost invariably the first step in any dispute procedure. In the Anglo-Irish and Australia-New Zealand agreements it is the only enforcement method, so that reliance is placed exclusively on the good faith of the Member States. There is much to be said for this approach, which avoids the contentiousness and ill-feeling that the other two methods can cause. However, good faith in international relations is a fragile commodity even between allies, as national governments strive to contend with domestic political pressures mobilized all too often in support of narrow national self-interest. Thus, the norm is for agreements, free trade or otherwise, to provide for supplementary remedies where the good will is not forthcoming.

The nature of these supplementary remedies tends to depend upon the nature of the agreement. In the more advanced schemes, such as the European Community and the Benelux Economic Union, outstanding disputes are referred to a community court for a binding decision.[105] Sanctions are not used even where the court's judgment is not followed.

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[100] It is, however, a mechanism that is common to all federal states. In Canada, for example, the federation is able to make laws and set policies within its area of competence that are directly applicable in all provinces and territories of the Dominion.

[101] *See EEC Treaty, supra*, note 1, art. 189.

[102] *See van Gend en Loos, supra*, note 99 at 130. *See also Sociaal Fonds voor de Diamantarbeiders, Antwerp* v. *S.A. Ch. Brachfeld & Sons* [2/69] (1969), [1969] C.M.L.R. 335 (European Ct.).

[103] *See, e.g., ANZCERT Treaty*, art. 22(2); *EFTA Treaty*, art. 31(1); *Eire Agreement*, art. XXIII(3); *Israel Agreement*, art. 19(1)(b), cited note 1, *supra*.

[104] *See, e.g., Israel Agreement*, art. 19(1)(c); *Austrian Agreement*, art. 27(2); *EEC Treaty*, arts. 169, 170; *Benelux Treaty*, art. 44, cited note 1, *supra*.

[105] *See EEC Treaty*, arts. 169, 170; *Benelux Treaty*, arts. 41, 44, cited note 1, *supra*.

Instead, the delinquent state may be brought before the court again,[106] or the matter may be passed on to the International Court of Justice.[107] There is no reason why such procedures could not be adopted within a free trade area, as the *Macdonald Report* suggests for Canada and the United States,[108] but in practice free trade agreements normally opt for the alternative of retaliatory action.[109] The Israeli-United States agreement does provide for a conciliation panel to examine disputes, but the panel's report is non-binding and its main function is to establish whether retaliation is justified.[110] The problem with the judicial route alone is to obtain an agreement to set up a tribunal with sufficient authority and a broad enough jurisdiction. Ultimately, it may prove easier in the Canada-United States context to emulate the Israeli-United States approach by providing for retaliation as a last resort after some form of impartial judicial proceeding.[111]

The rights of private individuals and entities arising under or as a result of any agreement for economic integration can normally only be enforced after they have been enacted into national law. Exceptions are the mechanisms of compulsory co-ordination and centralism, whereby such rights automatically become part of the Member States' legal order. But these mechanisms are peculiar to the European Community and are not likely to be adopted in a Canada-United States free trade area.

III. A Canada-United States Free Trade Agreement

The intention of this analysis is not to present a model free trade agreement or to discuss every potential issue that academic ingenuity can devise, but to examine, in light of the external factors that have just been discussed, the main problems relating to free trade in goods and services between Canada and the United States. This examination is done from the perspective of what would seem to be the two fundamental criteria that will underlie the Canadian approach to negotiations with the United States, namely: a) the need to achieve a workable, mutually beneficial and internationally acceptable agreement, and b) the desire to protect Canadian sovereignty as far as is consistent with the first criterion.

A. *Liberalization of Trade in Goods*

1. *Scope*

One of the more ill-informed aspects of public response in Canada to the idea of a free trade agreement with the United States has been the

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[106] *See EEC Treaty, supra*, note 1, arts. 169-71.

[107] *See Benelux Treaty, supra*, note 1, art. 50.

[108] *Supra*, note 17 at 321-2.

[109] *See, e.g., EFTA Treaty*, art. 31(4); *Israel Agreement*, art. 19(2); *Austrian Agreement*, art. 27(2), (3), cited note 1, *supra*.

[110] *See Israel Agreement, supra*, note 1, art. 19(1)(d), (e).

[111] *See* text (*Dispute Settlement Procedure*) in section III.D.2.(d), *infra*.

clamour to exclude from its ambit every sector of the economy that could conceivably experience difficulties as a result of any agreement. The unpalatable truth is that there is a definite limit on what may be excluded if the first criterion above is to be honoured.

In the first place, one of the main reasons for entering into a free trade agreement is to stimulate economic growth and prosperity, and this requires that the agreement be permitted to bring about a more efficient allocation of resources within the national economy.[112] Domestic industries that cannot survive without a protective wall of government subsidies must be left to their own fate, and the resources of capital and manpower that they consume to such little effect should be shifted to sectors of the economy that can survive and prosper against international competition. Clearly this implies a radical re-structuring of the Canadian economy, and any agreement must permit the Canadian authorites to take whatever steps are necessary to help this process along and mitigate its disruptive effects. There may, of course, be some industries that for a variety of public policy reasons need to be maintained despite their lack of viability, but, if the agreement is to have its desired economic impact, the emphasis in this country must shift from exclusion to the problems of re-structuring.

The second reason why the scope of any agreement cannot be set too narrowly is simply that it must be *mutually* beneficial. One can hardly expect the United States to expose its more vulnerable industries to free competition with their Canadian rivals without reciprocity on Canada's part.[113] The only alternative would be for both countries to exclude their weak industries from the free trade regime, in which case it becomes questionable whether a free trade agreement between them would be of any use at all.

Finally, there is the issue of *GATT* article XXIV, which requires any free trade agreement between contracting parties to cover substantially all of the trade between them.[114] As a legal limitation on Canada's freedom of manoeuvre, this article need not prove much of an obstacle.[115] Apart from the fact that it has never been properly adhered to in international practice, it would be quite easy to circumvent by postponing indefinitely the application of the agreement to those sectors of the economy that it is desired to exclude from the free trade regime.[116] But there are potent

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[112] *See* Curzon, *supra*, note 21 at 19.

[113] The free trade agreement between Ireland and the United Kingdom does take account of the relative weakness of the Irish economy by permitting Ireland to exclude up to three percent of its imports originating in the United Kingdom from the operation of the agreement. *Eire Agreement, supra*, note 1, art. I(5). The United States also agreed to permit Israel to apply tariffs against a maximum of 10 percent of imports from the United States in order to protect or establish new industries. *Israel Agreement, supra*, note 1, art. 10. It is doubtful, however, whether Canada could expect to benefit from such generosity.

[114] *Supra*, note 2.

[115] *See* note 76, *supra*. Note, however, the emphasis on compatibility with *GATT* article XXIV in the *Israel Agreement, supra*, note 1, art. 1.

[116] For example, the *Macdonald Report* suggests deferring agriculture. *Supra*, note 17 at 311, 382-3.

considerations for adopting an approach that is indeed compatible with the spirit of article XXIV. Canada's external trade is overwhelmingly intercontinental,[117] and such a heavy reliance on the American market cannot but put the country at the mercy of the American economy and reduce the scope for independent policies. In addition, this exclusiveness means that Canada is neglecting lucrative markets elsewhere. Such a situation calls for a concerted effort by government and industry to develop a genuinely international trade in Canadian goods and services,[118] and here Canada will have to rely heavily on a properly-functioning and perhaps expanded *GATT*. A Canada-United States trade agreement that openly flouts the *GATT* rules must inevitably undermine the credibility of the *GATT* and reduce the prospect of a successful new round of multilateral trade negotiations. The prospects for an internationalization of Canadian trade would be correspondingly diminished.

It is submitted, therefore, that a free trade agreement between Canada and the United States should, as a matter of principle, cover all trade between the two countries. Only those industries which, on the basis of valid and mutually acceptable public policy grounds it is deemed necessary to protect, should be excluded. Mere competitive weakness should not be considered such a ground. Instead, the two countries should identify the weak sectors of their economies and those that are subject to complex internal regulation (such as agriculture) and agree to the more gradual incorporation of these sectors into the free trade regime.[119] This gradualist approach should be complemented by a system of permitted government support to aid any necessary re-structuring of the economies. In order to maintain momentum and to ensure that the protective barriers are not indefinitely prolonged, a timetable for the incorporation should be established.

2. *Timetable*

The *Macdonald Report* suggests a ten-year transitional period for phasing in a Canada-United States trade agreement, with Canada possibly having a longer period to adjust.[120] Neither of these suggestions contravene article XXIV and the two-speed approach was adopted suc-

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[117] In 1985, exports to the United States accounted for almost 80 percent of Canada's external sales. *See* Statistics Canada, *Exports by Countries* (January-March, 1986) at 11, table 1.

[118] This is one of the thrusts of a federal government discussion paper. *See Minister for International Trade, How to Secure and Enhance Canadian Access to Export Markets* (Discussion Paper) by The Honourable J.F. Kelleher (Ottawa: Government of Canada, 1984).

[119] This approach is taken in the Australia-New Zealand agreement with respect to such goods as wine and dairy products, plastic products, carpets, whiteware, motor vehicles, apparel and certain iron and steel products. *See ANZCERT Treaty, supra*, note 1, art. 6.

[120] *Supra*, note 17 at 311, 382-3.

cessfully in the Ireland-United Kingdom free trade arrangement.[121] It might be advisable to allow for some flexibility by permitting the transitional period to be prolonged or shortened and, as suggested above, some sectors of the economy might be given a longer period altogether for incorporation into the free trade regime. In both cases, however, it is essential to establish the outer limits of any transitional adjustments as a guard against inertia and the comforts of protectionism.

3. *Discrimination in Law*

(a) *Tariffs*

A free trade area requires the elimination of restrictive duties on imports from other Member States. This does not include revenue duties,[122] anti-dumping and countervailing duties,[123] or appropriate customs fees.[124] Most free trade agreements do, however, seek to ensure that such charges are applied non-restrictively and do not represent an indirect form of protection.[125]

(b) *Quotas*

All import and export quotas on trade between Member States must be abolished, although article XXIV of the *GATT* does permit controls for balance-of-payments purposes, exceptions conforming to articles XX (General Exceptions) and XXI (Security Exceptions), and certain administrative quotas under article XI(2).[126] Free trade agreements normally provide for some or all of these exceptions,[127] but there is no absolutely uniform approach. The Australia-New Zealand agreement, for instance, does not permit balance-of-payments exceptions. One exception of particular interest to Canada might be the temporary export quota permitted under article XI(2)(a) to forestall or prevent critical shortages of essential

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[121] *See Eire Agreement, supra*, note 1, arts. I, VI.

[122] *See, e.g., ANZCERT Treaty*, art. 7(1); *EFTA Treaty*, art. 6; *Eire Agreement*, art. IV, cited note 1, *supra*. Revenue duties are, however, prohibited in the *Austrian Agreement, supra*, note 1, art. 4, presumably in order to place intra-area trade on the same footing as intra-EEC trade.

[123] *See, e.g., ANZCERT Treaty*, arts. 15, 16; *EFTA Treaty*, art. 17; *Eire Agreement*, art. XI; *Austrian Agreement*, art. 25, cited note 1, *supra*.

[124] *See, e.g., ANZCERT Treaty, supra*, note 1, art. 4(13)(a). No other agreement specifically refers to customs charges, but in practice they are allowed.

[125] *See, e.g.*, the wording of the *ANZCERT Treaty, ibid.*, permitting "fees or charges connected with importation which approximate the cost of services rendered and do not represent an indirect form of protection or a taxation for fiscal purposes".

[126] *See* the discussion of *GATT*, art. XXIV in section II.B of the text, *supra*.

[127] *See, e.g., ANZCERT Treaty*, art. 18; *EFTA Treaty*, arts. 12, 18, 19(1); *Eire Agreement*, arts. VIII, X, XVII, XVIII; *Israel Agreement*, arts. 6, 7, 11; *Austrian Agreement*, arts. 10, 20, 21, 28, cited note 1, *supra*.

products which, together with measures allowed under article XX(g) to conserve exhaustible natural resources, would allow Canada to include in an agreement with the United States guarantees against a continentalist exploitation of its energy resources.

Licences will be needed to administer any quotas permitted under a Canada-United States agreement. It may, therefore, be worthwhile to include a provision restricting to the minimum necessary to administer the quotas any formalities connected with discretionary licensing.[128]

(c) *Rules of Origin*

As one of the main methods of combating the deflection of trade that inevitably arises from the maintenance of national tariffs by Member States, free trade areas always establish rules of origin setting out which goods qualify for area treatment.[129] The exact format of the rules depends upon the patterns of trade involved and the structure of the Member States' industrial sector, and the various possible approaches can be used either alone or in an appropriate combination. A common requirement is that, where third country raw materials or intermediate goods are used, the value of this input must not exceed a certain percentage —50 percent is a popular figure — of the export price of the final product.[130] A refinement of this requirement is that certain third country inputs (normally those in short supply within the Member States as a whole) may be deemed to originate within the area.[131] With respect to part manufacture within a Member State, the final manufacturing process must normally take place within the area.[132] There are occasions where goods manufactured by a particular, specified process are allowed to qualify for area treatment no matter what percentage of third country inputs they contain.[133]

In cases of substantial discrepancies between national tariffs, the existing rules of origin may not sufficiently prevent deflections of trade. Most free trade agreements thus provide for a modification of the rules as an alternative to policy harmonization, or they allow for safeguard measures as a means of overcoming this problem.[134]

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[128] *See, e.g., Israel Agreement, supra*, note 1, art. 12.

[129] *See, e.g., ANZCERT Treaty*, art. 3; *EFTA Treaty*, art. 4; *Eire Agreement*, art. III; *Israel Agreement*, Annex 3; *Austrian Agreement*, Protocol 3, cited note 1, *supra*.

[130] *See, e.g., ANZCERT Treaty*, art. 3; *EFTA Treaty*, art. 4(1), cited note 1, *supra*. The *Israel Agreement, supra*, note 1, Annex 3, art. 1(c), however, sets the percentage at 65 percent.

[131] *See, e.g., EFTA Treaty, supra*, note 1, art. 4(2).

[132] *See ANZCERT Treaty, supra*, note 1, art. 3(1)(c)(i). *See also Israel Agreement, supra*, note 1, Annex 3, art. 4, which requires the article to be substantially transformed into something new and different.

[133] *See, e.g, EFTA Treaty, supra*, note 1, art. 4(1)(b).

[134] *See, e.g., ANZCERT Treaty*, art. 14(4)(b); *EFTA Treaty*, art. 5(2); *Eire Agreement*, art. III(2), cited note 1, *supra*.

(d) *Discriminatory Practices of Public Undertakings*

Both the *EFTA Treaty* and the Anglo-Irish agreement provide for the elimination of discriminatory practices by public undertakings against goods from other Member States, in particular, administrative measures that have an effect equivalent to tariffs or quotas.[135] Such practices by Canadian public undertakings are already a bone of contention with the United States[136] and this fact, together with the wider public involvement in the economy in this country, undoubtedly means that the practices will have to be covered by any Canada-United States agreement. If this is so, it is suggested that the EFTA and Anglo-Irish approach is preferable to leaving the problem to be dealt with under a general frustration of benefits and complaints procedure, as is done in the Australia-New Zealand and Israeli-United States agreements.[137] In this way, the obligations of the parties are clear from the outset and are not subject to the vagaries of treaty interpretation and the baleful influence of partisan domestic politics.

(e) *Government Procurement*

The application of free trade rules to government purchasing has long been a very controversial issue. On the one hand we are dealing with a very large and lucrative market which cannot be excluded from a free trade regime without seriously impairing the agreement's value to the Member States. On the other hand governments are subject to enormous political and economic pressures to favour domestic, and even local, industry. It is a problem that has not been resolved in the EEC despite that Community's extensive integration, and it still persists in federal states between the component units. Liberalization of government procurement practices is not required for free trade areas by Article XXIV[138] and is not included in the EFTA, Anglo-Irish and EEC-Austrian agreements.[139] However, both the Australia-New Zealand and Israeli-United States accords do contain a general obligation to liberalize at some unspecified time in the future (which the latter supplements with an immediate reduction of the threshold value for purchases subject to the Tokyo Agreement on Government Procurement from 150,000 SDRs (approximately US$180,000) to US$50,000).[140]

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[135] *EFTA Treaty*, art. 14(1); *Eire Agreement*, art. XIV(1), cited note 1, *supra*.

[136] An example is the practice, indulged in by the Ontario Liquor Control Board, of marking-up foreign wines.

[137] *See* the discussion of dispute settlement procedures in section III.D.2.(d), *infra*.

[138] *See* text, section II.B, *supra*.

[139] Some common rules on government procurement practices were eventually set out, but they do not represent a significant liberalization of this area. *See Public Undertakings: The Lisbon Ministerial Agreement Explained, EFTA Bulletin* (March-April, 1967) 3.

[140] *See ANZCERT Treaty*, art. 11; *Israel Agreement*, art. 15, cited note 1, *supra*. The Special Drawing Right (SDR) is an international reserve currency created under article XV of the IMF (*see* note 172, *infra*). They are used for various official international transactions and as a unit of account. As of August 15, 1986, 1 SDR = US$1.20 and C$1.66.

The *Macdonald Report* urges that government procurement practices be brought under a Canada-United States free trade agreement[141] and, for the reasons given above, this appears to be eminently desirable. If they are to be included, it would be wise to eschew a vague, general commitment in favour of a definite programme of liberalization to be attained according to a set timetable. This would at least make it easier for the authorities concerned to take what may be very unpopular steps, whereas an agreement to agree at a later date would be very likely to founder on the rocks of domestic, protectionist pressures.

(f) *National Treatment*

A strange omission which occurs in all of the free trade agreements that are the subject of special attention in this study is a comprehensive requirement for national treatment of imports from Member States. Most contain only a fiscal provision, modelled after *GATT* article III(2), which prohibits the levying of discriminatory internal charges on area goods.[142] Discriminatory national rules affecting the internal sale, offering for sale, purchase, transportation, distribution or use of imports from Member States are not mentioned, so that any problems in this regard are left to be resolved under the auspices of the *GATT* or whatever general procedures the agreement may contain. This is surely unsatisfactory and there is no logical reason for reproducing only part of *GATT* article III as a specific obligation that is subject to the enforcement provisions of the agreement. It is suggested that a Canada-United States agreement should contain a comprehensive national treatment provision modelled after *GATT* article III(1).

(g) *Exchange Controls*

Only the EEC-Austrian agreement contains a specific obligation with respect to payments for current intra-area transactions.[143] All the other agreements are content to allow the Member States' obligations in this matter to rest on their international obligations as members of the International Monetary Fund and the Organization for Economic Co-operation and Development (OECD).[144] But, if a free trade agreement is to regulate the commercial relationships of Member States, it is surely appropriate to include in it a provision guaranteeing that the elimination of tariffs and other barriers to trade will not be nullified by exchange action by the parties. Such a provision could be modelled on article 106(1) of the *EEC*

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[141] *See* note 61, *supra*.

[142] *See, e.g., ANZCERT Treaty*, art. 7(2); *EFTA Treaty*, art. 6(1)(a); *Eire Agreement*, art. IV(1)(a); *Austrian Agreement*, art. 18, cited note 1, *supra*.

[143] *Supra*, note 1, art. 19.

[144] *See, e.g., EFTA Treaty*, art. 29; *Eire Agreement*, art. XXI(b), cited note 1, *supra*.

Treaty[145] and could require Canada and the United States to authorize any payments connected with the movement of goods or services to the extent that such movement has been liberalized pursuant to the agreement.

(h) *Right of Establishment*

Both the EFTA and Anglo-Irish agreements give a qualified, rudimentary right of establishment designed to enable non-nationals to set up distribution, service and other facilities that may aid in the export of their goods within the free trade area.[146] This is an important consideration, for problems may arise when a Member State must rely totally on local capacities for such matters. At present there are no great barriers to Canadians and Americans setting up these types of facilities in each other's countries, but it might be worthwhile to enshrine the right to do so in the agreement.

4. *Discrimination in Fact*

A free trade agreement cannot realistically provide for the elimination of discriminatory laws of general application that are based on valid public policy considerations.[147] Nevertheless, if the free trade regime is to function properly, laws that impinge on the free movement of goods (for example, standards, labelling requirements and technical specifications) will have to be approximated. Most free trade agreements leave this task to be accomplished under general provisions dealing with frustration of the objectives of the agreement,[148] but, given the obstructive potential of discrimination in fact, this approach is too lax. A better model for Canada and the United States is the Australia-New Zealand agreement, which contains a specific article on the need to approximate laws.[149] However, even in that agreement there is no *obligation* to approximate. In order to ensure that this matter is dealt with effectively, it is suggested that a Canada-United States agreement should contain a provision placing the parties under a specific obligation to approximate in certain key areas and under a general obligation to approximate on an *ad hoc* basis whenever problems arise.

The problem that remains is the problem of discriminatory general laws that cannot be justified on public policy grounds.[150] Some free trade agreements prohibit general fiscal charges that, due to little or no produc-

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145 *Supra*, note 1.

146 *See EFTA Treaty*, art. 16(1); *Eire Agreement, art. XVI(1), cited note 1, supra.*

147 *See* text, section II.A.1.(b), *supra.*

148 *See, e.g., EFTA Treaty*, art. 31(1); *Eire Agreement*, art. XXIII(3); *Israel Agreement*, art. 19(1)(a); *Austrian Agreement*, art. 31, cited note 1, *supra.*

149 *Supra*, note 1, art. 12. It should be noted that the agreement uses the term "harmonization".

150 *See supra*, note 147.

tion of the goods in question in the taxing state, fall primarily on foreign goods and thereby afford effective protection to domestic goods that are substitutable for them.[151] There is no reason why this prohibition could not be cast more widely in a Canada-United States agreement so as to cover all domestic laws of general application that operate solely as an indirect form of protectionism.

5. *Exceptions*

(a) *Safeguard Measures*

Leaving aside the procedural aspect, which has already been discussed in the context of the requirements of *GATT* article XXIV and is mentioned again in the section on the proposed mechanics of a Canada-United States free trade agreement,[152] the questions to be addressed by any Canada- United States agreement concern the nature of the permitted safeguard measures and the circumstances in which they may be taken.

Article XIX of the *GATT*[153] permits contracting parties to safeguard particular industries by way of quantitative restrictions or tariff action. Traditionally, free trade areas have shown a partiality for quotas. The EFTA and Anglo-Irish agreements, for example, limit tariff action to the retardation of reductions due under the agreement,[154] while the EEC-Austrian and Israeli-United States agreements permit either type of measure.[155] But quotas are extremely disruptive of trade and have a greater impact on domestic prices than tariff protection. Accordingly, it is submitted that a better model for Canada and the United States would be the Australia-New Zealand approach, which relies primarily on tariff protection and permits quotas only in the most extreme circumstances when no other measure would be effective.[156] This last agreement also expressly obliges the Member States to apply any safeguard measures to the minimum extent necessary to ameliorate the problem; it is also the only agreement to set an absolute maximum period —two years —for their duration.[157] In addition, it specifies that safeguard measures taken under the agreement shall not be more restrictive than similar measures applied to third-country imports, and it allows the other Member State to introduce equivalent measures in respect of the same industry to achieve conditions of fair competition.[158] This last provision is a useful device, for it prevents

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[151] *See, e.g., EFTA Treaty*, art. 6(1)(b); *Eire Agreement*, art. IV(1)(b); *Austrian Agreement*, art. 18, cited note 1, *supra*.

[152] *See* section III.D.2.(c), *infra*.

[153] *Supra*, note 2.

[154] *EFTA Treaty*, art. 20; *Eire Agreement*, art. XIX, cited note 1, *supra*.

[155] *Israel Agreement*, art. 5; *Austrian Agreement*, art. 27(2), cited note 1, *supra*.

[156] *Supra*, note 1, art. 17(6)(b).

[157] *Ibid.*, art. 17(6)(a), (7)(a).

[158] *Ibid.*, art. 17(10), (8) respectively.

safeguard measures from being used as a sword rather than a shield against the other Member State. All in all, the Australia-New Zealand approach is commendable, although the two-year maximum may be too short a period to allow for the difficult adjustment to the rigours of free trade.

With regard to the circumstances justifying the use of safeguard measures, it is usual for free trade agreements to model these on *GATT* article XIX. For safeguard measures to be justified, most free trade agreements thus require a rise in imports that is due to the effect of a Member State's free trade obligations and which causes or threatens to cause serious injury to domestic producers of like products.[159] Only the EFTA agreement, however, includes the *GATT* requirement that this rise be due also to unforeseen developments.[160] The *Macdonald Report* suggests a further limitation, namely, that imports from Canada or the United States be the *primary* cause of injury to the other Member State.[161] Significantly, this is the approach taken in the Israeli-United States agreement, which requires that the rise in imports from the other Member State be a *substantial* cause of injury and specifically allows intra-area imports to be exempted from safeguard action where this is not the case.[162] Another possibility for a Canada-United States provision is to permit action in cases where imports rise due to the *absence* of restrictions or tariffs; this would cover the situation where the goods in question entered Canada freely prior to the conclusion of the agreement.

(b) *Deflection of Trade Countermeasures*

It is common for free trade agreements to permit action to be taken against imports from other Member States in cases of deflection of trade, although this is invariably used as a last resort where amendment of the rules of origin, tariff harmonization or some other remedy is not feasible.[163] In all cases except the Israeli-United States agreement this action is specifically provided for rather than left to be dealt with under a general dispute procedure.[164]

The circumstances justifying use of these countermeasures are not uniform. The exception is restricted in the EFTA and EEC-Austrian agreements to cases where there is injury or the threat of injury to domestic

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159 *See, e.g., ANZCERT Treaty, ibid.*, art. 17(2); *Israel Agreement, supra*, note 1, art. 5(1), (2). The wording of the *EFTA Treaty*, art. 20 and the *Eire Agreement*, art. XIX (cited note 1, *supra*) is different, but the sense is practically the same. The *Austrian Agreement, supra*, note 1, art. 26, on the other hand, omits any reference to the effect of free trade obligations.

160 *Supra*, note 1, art. 20.

161 *Supra*, note 17 at 315.

162 *Supra*, note 1, art. 5(1), (3).

163 *See*, in particular, *ANZCERT Treaty, supra*, note 1, art. 14.

164 *See, e.g., ANZCERT Treaty*, art. 14; *EFTA Treaty*, art. 5; *Eire Agreement*, art. III; *Austrian Agreement*, art. 24, cited note 1, *supra*. Compare *Israel Agreement, supra*, note 1, art. 19(1)(a).

producers caused by a rise in imports from another Member State. This rise must be due to the joint effect of the importing state's free trade obligations and the significantly lower national tariffs on third-country inputs in the exporting state.[165] The Anglo-Irish approach is a little broader, and also permits the exception where third-country inputs benefit from a remission of tariffs upon their re-exportation (drawback).[166] Broadest of all is the Australia-New Zealand agreement, under which action can be taken whenever the other Member State's policies, tariff or otherwise, enable its producers to obtain any inputs at artificially low prices and thereby cause a distortion in the pattern of intra-area trade.[167]

This last approach is tempting, as it provides a comprehensive, specific remedy for all possible causes of a deflection of trade, including subsidies. But it is too radical, for it in effect stretches the exception into a general unilateral remedy against the distortions that are bound to arise during the operation of a free trade agreement. A more constructive approach is surely to restrict this exception to cases of genuine deflection of trade through tariff disparity and, perhaps drawback as well, and to set up a co-operative mechanism for dealing with other causes of intra-area trade distortion.[168]

(c) *Balance-of-Payments Exception (GATT Article XII)*

It is a moot point whether Member States of a free trade area may agree not to extend to each other's exports quantitative restrictions that are imposed for balance-of-payments reasons. Article XIII of the *GATT* requires that such restrictions be applied on a non-discriminatory basis and, given that article XXIV(8) specifically permits their use in intra-area trade, this requirement could well be interpreted as applying to free trade partners as well.[169] Certainly most free trade agreements permit quotas against other Member States for balance-of-payments reasons, normally requiring only that they be applied in accordance with the *GATT* rules.[170] There is nothing to suggest, however, that article XXIV(8) mandates the inclusion of this exception in free trade agreements; indeed, by permitting such restrictions only *where necessary*, it could be said that it discourages this derogation from the free trade regime.[171] It should be noted that no question of incompatability with the *GATT* has arisen in the case of the Australia-New Zealand agreement, which does not include any balance-

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165 *See EFTA Treaty*, art. 5(1); *Austrian Agreement*, art. 24, cited note 1, *supra*.

166 *Supra*, note 1, art III(1).

167 *Supra*, note 1, art. 14(1).

168 *See* section III.D.2.(a) of the text, *infra*.

169 *See, inter alia*, Contracting Parties, B.I.S.D. (Supp. 9) at 76-7 (1961) (examination of the Stockholm Convention).

170 *See, e.g., EFTA Treaty*, art. 19(1); *Eire Agreement*, art. XVIII(1); *Israel Agreement*, art. 11; *Austrian Agreement*, art. 28, cited note 1, *supra*.

171 *See, inter alia, supra*, note 169.

of-payments exception. As to the approach to be adopted in a Canada-United States agreement, it is difficult to say whether the exception should be included or not. Exclusion would mean that Canada could lose many benefits of the agreement if the United States were to tackle its horrendous international deficit by wholesale quotas on *all* imports, including those from its free trade partner. Inclusion, however, would deprive Canada of being able to take action against the major source of its imports.

(d) *Exchange Restrictions*

Pursuant to article VIII(2) of the IMF articles,[172] restrictions on the making of payments and transfers for current international transactions may be imposed with the approval of the Fund. Furthermore, under article XV(9)(b) of the *GATT*, quotas may be used to make these exchange controls effective. Neither Canada nor the United States have historically made much use of exchange controls and so it may be sufficient to leave this matter to be regulated by existing international obligations.[173] Alternatively, exchange controls could be included as a specific exception and treated in the same way procedurally as trade exceptions,[174] particularly if an agreement between the two includes a provision akin to article 106(1) of the *EEC Treaty*.

(e) *Anti-Dumping and Countervailing Duties*

These duties are not restrictive of trade where they are imposed in conformity with *GATT* rules, and so they are not required to be prohibited in intra-area trade.[175] Many agreements leave the whole issue to be regulated by the Member States' *GATT* obligations,[176] but the Australia-New Zealand agreement sets out rules for their use within the free trade area that amplify the *GATT* provisions.[177] The latter approach is preferable as it both limits the use of these duties and subjects their abuse to the enforcement provisions of the agreement.

If a Canada-United States agreement were to emulate this latter approach, it must specify the circumstances under which these duties could be imposed and the procedures for doing so. The qualifying circumstances need not go beyond the *GATT* requirements but should include all

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[172] *Articles of Agreement of the International Monetary Fund and Articles of Agreement of the International Bank for Reconstruction and Development*, 27 December 1945, 2 U.N.T.S. 39 (Bretton Woods Agreement).

[173] This is done in *EFTA Treaty*, art. 29; *Eire Agreement*, art. XXI, cited note 1, *supra*.

[174] This is suggested in section III.A.3.(g) of the text, *supra*. *See also* section III.D.2.(e), *infra*.

[175] *See generally* section II.B of the text, *supra*.

[176] *See, e.g., EFTA Treaty*, art. 17(1); *Eire Agreement*, art. XI(1); *Israel Agreement*, art. 3, cited note 1, *supra*.

[177] *Supra*, note 1, arts. 15, 16.

the rules applicable to the imposition of provisional duties.[178] The suggestion in the *Macdonald Report* that these duties only be applicable where Canadian or American goods are the *exclusive* cause of injury to the other partner[179] seems to exceed the liberalization required by article XXIV and thus contravenes the MFN principle of article I.

(f) *General and Security Exceptions (GATT Articles XX and XXI)*

These non-protectionist exceptions are normally included in free trade agreements,[180] a practice that a Canada-United States agreement would presumably follow.

B. *Liberalization of Trade in Services*

1. *Scope*

Trade in services is not covered by the *GATT* and thus there is no limit on what may be excluded from this portion of a Canada-United States agreement. Indeed, it is not normal to include services at all in a free trade agreement,[181] but the *Macdonald Report* is doubtless correct when it asserts that the United States, at least, will want to extend free trade into this area.[182] It is not, however, likely that all services will be included and the question is what formula will be used for defining the scope of this part of the agreement. The approach taken in the EEC and Benelux treaties (which, at the very least, set up common markets and hence provide for free movement of services) is to include all services subject to certain exceptions,[183] but, in view of American expertise in this field, such a liberal approach would not be in Canada's interest. Nor is it appropriate for a free trade area, which, unlike the common markets of the EEC and Benelux Economic Union, is traditionally restricted to free trade in goods. The solution might well be to identify certain service industries in each country, such as insurance, communications, consulting and even banking, that would especially benefit from free trade without causing too great a disruption to the other Member State. Only these would be covered by the agreement.[184]

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[178] *See* the rules on provisional duties in the *ANZCERT Treaty, supra*, note 1, arts. 15(6), 16(5).

[179] *Supra*, note 17 at 314.

[180] *See, e.g., ANZCERT Treaty*, art. 18; *EFTA Treaty*, arts. 12, 18; *Eire Agreement*, arts. X, XVII, cited note 1, *supra*.

[181] They are, however, included in the Israel-United States agreement. *See, e.g., supra*, note 1, art. 16.

[182] *Supra*, note 17 at 308-9.

[183] *See, e.g., EEC Treaty*, arts. 55, 59, 66; *Benelux Treaty*, arts. 2(2)(b), 61, cited note 1, *supra*.

[184] The *Macdonald Report* advocates this approach. *Supra*, note 17 at 309. *See also Israel Agreement*, Declaration on Trade in Services, *supra*, note 1, Point 1, which refers to the entire sector.

2. *Discrimination in Law*

Once it has been determined which service industries are to come under the agreement, it would be advisable to set out, in addition to the basic right to provide services, the three ancillary rights of entry, residence and equality.[185] The detailed implementation can be left to the Member States, but the essentials should be guaranteed by the agreement instead of left as the privilege they are now.[186] This will ensure that the right to provide services is capable of proper exercise. It will also avoid conflict between the two countries later on.

(a) *Right of Entry*

The agreement should give providers of services the right to enter the other Member State to carry out their work subject to any necessary formalities. These formalities will include matters such as entry papers, proof of the services and penalties for non-fulfilment. The formalities should be approximated pursuant to the agreement. The Member States will probably wish to reserve the right to refuse entry on public policy and health grounds, but in these cases there should be some approximation as well. A common list of health grounds could easily be drawn up. There might be more difficulty with the public policy reservation where, traditionally, Canada has taken a more liberal line, particularly with respect to political affiliations and sexual mores. With this difference in mind, it might be worthwhile including a specific provision in the agreement limiting the public policy reservation to situations where there is "a genuine and sufficiently serious threat affecting one of the fundamental interests of society".[187] In default of approximation, this would at least ensure some uniformity of treatment. Further, if an arbitral court were set up to oversee the agreement, it could use such a provision to enforce a degree of uniformity.[188]

(b) *Right of Residence*

In order to provide services a provider may need to reside in the other Member State.[189] The agreement should give him or her the right to do so,

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185 These rights are guaranteed to providers of services under EEC law. *See Programme Général pour la suppression des restrictions à la libre prestation des services*, [1962] J.O. 32, no. 2. *See also* Council Directive 73/148/EEC, [1973] O.J. no. L 172/14.

186 *See Israel Agreement*, Declaration on Trade in Services, *supra*, note 1, point 9, which refers to "the possibility of transforming the provisions of this Declaration into legally binding rights and obligations".

187 This criterion is used in the EEC by the European Community Court of Justice in *R.* v. *Bouchereau* [30/77] (1977), [1977] 2 C.M.L.R. 800 at 825.

188 This is also suggested by the *Macdonald Report*. *See supra*, note 17 at 321-2.

189 *See Israel Agreement*, Declaration on Trade in Services, *supra*, note 1, point 2.

but, to avoid abuses, it should also specify that it is a temporary right limited to the duration of the services. Again there will be the question of formalities, which will involve work permits and residence cards, and approximation of the national requirements should be required by the agreement. The withdrawal or denial of the right of residence on public policy and health grounds could be handled in the same way as with denial of entry.

(c) *Right to Provide Services*

The agreement should make it clear that the right to provide services entitles the non-national to carry on work free of both direct *and* indirect discrimination. Specifically, it should single out for elimination measures equivalent to a direct prohibition and discriminatory prerequisites. Among the equivalent measures would be included such practices as refusing membership in a professional body where that membership is a pre-condition for providing the services, or withholding licences to practice a particular profession. Discriminatory prerequisites can be either substantive, such as requiring the non-national to pass special exams or furnish a special security, or formal, such as the need to obtain a special authorization. These types of prerequisites do not *per se* prevent the non-national from exercising his or her right to provide services, but, where they are onerous or time-consuming to fulfil, they must inevitably reduce the attractiveness of the right and thereby reduce the number of non-nationals taking advantage of it. In addition, the agreement should state that the right to provide services includes the right to advertise and canvass business. Entry and residence should also be guaranteed for carrying out these preliminaries.

(d) *Right to Equality*

While temporary residence in the other Member State cannot be expected to confer on the non-national provider the right to all the social programmes and other benefits available to permanent residents, there are nonetheless some rights that he or she must enjoy in order to render the basic right to provide services properly viable. Foremost among them are those connected with business, such as the rights to use non-national or foreign employees, to sue and be sued, to borrow money and to tax concessions related to the provision of the particular service. A more sensitive area is that of public service contracts and whether the non-national should have access to them. Some guarantee of such equality rights should be included in the agreement. Another equality right of relevance to providers who envisage a longer stay in the other Member State is the right to bring their family with them. At present there are few legal barriers to such family migrations, but, to avoid potential problems, family members and perhaps other dependents could be given the right of entry and residence under the agreement.

3. *Discrimination in Fact*

This is a crucial area, for there are in most states a plethora of rules of general application governing the provision of services that place non-nationals at a disadvantage. Qualification and licence requirements, rules for conducting a particular business and compulsory membership in professional associations or trade bodies are some examples. These rules can have a devastating effect on the freedom to provide services, for non-national providers can rarely comply with them without disrupting their own domestic affairs. At the same time, most of them are perceived as protecting the public interest, and Member States are unwilling to eliminate them as purely discriminatory. As a result, the primary method of tackling these barriers to free trade in services between Canada and the United States will have to be through the approximation of laws.[190] It is suggested that the agreement should place a clear obligation on both countries to do this according to a set timetable. Taking the European Community practice as a guide, there are three main ways in which this approximation can be accomplished.

First, there must be put in place some mechanism for the mutual recognition of qualifications. This should not prove overly difficult as there is a general equivalence of educational standards and methods in Canada and the United States. In the rare situations where one country requires a formal qualification and the other does not, there should be a system established whereby the pursuit of the activity for an agreed time in the one state is accepted as the equivalent of the other's formal qualification.[191] Second, there should be a harmonization of the rules governing the pursuit of activities coming under the agreement where the discrepancies between Canada and the United States make it difficult to provide services across the border. The least incursive approach would be to set up minimum standards for cross-border services, thereby leaving the Member States free to apply their own standards to domestic operations.[192] A third requirement is for facilitative measures to adapt remaining national rules to the needs of non-national providers. These should include special procedures for proof of qualifications, professional and financial standing, good repute and the like,[193] *pro-forma* membership in professional and trade bodies[194] and even the waiver of some rules that merely duplicate domestic requirements.[195]

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[190] *See, e.g., ibid.*, point 8.

[191] As mentioned above, this is the approach used in the EEC. *See* Council Directive 75/368/EEC, on miscellaneous activities, [1975] O.J. no. L 167/22, arts. 4, 5, 7.

[192] Common minimum standards are set in the EEC with respect to credit institutions. *See* Council Directive 77/780/EEC, [1977] O.J. no. L 322/30.

[193] An example of such measures in the EEC with respect to veterinarians can be found in Council Directive 78/1026/EEC, [1978] O.J. no. L 362/1, arts. 6, 8, 12.

[194] *See ibid.*, art. 12.

[195] The criterion for deciding when a waiver is appropriate could be where the conditions under which the provider operates in the home state are "comparable to those required by the State in which the service is provided and [where] his activities are subject in the . . . [home] State to proper supervision". *van Wesemael, supra*, note 19 at 111-2.

Although the emphasis in this area must be on approximation, there is no reason why the general prohibition on purely discriminatory general laws should not also apply to services.[196] A requirement of prior residence, for example, which has no discernible public policy justification and practically nullifies the right to provide services, would be the type of general rule that such a prohibition would cover.

C. *Policy Harmonization*

1. *Introduction*

Policy harmonization is necessary within a free trade area as a corrective measure to prevent distortions in the conditions of competition.[197] It will certainly be needed in any Canada-United States arrangement, for here are two states that, despite some very basic similarities, have nonetheless pursued significantly different economic and social policies in recent times. On the whole the United States has remained true to the laissez-faire capitalist ideals on which it was founded, while Canada, always the more interventionist of the two, has edged closer to the social democratic model provided by Western Europe. Problems already exist — Atlantic fisheries and British Columbia stumpage fees, to name but two recent examples — and free trade can only exacerbate them, unless there is harmonization of the policies that cause the distortions. This the agreement must provide for in a cohesive fashion. It is best achieved in the traditional free trade way by singling out certain obvious areas of potential trouble, as well as including a provision for *ad hoc* action to be taken against distortions arising from the operation of the agreement.[198]

The issue of policy harmonization is a difficult one for Canada. Although it is clearly needed as part of a free trade agreement with the United States, the disparity in size between the two economies must inevitably give the American position more weight. Add to this fact the ideological fervour with which a newly resurgent United States is presently pursuing its policies, and the danger that policy harmonization will degenerate into policy americanization becomes very real. To combat this, Canada's negotiators must take great care and skill in framing this part of the agreement.

It is submitted that the best approach for Canada to policy harmonization is to ensure that it is both limited and fair. This can be done by insisting on the inclusion in the agreement of two fundamental principles on which the process is to be based. The first is the traditional free trade limitation that policy harmonization be restricted to what is absolutely necessary to

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[196] This was suggested for the agreement in the context of free trade in goods. *See* text, section III.A.4, *supra*.

[197] *See* text, section II.A.2, *supra*.

[198] *See ibid.*

prevent distortions in the conditions of competition. The agreement should make this quite clear both as a general principle and with respect to any specific areas of harmonization that are singled out in it. Any government measures that are not distortive would thus not have to be harmonized. The second principle is that, in deciding which government measures are causing distortions, regard should be had to the whole context in which these measures operate. To take a recent American complaint over British Columbia stumpage fees as an example, it would be necessary to compare the overall expenses, including all forms of taxes, social security payments and wage levels, of Canadian and American lumber producers before determining whether and to what extent the stumpage fees are distorting the conditions of competition. The formal inclusion of such a principle in the agreement would ensure a more equitable treatment for Canadian producers, whose expenses are generally higher than those of their American counterparts.

As far as the specific areas of policy harmonization are concerned, these would comprise what is found in other free trade agreements, namely, government aids, restrictive business practices, customs administration, external tariffs, general economic and financial policies and possibly agricultural production and marketing schemes. Given the discrepancies in taxation between Canada and the United States and bearing in mind the probable addition of some free movement in services to the agreement, this is another area of harmonization that might be singled out. There need be no provision, however, for harmonization of social programmes. This is not to say that such programmes may not distort the conditions of competition, but any distortion would be in favour of the Americans in the form of higher Canadian production costs. There may well be some pressure from Canadian producers for changes in the programmes to combat any distortion, but this would be an internal Canadian matter and would have no place in an agreement with the United States.

2. *Government Aids*

The agreement should first of all define what is meant by a government aid, as there have been disagreements in the past between Canada and the United States on this point. Secondly, it is suggested that it divide the aids into three categories. The first category would comprise government aids that by their very nature must distort the conditions of competition, such as export subsidies. These would be prohibited under the agreement.[199] The second category would contain a list of permitted aids, among which could be included aids to facilitate adjustment during the transitional period, aids of a social and humanitarian character and aids granted for the maintenance of the cultural identity of a group or nation as a

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[199] *See, e.g., ANZCERT Treaty*, art. 9; *EFTA Treaty*, art. 13(1)(a); *Israel Agreement*, Annex 4, cited note 1, *supra*.

whole.[200] The third category would include all remaining aids and prohibit them to the extent that they cause distortions.[201] A Member State granting such an aid could be obliged to enter into consultations under the dispute settlement procedure with a view to eliminating it or face retaliatory sanctions for non-fulfilment of the agreement.[202]

3. *Taxation*

Significant differences in taxation rates could cause problems within the proposed Canada-United States free trade area by distorting the flow of goods and services. Higher indirect taxes on certain items in Canada, for example, would discourage consumption and thereby adversely affect American producers or lead Canadian producers to concentrate unduly on the lower-tax American market. Higher personal taxes in one Member State might encourage the provision of services in the other to the extent that the tax is not still payable in the Member State of establishment. Alignment of taxation rates is, however, a sensitive issue, and one that even the EEC countries have not yet been able to agree upon. It would be particularly difficult for a Canadian government to tackle, as any alignment would probably result in lower Canadian rates and the drop in government income could have an impact on social programmes and budget deficits. Clearly, any harmonization in this area would have to be through negotiation, so that at most the agreement might provide for the necessary consultation and co-operation.

4. *Agricultural Production and Marketing Schemes*

If and when the large agricultural sectors in both Canada and the United States are brought under the free trade regime,[203] the existing government schemes involving production quotas, guaranteed prices, subsidies and marketing agencies will have to be drastically revised in order to give fair access to products from the other Member State. It is not suggested that the two countries should aspire to anything as complex — or wasteful — as the EEC Common Agricultural Policy,[204] but it is difficult to see how distortions can be eliminated without either establishing a free market in agricultural goods or co-operating on joint production and marketing schemes. Once again, this is not a matter for detailed regulation by the agreement, although the agreement should provide for harmonization if agriculture is to be included at some stage.

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200 The *EEC Treaty, supra*, note 1, contains such a list in art. 92(2).

201 *See, e.g., EFTA Treaty*, art. 13(1)(b); *Eire Agreement*, art. XIII(1); *Austrian Agreement*, art. 23(1)(iii), cited note 1, *supra*.

202 *See* text, section III.D.2.(d), *infra*.

203 The *Macdonald Report* suggests the inclusion of agriculture to be deferred. *Supra*, note 108.

204 *See EEC Treaty, supra*, note 1, arts. 35-47.

5. *Restrictive Business Practices*

A probable cause of future distortions within a Canada-United States free trade area will be the restrictive business practices of both private and public commercial enterprises. This issue will therefore have to be dealt with by the agreement and it will involve some harmonization because of the stricter competition rules that prevail in the United States. One possible way to proceed would be to stipulate that certain business practices are incompatible with the agreeement to the extent that they cause distortions.[205] A Member State in which such a practice is tolerated could be required to enter into consultations under the dispute settlement procedure with a view to eliminating it or face retaliatory sanctions for non-fulfilment of the agreement.[206] Given the probability of problems in this area, this more detailed approach would be preferable to merely obliging the parties to harmonize their competition rules at some later date.[207]

6. *External Tariffs*

As pointed out earlier,[208] substantial discrepancies in national tariffs can cause distortions within a free trade area by giving producers in a low-tariff Member State a competitive advantage which rules of origin can only partly correct. As a result, free trade agreements routinely provide for some harmonization of national tariffs.[209] Exceptionally, the Australia-New Zealand agreement goes further and envisages the possibility of a common external tariff.[210] This is not an approach that recommends itself in Canada's case, as it would entail an unnecessary loss of sovereignty. However, in addition to a specific provision on tariff harmonization, a Canada-United States trade agreement could provide for either Member State to request consultations to remedy any distortions resulting from national tariff discrepancies.[211]

7. *General Economic and Financial Policy*

Free trade agreements often provide for some low-level harmonization of general economic and financial policies for the obvious reason that each Member State is affected by the policies of the others.[212] There is no

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205 *See, e.g., EFTA Treaty*, art. 15(1); *Eire Agreement*, art. XV; *Austrian Agreement*, art. 23(1), cited note 1, *supra*.

206 *See* text, section III.D.2.(d), *infra*.

207 This latter approach is taken in the *ANZCERT Treaty, supra*, note 1, art. 12(1)(a).

208 *See* text, section II.A.2, *supra*.

209 *See, e.g., ANZCERT Treaty*, art. 14(4)(a); *EFTA Treaty*, art. 5(2), (4); *Eire Agreement*, art. III(2); *Israel Agreement*, art. 18(1)(b); *Austrian Agreement*, art. 12, cited note 1, *supra*.

210 *See supra*, note 1, art. 14(4)(a).

211 *See* text, section III.D.2.(b), *infra*.

212 *See, e.g., ANZCERT Treaty*, art. 22(3)(c); *EFTA Treaty*, art. 30; *Eire Agreement*, art. XX, cited note 1, *supra*.

reason to make an exception in the case of Canada and the United States, particularly when the two countries are already both involved in the ongoing attempts at co-ordination of policy at the periodic economic summits of the ten leading western nations. Nevertheless, in keeping with the criterion of safeguarding Canadian sovereignty as far as possible, care should be taken to avoid a bilateral process of harmonization with the United States which is too far-reaching. For this reason the wording of the Anglo-Irish agreement is apposite, for it commits the two parties merely to a periodic exchange of views "to the extent necessary to ensure the attainment of the objectives [of the agreement] and the smooth operation of . . . [the] Agreement".[213]

8. *Customs Administration*

Disparities in the way goods imported from another Member State are treated by the customs authorities are another potential cause of distortion. Expensive and time-consuming formalities in one Member State can add to the cost of the imported goods and so put them at a disadvantage. To prevent such a distortion, a Canada-United States agreement should include a provision for the harmonization of customs procedures for intra-area goods.[214]

D. *Mechanics of Canada-United States Economic Integration*

1. *Introduction*

The norm for free trade arrangements involving only two nations is to rely, either exclusively or predominantly, on consultation and co-operation and to eschew any powerful, independent community institution. At most, they set up joint committees whose primary function is to facilitate this consultation and co-operation. Such an approach would have two advantages in the case of Canada and the United States. In the first place, by relying mainly on the normal flow of intergovernmental relations, it respects the principle of national sovereignty. Second, it is easier to negotiate and more likely to be politically feasible. It is not, however, the most effective method for bringing about economic integration.[215] The *Macdonald Report* suggests endowing a Canada-United States free trade area with some institutions and supplementing consultation and co-operation with a substantial degree of co-ordination.[216] It envisages a Committee of Ministers empowered to implement and interpret the agreement and would give responsibility for administering exceptions and non-tariff

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213 *Supra*, note 1, art. XX.
214 *See, e.g., ANZCERT Treaty*, art. 21; *EFTA Treaty*, art. 9, cited note 1, *supra*.
215 This point is also made in the *Macdonald Report, supra*, note 17 at 318, 320-1.
216 *Ibid.* at 319-20, 382-3.

barriers to a Canada-United States Trade Commission (CUSTC), subject to review by the Committee of Ministers. An Arbitral Court of last resort would be set up with binding powers to resolve disputes over the interpretation of the agreement. Some of these suggestions have merit, but others seem to compromise Canadian sovereignty unnecessarily. The main modifications suggested below entail a downgrading of the proposed CUSTC by transferring its decision-making powers to the Committee of Ministers or to the Member States.

2. *The Committee of Ministers*

The *Macdonald Report* urges that the main executive institution of the Canada-United States free trade area be comprised of senior ministerial representatives from the two Member States in order to give it the necessary authority to deal with the difficult decisions that must be made on the implementation and operation of the agreement.[217] It would thus seem to favour an institution somewhat like the Benelux Committee of Ministers, with broad powers of voluntary and obligatory co-ordination to be exercised on the basis of unanimity.[218] There is, of course, a danger for Canadian sovereignty in such a Committee, but it should not be overplayed. The rule of unanimity and the constant accountability of the Canadian representatives to a Parliament jealous of Canada's independence should provide a sufficient safeguard. Indeed, it is submitted that there is less danger in giving powers to such an institution than to an independent Commission. Thus, on balance, the benefits for free trade of setting up a Committee of Ministers would seem to outweigh the potential disadvantages.

(a) *Implementation of the Agreement*

In order to utilize its full potential, the Committee of Ministers should play a major role in all aspects of the agreement. In the first place, it should be charged with the agreement's full implementation. This should include responsibility for the elimination of tariffs and non-tariff barriers, restrictions on services and purely discriminatory general laws, and the approximation of laws and policy harmonization. The proposal by the *Macdonald Report* to give primary responsibility for the dismantling of non-tariff barriers to CUSTC should not be followed. This is due to the fact that this extremely sensitive and complex matter requires precisely the political authority that the *Macdonald Report* suggests for the Committee.[219] To facilitate the Committee in this enormous task of implementation, the agreement should spell out, wherever practicable, the precise obligations of the parties.

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217 *Ibid.* at 320.

218 *Ibid. See also Benelux Treaty, supra*, note 1, arts. 16-19.

219 *See Macdonald Report, ibid.*

The Committee's implementing role will take two forms. First, it will have to oversee the enactment into national law of any immediate obligations imposed by the agreement.[220] Second, it will have to formulate proposals (pursuant to guidelines set down by the agreement) for subsequent national enactment with respect to the approximation of laws, policy harmonization and the details of some of the more complex liberalization required by the agreement.[221] In both cases the Committee should have the authority to issue recommendations or binding decisions as best suits a particular situation.[222] Although Canadian sovereignty might be better protected by restricting the Committee to voluntary co-ordination, such an approach would mean that neither Member State could be placed under an obligation to act. This could undermine the credibility of the Committee and impair the agreement's proper implementation. At worst, it could lead to an unequal implementation.

(b) *Additional Measures Arising Out of the Operation of the Agreement*

Closely related to its implementing role is the general authority that should be given to the Committee to propose additional measures not specifically provided for in the agreement. These will be necessary to deal with the distortions, frustration of benefits and difficulties that are bound to arise from time to time. Most free trade agreements provide in some way for such *ad hoc* action,[223] although sometimes it is also included as part of the dispute settlement procedure.[224] This is an unfelicitous approach as it establishes an adversarial relationship when what is needed is co-operation to deal with the inevitable problems of adjustment. The procedure suggested here for a Canada-United States agreement is that a Member State which becomes aware of a problem of this type should be able to refer the matter to the Committee for consultations leading to a mutually acceptable solution. The resulting proposal could relate to policy harmonization, the approximation of laws, the slowing-down or acceleration of liberalization or even an amendment to the agreement. Again the Committee should be able to act by recommendation or binding decision, except in the case of proposed amendments. Here the Committee's powers should be restricted to recommending that the Member States enter into negotiations on the

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220 The best way to ensure a more or less uniform and immediate implementation of the agreement would be to enact it into national and, where necessary, state or provincial law. But this would probably not be feasible for political reasons. *See ibid.* at 318-9.

221 The rights of providers of services are an example of liberalization where the details will have to be worked out later.

222 *See, e.g., EFTA Treaty, supra*, note 1, art. 32(4).

223 *See, e.g., ANZCERT Treaty*, art. 22(2); *EFTA Treaty*, art. 31(1); *Eire Agreement*, art. XXIII(3); *Israel Agreement*, art. 19(1)(a), cited note 1, *supra*.

224 *See, e.g., EFTA Treaty, ibid.; Israel Agreement, ibid.*

basis of its proposal, for amendments will involve a change in the fundamental obligations of the parties towards each other.[225]

(c) *Review and Amendment*

It is open to question whether the Committee should be given responsibility for periodic reviews of the operation of the agreement and any subsequent proposals for amendment. Free trade areas with an equivalent institution normally go this route,[226] but there is much to be said for giving the Member States themselves this task, perhaps in the form of periodic summit meetings between heads of government. In this way, fresh impetus may be given to resolving long-standing and seemingly intractable problems. In the European Community, the European Council, made up of heads of government and the French President, fulfils just this role.

(d) *Dispute Settlement Procedure*

The Committee has a crucial role that it can play in the dispute settlement procedure, which should, as indicated above, be restricted to genuine disputes such as non-fulfilment of obligations and conflicting interpretations of the agreement. As a first step in the procedure either Member State should have the right to bring a dispute before the Committee for consultations in order to achieve a mutually acceptable solution.[227] If a settlement is not achieved, the matter should be referred to a tribunal for an interpretation of the agreement or a finding on whether there has been non-fulfilment. This tribunal could take the form of either an *ad hoc* panel, as in the Israeli-United States agreement,[228] or, preferably, a permanent court.[229] Once the finding has been made and, where appropriate, remedial measures have been suggested by the tribunal, it is submitted that the Committee should again be convoked to attempt to find a solution. This is not the case in the Israeli-United States procedure,[230] but it has two advantages. First, it is possible that a solution may be easier to achieve once the tribunal has clarified the legal position. Second, it gives the

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225 Only the EFTA Council has the authority to decide on amendments to the agreement. *See EFTA Treaty, supra*, note 1, art. 32(1), (4). The Joint Committees under the Israel-United States and EEC-Austrian agreements are restricted to making recommendations. *See Israel Agreement*, art. 17(2)(c); *Austrian Agreement*, art. 27(2), cited note 1, *supra*.

226 *See, e.g., EFTA Treaty*, art. 32(1); *Israel Agreement*, art. 17(2)(a); *Austrian Agreement*, art. 31(2), cited note 1, *supra*.

227 This is similar to the procedure adopted in the *Israel Agreement, supra*, note 1, art. 19(1)(c) and the *Austrian Agreement, supra*, note 1, art. 27(2).

228 *Supra*, note 1, art. 19(1)(d).

229 This is suggested by the *Macdonald Report, supra*, note 17 at 321. See also the discussion in section III.D.8 of the text, *infra*.

230 *See Israel Agreement, supra*, note 1, art. 19(2).

Member States the opportunity to reach their own settlement or interpretation. If this second attempt at co-operation fails, then either the interpretation of the tribunal will stand or the measures it has suggested must be taken by the delinquent Member State. Failure to take the measures will entitle the other Member State to apply retaliatory sanctions. Although it would be preferable to rely on the good will of the parties, it is submitted that retaliation is probably necessary.[231] Interim measures needed to prevent irremediable damage could be permitted at any time.[232]

(e) *Exceptions*

The *Macdonald Report* suggests turning over the administration of exceptions to the agreement to CUSTC.[233] This is unrealistic because these matters are of national and political importance and are too vital to leave to international bureaucrats. Nor is it desirable from the sovereignty point of view, for such a Commission would be removed from national control and could conceivably be dominated by one Member State or the other. It is submitted that a viable alternative is to deal with them in a manner similar to disputes. Thus, a Member State intending to apply *any* types of exceptional trade measures against the other, even general or security exceptions,[234] would first have to bring the matter before the Committee of Ministers for consultations with a view to achieving an agreed course of action.[235] If this is not forthcoming, the matter would be referred to the tribunal for a ruling on whether the proposed measure, or a modification thereof, is justified under the agreement.[236] In the case of anti-dumping or countervailing duties, however, it would seem more politically feasible to refer the matter to the existing national tribunals. If the appropriate tribunal were to rule against use of the proposed measure, that should be the end of the matter. Otherwise, the third step would be for the Committee of Ministers to consider the matter again in the light of the tribunal's ruling in favour of the measure and to again seek a mutual accommodation. Finally, in default of such an accommodation, the Member State would be free to apply the proposed measure subject to any modifications required by the tribunal. As with disputes, interim measures, including provisional anti-dumping or countervailing duties, should be permitted at any stage.[237] There would seem to be no need to set up a

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231 *See* the discussion on retaliatory sanctions in the text, section II.C.2.(f), *supra*.

232 Only the *EFTA Treaty, supra*, note 1, art. 31(5) permits interim measures on a general basis. *Compare* the *Austrian Agreement, supra*, note 1, art. 27(3)(d).

233 *Supra*, note 17 at 382-3.

234 Only the *Israel Agreement, supra*, note 1, art. 18(1)(a) has such a general scope.

235 This is the procedure adopted in the *Austrian Agreement, supra*, note 1, art. 27(2).

236 Oddly, the Israel-United States agreement does not use a conciliation panel in this situation.

237 Most agreements allow interim measures in at least some cases. *See, e.g., ANZCERT Treaty*, arts. 15(6), 16(5); *EFTA Treaty*, arts. 20, 5(3); *Eire Agreement*, arts. III(2), XVIII(2), XIX(1); *Israel Agreement*, art. 18(3); *Austrian Agreement*, art. 27(3)(d), cited note 1, *supra*.

special procedure for safeguard measures, as the tribunal's ruling would qualify as the multilateral authorization that may be the least the *GATT* requires.[238]

3. *Artibral Court*

With the exception of the Israeli-United States ad hoc tribunal, free trade agreements do not normally provide for a community court. There is, however, much merit in the *Macdonald Report's* suggestion of a permanent Arbitral Court.[239] It is preferable to an *ad hoc* tribunal as it would have more prestige and its rulings would be more likely to be followed by the Member States or would be more likely to induce them to compromise. It is also preferable to invoking the International Court of Justice; first; because the Arbitral Court would doubtless evolve a special expertise, and second; because it would offer a more intimate and less acrimonious proceeding than one played out on the international stage.

The role that has been assigned to the Artibral Court in this study differs significantly from that suggested by the *Macdonald Report*.[240] It would cover not only the interpretation of the agreement but would also extend to setting out remedial measures in cases of non-fulfilment and modifications to exceptional measures proposed by Member States. It is submitted that only by extending the Court's jurisdiction in this way can it be given a meaningful role in the conciliation process. The *Macdonald Report* also takes the view that the Court's rulings should be binding without further ado.[241] This study suggests removing the agreement from too strict a legal straitjacket and permitting the Member States, where possible, to agree on their own measures and interpretation of the agreement. In both the dispute settlement and exceptions procedure it is therefore suggested that the Court's rulings only become binding in default of an agreement between the Member States.

4. *Canada-United States Trade Commission (CUSTC)*

While this study has taken the view that the role of this Commission should be downgraded, there is still a multitude of useful functions that an independent Commission could undertake. Primarily it could be given the task (similar to the one assigned to the European Commission) of preparing draft proposals for the Committee of Ministers, either on the Committee's request or on the Commission's own initiative. Such input would counterbalance the more self-interested proposals prepared by the national bureaucracies. The Commission could also be given responsibility for

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238 *See* section II.B of the text, *supra*.
239 *Supra*, note 17 at 382ff.
240 *Ibid.*
241 *Ibid.* at 384.

preparing general reports on the progress of the area, statistical studies and informational material for the public.

5. *Committee of Permanent Representatives*

While it may be essential to have senior ministers sit on the Committee of Ministers, it must also be recognized that they will not always have the time to deal properly with all the matters that come before the Committee. This was a problem with the Council of the European Community and the solution devised was to set up a Committee of Permanent Representatives to prepare the work of the Council.[242] In this permanent committee, national representatives go over the matters at issue and attempt to come to an agreement. Where agreement has been secured, the Council merely gives its official blessing without having to waste time on discussions and compromises. The Council is thus free to devote its time to more contentious matters on which preliminary agreement was not possible. Such a system could profitably be incorporated into a Canada-United States agreement.

E. *The Future*

The argument in this study has been for a detailed agreement that deals comprehensively with all of the aspects of economic integration that go toward creating an effective free trade area. It has also been proposed that this area should have a relatively powerful set of community institutions and should adopt the mechanisms of voluntary and obligatory co-ordination as well as consultation and co-operation. Only in this way, it is submitted, can the first criterion of achieving a workable, mutually beneficial and internationally acceptable agreement be fulfilled. But what of the second criterion, the protection of Canadian sovereignty? Will it be sufficient to eschew the more radical mechanisms of integration, restrict policy harmonization to its corrective function within the traditional free trade areas and avoid giving authority to an independent commission?

No one can give a definite answer to this vital question. The *Macdonald Report* is correct in pointing out that economic integration does not inevitably lead to political union,[243] but that is to state the problem too baldly. In the peculiar context of Canada and the United States it is more a question of whether free trade will create such an intermeshing of national interests that the sovereignty of the junior partner, Canada, will come to be seen as an anachronism. In this regard, the words of Victoria Curzon on the EFTA could serve as a warning: "EFTA experience shows that even the loosest form of economic integration engenders a slippery slope of its

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[242] *See Merger Treaty, supra*, note 88, arts. 1-4.
[243] *Supra*, note 17 at 355.

own, in the sense that cooperation on an ever-widening number of issues is necessary to keep a free trade area operational.''[244]

In the final analysis only time and the depth of Canadians' attachment to their political independence can give the definitive answer. But the danger of the loss of sovereignty cannot be so airily dismissed as the *Macdonald Report* would believe, and a workable free trade agreement can only go so far in providing concrete protection against this loss.

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[244] *Supra*, note 21 at 38.