THE SENATE **LE SÉNAT**

UNCERTAIN ACCESS: THE CONSEQUENCES OF U.S. SECURITY AND TRADE ACTIONS FOR CANADIAN TRADE POLICY (Volume 1)

Report of the Standing Senate Committee
on
Foreign Affairs

Chair
The Honourable Peter Stollery

Deputy Chair
The Honourable Consiglio Di Nino

June 2003

Ce rapport est disponible en français.

MEMBERS

The Honourable Peter Stollery, *Chair*

The Honourable Consiglio Di Nino, *Deputy Chair*

and

The Honourable Senators:

Raynell Andreychuk
Jack Austin, P.C.
Roch Bolduc
Pat Carney, P.C.
*Sharon Carstairs, P.C. (or Fernand Robichaud, P.C.)
Eymard G. Corbin
Pierre De Bané, P.C.
Jerahmiel Grafstein
Alasdair Graham, P.C.
Rose-Marie Losier-Cool
*John Lynch-Staunton (or Noël Kinsella)
Raymond Setlakwe

* *Ex officio* members

In addition to the Senators indicated above, the Honourable Senators Maria Chaput, Joseph Day, Edward M. Lawson, Frank W. Mahovlich, Pana Merchant, Gerard A. Phalen, David P. Smith and Terry Stratton were members of the Committee at different times during this study or participated therein during the Second Session of the Thirty-Seventh Parliament.

Staff from the Parliamentary Research Branch of the Library of Parliament:
Peter Berg, Analyst
Michael Holden, Analyst
Janna Jessee, Intern from the Norman Paterson School of International Affairs

François Michaud
Clerk of the Committee

ORDER OF REFERENCE

Extract from the *Journals of the Senate* of Thursday, November 21, 2002:

The Honourable Senator Stollery moved, seconded by the Honourable Senator Adams:

THAT the Standing Senate Committee on Foreign Affairs be authorized to examine and report on the Canada – United States of America trade relationship and on the Canada – Mexico trade relationship, with special attention to: a) the Free Trade Agreement of 1988; b) the North American Free Trade Agreement of 1992; c) secure access for Canadian goods and services to the United States and to Mexico, and d) the development of effective dispute settlement mechanisms, all in the context of Canada's economic links with the countries of the Americas and the Doha Round of World Trade Organisation trade negotiations;

THAT the Committee have power to engage such counsel and technical, clerical and other personnel as may be necessary for the performance of this order of reference;

THAT the Committee have power to adjourn from place to place inside and outside Canada for the purpose of this reference; and

THAT the Committee shall present its final report no later than December 19, 2003, and that the Committee shall retain all powers necessary to publicize the findings of the Committee as set forth in its final report until January 31, 2004.

After debate,

With leave of the Senate and pursuant to Rule 30, the motion was modified to read as follows:

THAT the Standing Senate Committee on Foreign Affairs be authorized to examine and report on the Canada – United States of America trade relationship and on the Canada – Mexico trade relationship, with special attention to: a) the Free Trade Agreement of 1988; b) the North American Free Trade Agreement of 1992; c) secure access for Canadian goods and services to the United States and to Mexico, and d) the development of effective dispute settlement mechanisms, all in the context of Canada's economic links with the countries of the Americas and the Doha Round of World Trade Organisation trade negotiations; and

THAT the Committee shall present its final report no later than December 19, 2003, and that the Committee shall retain all powers necessary to publicize the findings of the Committee as set forth in its final report until January 31, 2004.

The question being put on the motion, as modified, it was adopted.

Paul Bélisle
Clerk of the Senate

RECOMMENDATIONS

RECOMMENDATION 1

That the Government of Canada ensure that U.S. decision-makers recognize how seriously Canada takes security concerns. The government should immediately launch an active campaign to inform such decision-makers of the unprecedented cooperation between Canada and the U.S. on border security issues and the reality that Canada is a secure trading partner.

RECOMMENDATION 2

That, since a trade-efficient border is the lifeline of Canada's economic prosperity and since the current infrastructure at key border crossings is woefully inadequate to handle the tremendous growth that has occurred in bilateral trade, the Government of Canada accelerate the implementation of the 30-point Border Action Plan by:

a) Encouraging Canadian and U.S. authorities to accelerate the construction of new bridge and tunnel crossings into the United States;

b) Injecting considerably greater financial resources into the construction of additional border infrastructure other than bridges and tunnels; and

c) Accelerating efforts to establish a pre-clearance system for the shipment of goods across land border crossings, thereby "moving the border away from the border" to reduce border impediments to trade, investment and business development.

RECOMMENDATION 3

That the Governments of Canada and the United States intensify efforts to ensure that any implementation of Canadian and American security measures adequately take into account any effects on bilateral trade and investment.

RECOMMENDATION 4

That Canada and the United States initiate negotiations to achieve substantial trade remedy (e.g., anti-dumping, countervail, safeguards) relief in economic sectors (e.g., steel) in which producers would favour such action.

RECOMMENDATION 5

That in the Doha Round of WTO trade negotiations, the Government of Canada give top priority to obtaining a WTO agreement to:

a) clarify and improve upon existing provisions on subsidy and dumping definitions;

b) tighten existing WTO provisions governing the use of trade remedies (e.g., anti-dumping, countervail, safeguards) so as to restrain protectionist abuses; and

c) avoid continental trade conflicts.

RECOMMENDATION 6

That during FTAA negotiations on the introduction of an effective hemispheric dispute resolution system, the federal government seek to retain, as a minimum, the NAFTA Chapter 19 dispute settlement process as an option for NAFTA trade.

RECOMMENDATION 7

That Canada, Mexico and the United States implement NAFTA Article 2002 calling for the establishment of a permanent NAFTA Secretariat and provide this Secretariat with the following mandate:

a) To examine means by which trade disputes and irritants can be resolved within the NAFTA rather than at the WTO, and to help expedite the resolution of these trade conflicts;

b) To examine medium- and long-term trade policy issues and to generate reports including recommendations for action by NAFTA partners; and

c) To review developments within the multilateral trade system and their relationship to the NAFTA trade framework.

RECOMMENDATION 8

That the Government of Canada, in association with affected provinces, maintain as its objective a permanent arrangement with the United States that provides for an unrestricted market for softwood lumber. In the interim, any short-term agreement to allow time to complete this permanent arrangement should not surrender Canada's right to obtain the judgements of the WTO and NAFTA panels or the processes under NAFTA Chapter 11 and should require that:

a) anti-dumping duties against Canadian softwood lumber producers be dropped; and

b) all countervailing and anti-dumping duties already collected be returned to Canada.

RECOMMENDATION 9

That the Government of Canada:

a) Work with like-minded countries to remove from the WTO's draft agriculture negotiation document any proposal to phase out state trading enterprises or such farmer-controlled enterprises as the Canadian Wheat Board; and

b) Direct its efforts at tightening the WTO's anti-dumping rules to give the agricultural sector special consideration, in view of the frequency of externally driven commodity price movements that cause prices to decline below costs (a trigger for anti-dumping action).

RECOMMENDATION 10

That the federal government:

a) Substantially increase the number of consulates in the United States from its current planned level. The new consular offices should be designated as trade and investment offices and staffed with appropriate and experienced professional personnel;

b) Immediately initiate a focused campaign to inform U.S. decision-makers of the importance of the bilateral trade relationship;

c) Increase its funding of efforts to promote Canadian trade and investment interests in the U.S., and make its advocacy strategies in that country more effective; and

d) Strengthen bilateral relationships at the executive and legislative levels of government. Strategies should be formulated to more effectively engage and regularly interact with the U.S. Senate and House of Representatives on issues and concerns of importance to both countries, and appropriate budgetary resources should be provided. To this end, the government should establish a Parliamentary Office in Washington to assist Canadian Parliamentarians in their interaction with U.S. legislators and other key U.S. decision-makers.

RECOMMENDATION 11

That the Government of Canada refrain from entering into any discussions on the establishment of a customs union with the United States.

RECOMMENDATION 12

That the Government of Canada carefully investigate the impact that regulatory differences with the United States have on the Canadian economy, and release its findings to the public. The government should seriously examine the concept of mutual recognition of each country's regulatory standards and procedures, under which standards would be tested and inspection and certification would be carried out only once within the Canada-U.S. market. Moreover, the government should identify those sectors in which the U.S. and Canadian regulatory systems are similar and the mutual recognition approach could be applied.

RECOMMENDATION 13

That, noting the valid objective of engaging in regulatory cooperation with the European Union within the proposed Canada-EU Trade and Investment Enhancement Initiative, the federal government retain as a goal the successful negotiation of a comprehensive Transatlantic Free Trade Agreement.

RECOMMENDATION 14

That the Government of Canada make free trade with Asia a priority and initiate trade-liberalization negotiations with China, Japan, South Korea, India and members of the Association of Southeast Asian Nations (ASEAN). The federal government should also develop new strategies to increase the interest of Canadian businesses in Asian markets, help Canadian firms construct durable partnerships with Asian companies and establish a better image for Canadian products in Asia.

RECOMMENDATION 15

That the Government of Canada establish a Trade and Investment Council to conduct comprehensive analytical research on external trade and investment issues.

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FOREWORD

This report is not intended to be a rerun of the old arguments about the Canada-U.S. Free Trade Agreement. Members of the Foreign Affairs Committee, which also deals with Foreign Trade, reviewed the Free Trade Agreement – it has been in effect for about fifteen years – and took a look at what actually happened. What we learned certainly surprised me and I was an active member of the committee fifteen years ago when the Free Trade debate took place.

Over the course of the Committee's hearings, we met with 95 witnesses in Canada during 25 sets of hearings in Vancouver, Calgary, Winnipeg and Ottawa. We went west partly because of the softwood lumber dispute, so important to the British Columbia economy.

The Committee also heard from 72 individuals in Washington. We did not complete the Mexican part of what has become NAFTA because of scheduling conflicts brought about by the Mexican electoral calendar. We will complete that part of our investigations later. To put our Canada - US - Mexico trade in perspective, roughly 75% of our 2-way trade is with the U.S. and 2.6% with Mexico.

Apart from security issues, which we address in our report, three themes seem to me to have been at the centre of our conversations. The first theme to consider is tariff reduction. When most people think of freer trade they think of lowering tariffs. That certainly was an element of the Free Trade Agreement. In 1985, the MacDonald Royal Commission noted that because of the Auto Pact and, 'the high level of duty-free resource imports', average US tariffs against Canadian goods were about 1% and average tariffs on dutiable goods were in the 5 to 7 per cent range. In contrast, Canadian average tariffs on dutiable imports were at 9 to 10 per cent. I doubt if many consumers noticed when under the agreement all tariffs ended 5 years ago in 1998. That part of the life of the FTA ended at that point.

In the 1980s, US protectionism was thought to be on the rise. When the MacDonald Royal Commission made its report on the Canadian economy in 1985, the Commissioners noted, "…many Canadians are deeply concerned that because trade with Canada is quantitatively less important to Americans than is their trade with us, the United States might implement protective trade measures harmful to Canadians and be relatively unaware of, or unconcerned by, the consequences".

They went on to say, "It is imperative that Canada reduce both the uncertainty of our access to U.S. markets and the adverse effects that might result from any trade-restrictive measures".

The second theme of our hearings was whether or not the system for settling trade disputes adopted in the agreement between Canada and the United States has worked. Ninety-five per cent of Canada's exports to the US are trouble free. 5% of our trade is disputed. That 5% is quite a lot when you realize that, of our total exports to the US, 13% goes through either a pipeline or along transmission lines and 25% is accounted for by the Auto Pact.

Anyone who has followed softwood lumber, the problems of the Canadian Wheat Board or the difficulties of the Canadian beef industry would have to say that the NAFTA dispute-settling system has not worked at all. I was certainly taken aback when we were given an estimate of $800 million dollars in legal fees on softwood lumber since the 1980s. Mike Moore, former Director General of the WTO, has said that just the case before the WTO on softwood lumber cost $US 200 million and that was before the most recent decision on stumpage which ruled in Canada's favour.

The reason the system has not worked is pretty straightforward. The arrangement agreed to, known as Chapter 19 of the agreement, is well-described in a document produced by the Trade Remedies Division of DFAIT: "Bi-national panels determine whether a final determination is in accordance with anti-dumping laws of the NAFTA country in which the decision is made. If a panel finds that the determination was in accordance with domestic law, the determination is affirmed". It is the fatal flaw. If you want to export lumber to the United States and US lumber producers want to stop you they appeal to US law, which is written by their representatives. The dispute is judged on that US law and if for some reason they lose they will change the law and bring the case forward again.

There was no WTO in 1988. The FTA dispute-settling system, with its fatal flaw seemed an improvement over the weak GATT fifteen years ago. The WTO system, more expensive but much improved, with panels made up of members from neutral countries, came into being in 1995. It could be argued that that part of the FTA ended its useful life when the WTO dispute-settling system was put in place in 1995.

The third issue relates to the changes in the value of the Canadian dollar over the past fifteen years. About 86% of our exports go to the United States. In 1988 that figure was about 75%. In 1988, the Canadian dollar was worth about 85 cents U.S. and in 1992 it rose to nearly 89 cents. Then the Canadian dollar declined to almost 63 cents U.S. You would expect our exports to rise. Interestingly, last year our exports to the U.S. actually declined from the year before. Certainly, almost every witness we heard from said that the value of the dollar was crucial to our exports and that the value of the dollar was responsible for our increase in exports to the U.S.

Over the same period, exports from the U.S. to Canada did not increase very much.

Just about everyone that we heard from agreed that the Canada - U.S. part of the NAFTA had run its course. It is in the past. The important question that Canadians should be asking their government is where do we go now. The Committee has provided guidance in this area, with substantial sections of our report devoted to what our long-term trade policy ought to be. Now is the time, however, for a national debate on this very important issue.

On behalf of the members of the Foreign Affairs Committee, I would like to express my appreciation to the Clerk of the Committee, Mr. François Michaud; Mr. Peter Berg, Mr. Michael Holden and Ms. Janna Jessee from the Research Branch of the Library of Parliament; Mr. Ian Parker, our communication consultant, as well as all the reporters, interpreters, translators, editors and other support staff for their important work on this study.

Peter Stollery
Chair

UNCERTAIN ACCESS:

THE CONSEQUENCES OF U.S. SECURITY AND TRADE ACTIONS FOR CANADIAN TRADE POLICY

PART 1: INTRODUCTION

A truck crosses the Canada-U.S. border every 2.5 seconds. What would happen if that time interval were to double to 5 seconds? For Canadians, this question is a highly pertinent one, as we have become highly vulnerable to any U.S. security-related actions that have the effect of blocking or restricting trade across that border.

It is unlikely that the current American preoccupation with national security will diminish. In Washington, the Committee was informed that security is a long-term (perhaps twenty years) concern, that seemingly all issues are being viewed in the U.S. through a security prism, and that Canada cannot afford to turn a blind eye to American security needs. In essence, U.S. security concerns have become our concerns, and we must take them seriously if we want to continue to take advantage of what is by far our most important bilateral trade relationship.

All in all, Canada sends an overwhelming 87% ($346.5 billion) of its merchandise exports south of the border, generating 35% of this country's GDP, with the greater part of those exports (70%) transported by truck. Our exports to the U.S. market exceed those of all 15 EU members and are three times those of Japan, giving Canada a full 19% share of the U.S. import market. Trade between Canada and the U.S. is of critical importance, and continued access to the U.S. market is vital. Moreover, a full 76% ($218.2 billion) of our merchandise imports are sourced in the U.S., and bilateral goods and services trade with the U.S. is approaching US$700 billion per year. It is useful to note that although a 5,000 km border separates the two nations, by far the largest number of vehicle crossings occur on the Ontario-Michigan[1] and Ontario-New York[2] borders. The movement of goods across the Detroit/Windsor border alone exceeds total U.S. trade with Japan. Over half a million individuals and 45,000 trucks cross the border there daily. The British Columbia-Washington land crossing at Blaine, B.C., and the Quebec-New York crossing at Lacolle, Quebec, are two other important border points.

1 The two Ontario-Michigan border crossings are Windsor-Detroit and Sarnia-Port Huron.

2 The Fort Erie-Buffalo connection is by far the most active of the Ontario-New York border points, although the Lansdowne-Alexandria Bay crossing also attracts significant vehicular movement.

As Thomas d'Aquino (President and Chief Executive Officer, Canadian Council of Chief Executive Officers) informed the Committee, most of the world would envy our position as the top foreign supplier of the U.S. market. However, it was also pointed out to us by Richard Harris (Professor, Economics Department, Simon Fraser University), quite correctly, that Canada faces a key problem: not only have emerging countries such as China and India seen their access to the U.S. market improve relative to ours, thereby eroding our free-trade advantage in a large number of manufactured goods, but any increased land border costs will hamper our access to the U.S. market significantly.

According to Harris, roughly one half of Canada's trade, typically intra-industry trade occurring in important industries such as automobile manufacturing, is sensitive to border problems. The integrated nature of the North American economy, together with Canada's enormous trade dependence on the U.S., has made us extremely vulnerable to border disruptions. The U.S. decision to close the border to Canadian beef exports, owing to "mad cow" disease in Western Canada is the most recent example of this vulnerability.

Another terrorist attack on U.S. soil will always remain a possibility. Moreover, U.S. authorities are contemplating three specific measures with potentially adverse impacts on trade: the imposition of entry/exit controls at the border; the creation of onerous advance notification requirements for cargo manifests; and the registration of all foreign facilities that manufacture, process, pack or hold food for human or animal consumption, with advance notification to be provided to the U.S. Food and Drug Administration for foreign food shipments into the United States.[3] Fortunately, some relief may be forthcoming regarding the proposed entry/exit requirement, as Canadian citizens may receive an exemption from the planned controls.

Donald Barry (Professor, International Relations, University of Calgary) told us that the most important challenge for Canadian decision-makers is how to respond to the post-September 11 (2001) security environment while ensuring the free flow of goods across the border. Fortunately, quick action by Canadian officials led to the December 2001 "Smart Border Action Plan" to create a secure and trade-efficient border, and steps are being taken to flesh out the principles contained in the Plan. However, there are still allegations in the U.S. media and by U.S. legislators that the Canada-U.S. border is porous and that Canada is not taking American security concerns seriously enough.

3 There are also indications that the quantity of U.S. border inspections would increase should the Government of Canada proceed with the decriminalization of marijuana.

Trade measures taken by the U.S. have also proven to be problematic for Canada. Examples of actions that are, in the view of many of the Committee's witnesses, unjustified include the continued use of U.S. trade remedies (e.g., American trade action on softwood lumber, the Canadian Wheat Board and a range of other agricultural commodities, most recently blueberries); the imposition by the U.S. of non-tariff barriers to our products; the adoption of the U.S. Farm Bill and the deleterious effects it has on our farmers; and the American position on state trading enterprises and supply management at the World Trade Organization (WTO).

There is no doubt that the original Canada-U.S. Free Trade Agreement stimulated bilateral trade and investment and had a positive effect on the Canadian economy. However, Canadian and American negotiators of the original Canada-U.S. Free Trade Agreement (FTA) did not secure exemption from each other's trade remedies (e.g., anti-dumping and countervailing duties). Nor were the negotiators successful in devising a made-in-North America set of definitions and rules on subsidies to limit the use of countervailing duties as well as competition legislation designed to replace anti-dumping duties. The reality is that without subsidy rules and anti-dumping codes in place to govern trade in North America, Canada will continue to face U.S. trade remedy action in key industries, and U.S. consumers of Canadian products (e.g., softwood lumber, wheat) will continue to pay additional costs imposed on them by a trade remedy system that is strictly geared to meet the needs of U.S. producers.

What the FTA negotiators did achieve was a system of binational panel review to deal with cases in which the two sides are unable to resolve their trade differences through consultation.[4] However, the system in place is not a true dispute resolution system, in which offending trade actions would be measured against some common codes of conduct. Rather, the dispute settlement process simply checks to ensure that national trade remedy laws are applied properly. It should come as no surprise, therefore, that the Committee heard conclusive evidence that bilateral disputes are increasingly being referred to the WTO for resolution (as opposed to NAFTA), since it offers a considerably more effective dispute settlement mechanism. The Committee seeks means whereby these trade rules and dispute settlement systems can be improved, and is disappointed that made-in-North America solutions have not materialized.

Why are the above-mentioned actions being taken against Canada or, in the case of additional security measures, being contemplated? On the security side, Canada does not pose the risk to U.S. homeland security that so many Americans perceive. Most importantly, the perpetrators of the events of September 11, 2001, did not enter the U.S. through Canadian checkpoints. In addition, an April 2003 analysis of ten years' worth of data from the U.S. Immigration and Naturalization Services by the Association for Canadian Studies reveals that Canada does not deserve its poor

4 Softwood lumber (see Appendix 2) and steel are two examples of bilateral trade disputes that have been dealt with through the FTA/NAFTA dispute settlement mechanism.

reputation as a gateway for illegal entry to the United States.[5] The study showed that Canada ranked 15th in terms of the point of origin of "illegal aliens" living in the U.S. in 2000, well below Mexico and Central and South American countries.[6] As several witnesses reminded the Committee, the Mexico-U.S. land crossing is far more porous than the Canada-U.S. border in terms of the entry of unauthorized individuals. A third point to make is that, as several witnesses indicated to the Committee, the number of unaccounted-for Canadian refugee claimants facing removal orders – a point of contention with certain Americans – is proportionally no higher than the number of such individuals in the United States.

The problem here is that there appears to be a mismatch between reality and Americans' continuing impression that the Canadian border is porous and that Canada represents a threat to U.S. security. In reality, cooperation between the two countries on border security is unprecedented. and Canada is fully committed to maintaining a safe and secure border. The misguided perceptions that linger south of the border will need to be reversed.

Regarding trade, Canada is the United States' largest trading partner and the leading merchandise export market for 39 of the 50 states (2002). It is unclear to the Committee how many Americans are aware of this reality; more needs to be done to promote this fact. In the aggregate, over $1.5 billion in merchandise trade now crosses the Canada-U.S. border every single day, of which American exports to Canada total US$165 billion, roughly one quarter of the U.S. international market. We are anxious to preserve this mutually beneficial flow of goods and services, and wish to rid ourselves of U.S. trade disputes.

Also of great importance is the fact that Canada plays a key role as a supplier of oil, natural gas and hydroelectricity to the American market. Indeed, Canada is the United States' largest supplier of energy, exporting more crude and refined oil products to the U.S. than Saudi Arabia does, and shipping large quantities of hydroelectricity south of the border.[7] Pierre Alvarez reminded us that Canada's oil and gas reserves are so vast that they cannot be consumed in any realistic time frame. In terms of national security, those exports contribute significantly to U.S. national energy needs. The importance of obtaining one's largest supply of imported energy from a reliable source next door cannot be overstated. Once again, is this reality known south of the border?

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5 Jack Jedwab, "Canadian Aliens: The Numbers and Status of Our "Illegals" South of the Border," *Paper prepared for the Canadian-American Research Symposium on Immigration*, Association for Canadian Studies, 26 April 2003.

6 *Ibid*., p. 1.

7 Indeed, Canada supplies the U.S. with 94% of its natural gas imports, close to 100% of its electricity imports, 35% of its uranium imports used to generate nuclear power, and 17% of its crude and refined oil imports.

Turning to the Canada-Mexico trade relationship, it is worth noting that total bilateral trade with Mexico is greater than our bilateral trade with any European country and is exceeded only by our trade with the U.S. and with each of our top two Asian trading partners (Japan and China). In other words, it is our fourth largest trading relationship in the world. Moreover, Canada is Mexico's second largest export destination and trading partner, and our investment in Mexico has more than tripled since the start of NAFTA.

Even though the bilateral relationship remains by far the least developed side of the NAFTA triangle – trade with the U.S. is 37 times greater than trade with Mexico – it has undergone tremendous growth. Two-way trade rose from $5.6 billion in 1994 to $15.1 billion in 2002, and there is considerable potential for trade growth and increased bilateral economic cooperation.

Indeed, witnesses informed the Committee that Mexico was an emerging economic force within NAFTA and that the Canada-Mexico trade and investment relationship was generally an important and positive one. Opportunities for expanding the relationship remain untapped. Luis Ernesto Derbez (Mexico's Secretary of Foreign Affairs) told the Committee that one of the key issues in Mexican foreign policy was how best to strengthen bilateral ties, given that the trade relationship could still be improved. In addition, the two countries face similar challenges in dealing with the U.S., and can thus learn from each other's experiences and develop joint positions in discussions with U.S. authorities.

To learn more about the state of the two bilateral relationships that Canada has in North America, the Committee undertook an extensive set of hearings in Ottawa, with focused panels on the key issues affecting our trade ties with these countries. We travelled to Western Canada to gauge the views of individuals and groups directly affected by Canada-U.S. trade disputes and irritants, especially in the softwood lumber and agricultural products areas, and to obtain testimony on the general state of Canada-U.S. economic relations. The Committee also went to Washington to obtain further information on key bilateral issues and to initiate an important dialogue with important decision-makers there.

Regrettably, the onset of Congressional elections in Mexico kept us from continuing our southern visit to that country and obtaining the important Mexican perspective on the North American trade situation, although the Committee did participate in an important panel session on Canada-Mexico relations in Ottawa and received valuable testimony from Luis Ernesto Derbez, Mexico's Secretary of Foreign Affairs. We intend to supplement the testimony on Mexico that we have already received with information to be obtained during a planned fact-finding mission to that country in the fall, and subsequently issue a stand-alone report on the state of this vital bilateral relationship. Mexico is becoming a vital economic partner of Canada, and the Committee would be remiss if it did not devote additional attention to the relationship.

The Committee's report consists of three parts, beginning with this introduction (Part 1). In Part 2 of the report, the various challenges to securing trade between Canada and the U.S. are described. They include ensuring a free-flowing border; limiting the use of American trade remedy action; enhancing the dispute settlement mechanisms that we have available to us; assessing the need for stronger North American institutions to manage trade; resolving current trade disputes; examining ways to spend our official resources in the U.S. more wisely; and promoting Canada's reliability as a secure trading partner.

The report also focuses on the longer-term issue of how close the relationship between Canada and the U.S. ought to be (Part 3). In essence, is closer formal economic integration warranted, or should a strategy of aggressive trade diversification be entertained in concert with safeguarding existing bilateral trade? Drawing on important testimony received by the Committee, the argument will be made that past steps to formally integrate the two economies have faced diminishing returns, and that the benefits of even closer formal integration do not appear to be substantial. Since Canada's vulnerability is now being exposed on both the security and trade side, a prudent policy choice is to lessen our dependence on the U.S. market and to diversify our trade. That does not mean that we should neglect trade relations with our most important economic partner; it just implies that we should not continue to "put all our eggs in one basket."

PART 2: SECURING CANADA-U.S TRADE

ENSURING THE FREE FLOW OF GOODS AND SERVICES ACROSS THE BORDER

Although positive measures have been adopted to render the Canada-U.S. border more secure and trade efficient, ensuring the free flow of goods and services across the border remains the leading economic challenge facing Canadians. The Committee believes that the border situation requires constant monitoring as the U.S. become more inward-looking and security-conscious, and as strengthened homeland security measures are implemented. As several witnesses reminded Committee members, the U.S. is clearly preoccupied with national security issues, and Americans (albeit misguidedly) perceive Canada as part of the problem and not part of the solution. However, their preoccupation with security has becomes our problem.

Richard Harris, a former member of the Research Advisory Group on Trade Policy (Economics) of the Macdonald Commission, which recommended free trade with the U.S.,[8] provided the Committee with a graphic description of the most dire effects of the problem, in what he admittedly called his "pessimistic scenario." He observed that increases in border costs had to be regarded "as one of the single most important national economic issues of this decade" in that it could reverse the positive economic trends of the past fifteen years.

According to Harris, for the past 15 years Canada has been pursuing a seamless border so as to have integrated North American manufacturing and service sectors. If the Americans implement additional security measures at the border, a substantial increase in border costs will occur for Canadian producers. Such a cost increase will bring about several adjustments. First, Harris argued that a 10% increase in border costs would lead to a reduction in Canada-U.S. trade volumes of roughly 25% and a drop in Canadian export prices of about 10%. The long-run impact that such a loss of access to the U.S. market would have on our living standards would be great: Canada would have to search for other trading partners or trade with the U.S. at a much higher cost.

Second, Harris noted that industrial restructuring will occur as the existence of higher border costs causes a reorganization of the type of time-sensitive delivery in intermediate goods and manufacturing (just-in-time inventory activity) located near the border – the natural advantage that Canadian and Mexican locations had will have been eliminated – and a transformation of the domestic economy as Canada is pushed into final-goods trade. Canada would then have to resort to its original model of fully developing an indigenous manufacturing sector. The United States could always reorganize its production and supply its market domestically, he argued.

8 He was also a special adviser to the Government of Canada during the negotiations leading to the Canada-U.S. FTA.

Third, trade will naturally be diverted to other markets such as Asia and Europe. While the Committee would be supportive of such a development, the costs of a large-scale disruption of the traditional north-south trading pattern could be quite onerous for Canadians.

Hopefully, Harris's "pessimistic scenario" will not materialize. To avoid all of the potential effects described above, the Government of Canada must constantly strive to convince U.S. decision-makers that it deems their security challenges to be important. The Committee hopes that in so doing, Canada would not only assist in the war against terrorism but also be shielded from certain trade-restricting U.S. security-related actions. The Committee recommends:

RECOMMENDATION 1

That the Government of Canada ensure that U.S. decision-makers recognize how seriously Canada takes security concerns. The government should immediately launch an active campaign to inform such decision-makers of the unprecedented cooperation between Canada and the U.S. on border security issues and the reality that Canada is a secure trading partner.

A. The Effects Of September 11

The terrorist attacks that occurred in the United States on September 11, 2001, had serious short-term effects on the Canadian economy. Whereas prior to that date the facility of movement across the border had been largely taken for granted and progress in improving the border had been neglected, the situation had now changed. With the U.S. government clearly intent on ensuring the security of its citizens from potential terrorist threats, concerns were raised here in Canada that our southern neighbour would erect what would amount to a fence around its borders.

One of the first impacts to be felt was the sudden and lengthy backlog at the Canada-U.S. border. Immediately following the terrorist attacks, the U.S. closed its airports, seaports and land crossings. When the border with Canada reopened, individuals and goods were delayed while both countries wrestled with security concerns and subjected commercial and passenger traffic to thorough scrutiny. The resulting inspections delayed trucks for 12-18 hours[9] for days afterwards, and it was weeks before the situation returned to normal. Certain companies heavily dependent on trade with the United States ceased factory production temporarily, which affected employment.

9 These delays can be contrasted with designated standard wait times: 10 minutes for the Monday-Thursday period, and 20 minutes for the Friday-Sunday and holiday periods.

In addition to hurting productivity and raising the cost of doing business in both countries, border delays undermine exports and harm employment. This is true not only for manufacturers but also for the tourism and hospitality industries, which are affected by reductions in border crossings by individuals concerned about potential crossing delays. A high percentage of Canada-U.S. trade is in intermediate products that are transported on a "just-in-time" basis to manufacturing plants on both sides of the border and assembled into larger products. These deliveries enable firms to maintain fewer inventories as a cost-saving measure. The downside is that under this system, border delays quickly result in plant closures, financial losses for business and employee layoffs. David Adams (Vice-President, Policy, Canadian Vehicle Manufacturers' Association) suggested that a one-hour assembly line shutdown would cost $1.5 million in forgone revenue, and the addition of an extra hour's revenue would range from US$400,000 to $800,000.

Canadian businesses were also concerned that decisions on future business investment would be made on the basis of domestic firms' continuing ability to supply the American market. Without reliable access to that prized market, foreign-based companies may be reluctant to establish business operations in Canada. Others, both domestic and foreign, may wish to relocate existing facilities south of the border.

B. The 30-Point Border Action Plan And Its Implementation

Fortunately, concrete action was forthcoming after the events of September 11. The Government of Canada adopted certain measures to reduce border delays while, at the same time, ensuring an adequate level of border security. These actions included the employment of additional personnel at the border, the establishment of dedicated traffic lanes for commercial traffic, the opening of additional lanes for passenger vehicles, and the designation of special processing lanes for trucks having already passed through expedited pre-clearing.

In conjunction with its own independent action, the federal government also pushed aggressively for a joint strategy (with the Americans) for the border. In December 2001, the two countries signed a declaration spelling out the creation of a "Smart Border for the 21st Century."[10] An accompanying 30-point Action Plan, based on four pillars (the secure flow of people, the secure flow of goods, secure infrastructure, and coordination and information-sharing) was designed to lead to collaboration in identifying and addressing security risks (i.e., keeping terrorists out) while achieving an efficient and effective expediting of the flow of legitimate people and goods across the shared border (see Appendix 4). It leaned heavily on the principle of risk management, by concentrating resources on individuals and products displaying higher degrees of risk. A Canadian Border Task Force was established for its implementation.

10 *Canada And The United States Sign Smart Border Declaration*, Department of Foreign Affairs and International Trade News Release No. 162, December 12, 2001.

To effectively carry out the Action Plan, both governments set aside significant financial resources. On this side of the border, the Canadian Federal Budget of December 10, 2001, allocated $1.2 billion in future years to make the border more secure, open and efficient. Roughly one half of this funding has been directed towards the improvement of border infrastructure (e.g., improvement of access roads, addition of new lanes, purchase of electronic scanners for quicker inspections), with the other half devoted to enhancing border security through enforcement, intelligence-gathering for security purposes and equipment. Most of the infrastructure money will be destined for Canada's six major border crossings, with $300 million ($150 million federal; $150 million provincial) committed to new border infrastructure in the Windsor-Detroit area.

While the U.S. government has also committed additional funding to bolster border security, the funding required to upgrade technology and infrastructure and to increase the quantity of border staff has been slow in coming. The shortage of funding from Washington to provide more U.S. customs officers at the northern border has historically been blamed for creating traffic delays there. Lewiston, N.Y., resident Jim Phillips (President and Chief Executive Officer, The Canadian/American Border Trade Alliance) assured the Committee that the staff shortage problem is currently being dealt with.

Witnesses addressing border issues were generally very supportive of the progress made to date with respect to the Border Action Plan, even if considerable implementation work remains to be done. The border is now both more secure and more trade-facilitating than it was at the time of the terrorist attacks. Proof of this lies in the fact that when the U.S. recently moved to the Code Orange security leve[l11] and brought in Operation Liberty Shield, there was little border disruption. Phillips suggested that public security and economic security were viewed in the U.S. as twin goals, both of them important.

In March 2002, the two countries began cooperating on a Port Security Initiative to identify and screen high-risk marine cargo before it arrives in either country. Canada has customs officers stationed in Newark and Seattle-Tacoma for this purpose, and the U.S. has staff in Vancouver, Montreal and Halifax to inspect containers to be transhipped south of the border. The two sides share intelligence information.

Fast lanes for low-risk, pre-cleared travellers (as opposed to shippers) were opened in June 2002 at two British Columbia-Washington State border crossings. This joint program, known as NEXUS, uses proximity readers to obtain security-related information from hand-held identification cards. The program is now running at four border crossings and will be expanded to include all other high-volume crossings by the end of 2003.

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11 Under Code Orange, U.S. border staff perform a trunk inspection on 75% of all vehicles. The highest level of security alert (Code Red) requires even more stringent coverage, with all vehicles being inspected, but it is only issued for specific, targeted threats. Unlike orange and yellow, red is not a general state of security.

Plans are also underway to launch a new program incorporating fast lanes for low-risk air travellers, referred to as NEXUS-Air. Pilot projects in Ottawa and Montreal are to begin in 2003.

In September 2002, President George W. Bush and Prime Minister Jean Chrétien formally announced the launch of a new joint program (Free and Secure Trade, or FAST) to ensure a secure supply chain for low-risk goods (facilitate the movement of commercial shipments across the border). Among other things, this program establishes fast lanes for approved, lower-risk shipments (i.e., those purchased by pre-authorized importers and transported by pre-authorized drivers and carriers). Subjecting truckers to a rapid electronic security check in these lanes will, it is hoped, result in more efficient border processing. The FAST program enables low-risk trucks and drivers to have their manifests sent by transponders to the customs agent at the border before the trucks arrive. FAST went into operation in December 2002 at six border crossings (4 in Ontario, 1 in British Columbia and 1 in Quebec).

Other signs of progress worth mentioning include strengthened cooperation between the two countries to increase their ability to intercept high-risk travellers before they leave for North America; the establishment of Integrated Border Enforcement Teams to catch criminals and terrorists before they cross the border; the coordination of intelligence-sharing, financial surveillance, customs cooperation, immigration practice and infrastructure protection; and the initialling of a Safe Third Country Agreement to deal with the treatment of persons seeking refuge and asylum at our land borders.[12]

On the negative side of the ledger, progress on developing the infrastructure required to establish a more effective border-crossing network has been slow. David Adams remarked that the 120% growth in two-way trade since the launch of NAFTA has not been accompanied by any commensurate increase in border infrastructure.

While the 30-point Border Action Plan has generally received critical acclaim, the Government of Canada has been criticized for not devoting enough attention to injecting funds into the construction of border infrastructure. For example, there are too few approaches to the border, with frequently used border locations such as Windsor-Detroit still requiring additional crossing points and/or expansion of existing ones to provide for the separate lanes required to streamline traffic. The three busiest border crossings all involve old bridges: the Ambassador Bridge connecting Windsor and Detroit was constructed in 1929; the Peace Bridge linking Fort Erie with Buffalo was erected in 1927; and the Blue Water Bridge between Sarnia and Port Huron was built in 1938. Other bridges span the St. Lawrence River between Canada and the State of New York. Construction of new bridges at key border crossings must be part of any border infrastructure solution.

12 Under this agreement, the claim for asylum has to be heard in the first country of arrival. As Bertin Coté (Deputy Head of the Canadian Mission in Washington) told the Committee, a full 70% of refugees arriving in Canada do so across the land border, and they will now have to be processed in the U.S.

Programs such as NEXUS and FAST will only be as good as the border infrastructure that is established, for there is little point to having special lanes for security-cleared, low-risk shippers and travellers if access to the lane occurs only a few car lengths from the actual border. These programs will require new investments in infrastructure before they can be truly effective.

In addition, border security must be pushed outward by moving customs inspection and paperwork away from the actual border. The pre-clearance system devised for airports could serve as a model for a similar development at land border crossings. According to the Canadian Chamber of Commerce, however, there has been little evidence of progress in moving pre-clearance away from the land borders.

Given the critical importance of the border to Canada's economic prosperity, the federal government should be investing a considerably greater quantity of resources in infrastructure at high-volume border crossings. It would also be helpful if quicker action could be taken on adopting a pre-clearance system for the movement of goods across the border, under which Canadian agents would work on U.S. soil and vice versa. Witnesses suggested that progress in this area would require a resolution of the guns issue (U.S. border guards carry weapons whereas Canadian guards do not) and Charter of Rights and sovereignty issues. The Committee recommends:

RECOMMENDATION 2

That, since a trade-efficient border is the lifeline of Canada's economic prosperity and since the current infrastructure at key border crossings is woefully inadequate to handle the tremendous growth that has occurred in bilateral trade, the Government of Canada accelerate the implementation of the 30-point Border Action Plan by:

a) **Encouraging Canadian and U.S. authorities to accelerate the construction of new bridge and tunnel crossings into the United States;**

b) **Injecting considerably greater financial resources into the construction of additional border infrastructure other than bridges and tunnels; and**

c) **Accelerating efforts to establish a pre-clearance system for the shipment of goods across land border crossings, thereby "moving the border away from the border" to reduce border impediments to trade, investment and business development.**

C. New Border Restrictions On The Horizon And How To Deal With Them

A brief reference to the new U.S. security-related actions looming on the horizon has already been made. These potential actions are fraught with problems for Canada, as Canadian producers could be kept out of the U.S. supply chain unless these plans are modified. David Bradley (Chief Executive Officer, Canadian Trucking Alliance) stressed that additional border restrictions, apart from adversely affecting transborder shipments, could undo the progress achieved under the Border Action Plan. That said, a number of individuals whom the Committee met in Washington, including U.S. Senator Susan Collins (R-Maine) and William Lash III (Assistant Secretary of Commerce for Market Access and Compliance, Department of Commerce), insisted that a key objective in applying these security requirements was to ensure that the movement of trade and people across the border would not be compromised.

The first of the security measures to note is the U.S. Patriot Act (October 2001) requirement that the U.S. Attorney General precisely track the movement of all individuals in and out of the country. According to recent statements, U.S. Ambassador to Canada Paul Cellucci has hinted that the U.S. Administration has agreed to exempt Canadian citizens from the documentation requirement contained in this entry/exit control system. However, foreign nationals residing in Canada would have to register. Regarding the imposition of exit controls, John Murphy (Vice-President, U.S. Chamber of Commerce) observed that discussions are currently underway to make the Canadian side of the border the U.S. exit point and thereby avoid the introduction of an additional security checkpoint.

Second, the U.S. is planning to insist (by October 2003) on advance notification of the contents of all commercial shipments into the country: four hours for truck shipments, 12 for air shipments and 24 for rail and marine shipments. These requirements are quite onerous for a number of key Canadian industries; according to U.S. Representative Earl Pomeroy (D-North Dakota), they are also of great concern to the Northern Border Caucus of the U.S. House of Representatives, which he co-chairs.

The third action is the June 2002 passage of the *U.S. Public Health Security and Bioterrorism Preparedness and Response Act of 2002* to help the U.S. prevent, prepare for and respond to bioterrorism and public health emergencies. The draft regulations accompanying the legislation would require the registration of foreign facilities that manufacture, process, pack or hold food for animal or human consumption, as well as the provision of advance notification to the FDA of every shipment of food products into the U.S. market.[13] Rory McAlpine (Acting Director General, International Trade Policy Directorate, Agriculture and Agri-Food Canada) referred to this legislation as his department's most pressing concern from an agricultural trade perspective. Industry representatives also expressed concern about the complexity of the Act and its regulations, and the impacts that it will cause.

13 For FDA-regulated products, the draft regulation requires that notice be given by noon the day before the truck in question reaches the border crossing. The advance notification requirement is thus different for food than for other products. Without adequate notice, the product will be refused entry into the U.S.

In Washington, Sharon Bomer-Laurentsen (Deputy Assistant U.S. Trade Representative for Agricultural Affairs) pointed out that considerable effort is being expended within the USTR to ensure that trade in the products affected by the regulations remains relatively unhindered.[14] However, she cautioned the Committee that it is reasonable to expect that firms will have to modify in some respects the way that business is carried out.

Ronald Bulmer (President, Fisheries Council of Canada) informed Committee members of the Canadian seafood industry's concerns about proposed U.S. regulations on plant registration requirements and prior notice, as well as upcoming FDA employee empowerment rules at the border and required record-keeping for products traversing the border. The Government of Canada is currently consulting with affected industries to formulate an appropriate response. The ultimate goal is to minimize the regulations' impact on cross-border trade.

How should Canada deal with these and other security-related measures? One option would be the development of "strategic bargains" that would, it is hoped, exchange actions taken by Canada on security for U.S. concessions on trade. As Kathleen Macmillan (President, International Trade Policy Consultants) noted, these actions would be designed to provide Americans with comfort about security concerns. Both she and Peter Clark (Partner, Grey, Clark, Shih and Associates, Ltd.) felt that the provision of such comfort would be a positive development.

Donald Barry observed that since September 11, a number of individuals and groups in Canada had released proposals linking security measures taken by Canada with U.S. trade concessions. For example, the November 2001 report of the Coalition for Secure and Trade Efficient Borders advocated an integrated and comprehensive response to security and border issues. In the spring of 2002, Wendy Dobson, professor at University of Toronto, called for a new bilateral arrangement to offset our support of U.S. objectives on border security, immigration and defence with enhanced access through a customs union/common market.

Thomas d'Aquino informed the Committee that in January 2003 the Canadian Council of Chief Executives (CCCE) had unveiled the North American Security and Prosperity Initiative (NASPI), a new bilateral partnership for trade, immigration, energy, security and defence designed to ultimately transform the internal border into a shared checkpoint. This proposal does not involve a customs union, common market or currency union since, according to d'Aquino, the likelihood of their acceptance in Washington is not great. Altogether, NASPI has five components:

14 In this regard, it would be helpful if U.S. customs officers were to apply the regulations governing trade more consistently across the border.

- The establishment of a protection zone around North America together with elimination of regulatory, procedural and infrastructure barriers at our internal border. Shared approaches to commercial processing, infrastructure, intelligence and policing, North American identity documents would be developed, and a common institution to provide oversight would be established;
- Regulatory cooperation, through mutual recognition or other forms of harmonization, to remove regulatory redundancies on a sector-by-sector basis. Included here would be trade remedies, restrictions on access and ownership in major industries, and impediments to skilled labour mobility;
- Achieving resource security (in the form of a resource security pact that would end once and for all the resource pricing and subsidies issues) in oil, natural gas, electricity, coal, uranium, primary metals, forest products and agriculture;
- A North American defence alliance involving greater investment in the Canadian military and an enhanced Canadian homeland security capability; and
- The establishment of four specialized joint commissions to deal with the above four areas. These commissions would have to be accountable to political authority on both sides of the border. The Council is examining models such as the International Joint Commission.

Witnesses appearing before the Committee were divided on the merits of presenting broad security and trade initiatives to the Americans. It goes without saying that D'Aquino is a strong proponent of this approach. Richard Harris told the Committee that the North American security problem should have been dealt with as a North American perimeter issue instead of as a land-border issue, and now that window of opportunity appears to have closed. This view was supported by David Bradley, who observed that so much investment had been made in the land border that no one was discussing perimeter security any more.

Other witnesses felt that there was still time for Canada to respond more vigorously to U.S. homeland security concerns and thus, it is hoped, to obtain relief from U.S. actions. For example, Fred McMahon (Director, Centre for Globalization Studies, Fraser Institute) argued that Canada had risked its physical and economic security by ignoring the development of a North American security perimeter. McMahon was of the view that while the 30-point Border Action Plan was a good start, it needed to be accelerated and it did not go far enough. He thought that the key short-term issue for Canada did not involve entering into a deeper trade agreement, but rather dealing with the security-related threat to our current trade. Measures to be taken include dealing with the terrorist threat better by altering refugee immigration policies and by improving the tracking of existing immigrants,[15] and making the supply chain more secure.

15 The U.S. is concerned about the administration of Canada's refugee policy and the resulting possibility that terrorists could slip across the border.

Rolf Mirus (Director, Centre for Economic Research, School of Business, University of Alberta) observed that our national interest dictates that we take the initiative with the U.S. to secure and reshape our trade and security relationship. The status quo is not an option since border closures and slowdowns are large risks and foreign investment may be deterred. The issue-by-issue approach is perhaps not workable in this climate. We should make a commitment to improve security at our borders – so that the U.S. has confidence in us – and work together to improve security for ships and aircraft. He envisions common procedures at a North American security perimeter. Moreover, U.S. confidence would increase if Canada had a stronger military.

On the negative side, Donald Barry did not hold much hope in the short term for such a new security/trade partnership, since the Bush Administration, fixated as it is on security concerns and domestic issues, does not have any interest in this type of approach. He also wondered, since Washington's priority is security while ours is trade, exactly how the security/trade bargain would be weighted, who would set the terms and whether Congress would be interested? Also, deeper cooperation is likely to occur on a North American basis, not a Canada-U.S. one. Instead, Canada should continue to build up its security and defence capabilities, since it makes sense for us to do so anyway, and such actions can help, albeit in a modest way, to reverse U.S. security perceptions of Canada. Most importantly, we need to continue the efforts under the Border Action Plan.

In Washington, lobbyist Paul Frazer (Murphy Frazer Selfridge) stressed the importance of performing the "grunt work" required at the border to ease U.S. security concerns and to facilitate trade. He rejected the "strategic bargain" approach previously described.

In his written submission to the Committee, Jim Stanford (Economist, Canadian Auto Workers) was very critical of any proposals or measures that would sacrifice Canada's capacity to independently determine its immigration, security and foreign policies in order to ensure that border crossings operate smoothly. Unconvinced that any such moves would "buy" Canada any special treatment from U.S. authorities, he favoured continued emphasis on sensible, incremental measures to enhance the efficiency of cross-border trade.

The Committee agrees. The answer to the border problem does not lie in the development of "strategic bargains" to remove border-related impediments to trade. It is highly doubtful that the Bush Administration would be interested and, as Kathleen Macmillan pointed out, it is not clear that the Americans would ever be satisfied with sovereignty-restricting actions that we would take to boost security. They may continue to impose ever more stringent security-related measures at the border. Moreover, we want Canada to retain its decision-making ability in the important policy fields mentioned by Stanford above.

Rather, it would appear that the best solution is to continue to work within the framework of the Border Action Plan to improve North American security. Lobbying hard for an easing of the planned new border requirements also makes sense, since their implementation in their current state would be harmful to economic interests on both sides of the border. The Committee recommends:

RECOMMENDATION 3

That the Governments of Canada and the United States intensify efforts to ensure that any implementation of Canadian and American security measures adequately take into account any effects on bilateral trade and investment.

CURBING THE USE OF TRADE REMEDIES

Another key impediment to realizing secure access to the U.S. market is the continued application of U.S. trade remedy (e.g., anti-dumping, countervail) actions against Canadian producers. Even if the overwhelming majority of North American trade runs smoothly and without adverse incident, other than border problems – indeed, over 95% of Canadian exports to the U.S. appear to be trouble-free at this time – there is no denying that from time to time certain trade irritants and disputes seem to define the bilateral relationship. In a number of key industries (e.g., softwood lumber, agricultural products), Canada faces frequent trade remedy disputes, with the U.S. periodically attempting to alter its domestic trade remedy laws to provide protection for its producers.

Moreover, the incidence of protectionist activity in the U.S. could increase if the U.S. economy deteriorates. Appearing before the Committee, Richard Harris expressed concern about the current level of U.S. protectionism and what he described as an inward focus in the United States as well as a possible abandonment of the multilateral agenda by an administration that he claimed was quite willing to accommodate protectionist interests.

The Committee shares Canadians' frustrations with chronic trade battles such as the eleven Canadian Wheat Board challenges and the numerous conflicts over softwood lumber exports, and is concerned about the huge legal fees – $800 million on the softwood case in Washington since 1986, US $200 million on softwood at the WTO and $10 million on the current Wheat Board case – that Canadian companies have to spend in their defence. We strongly believe that American producers, by constantly initiating these trade actions in some sectors, are not living up to at least the spirit of the existing free trade agreement.

A. The FTA: Objective Not Met

Trade disputes and irritants tend to arise from the imposition of protectionist measures by countries attempting to insulate their own industries from international competition. The aim of the FTA negotiators was to prevent such protectionism and to remove existing protectionist measures; these actions hardly seem consistent with free trade. Ideally, there would not currently be any such measures with respect to trade between Canada, Mexico and the United States.

Indeed, the main reason Canada entered the FTA negotiations in the first place was, as John Helliwell (Professor, Department of Economics, University of British Columbia) reminded the Committee, to obtain easier access to the U.S. market and to be exposed to less danger from U.S. trade remedy action. Before the FTA came into effect, private and government interests in the U.S. were increasing their efforts to impede Canadian imports through the use of domestic trade remedy legislation. In the decade before the FTA's implementation, for example, the United States had initiated some 30 investigations against Canada in the trade field; they involved major exports such as softwood lumber, pork, potash, and fish products. Also worth mentioning is the fact that at the time of the FTA negotiations there was no effective dispute settlement mechanism at the global level such as the current WTO mechanism.

The main strategy used by Canada to achieve secure market access was to attempt to obtain an exemption from the application of anti-dumping and countervailing duties. Anti-dumping actions are generally taken when it can be shown that a foreign competitor sold products into a given market (e.g., the American market) at prices that are below cost or below comparable prices in the home market (e.g., the Canadian market). Alternatively, countervailing duties are imposed by governments on exporting countries to offset perceived production subsidies in those countries.

American FTA negotiators flatly refused the AD/CVD exemption proposal because they believed Canadian products were being subsidized and that U.S. producers required the protection of domestic AD/CVD law. In response, the Canadian negotiators suggested that North American competition legislation be introduced as a replacement for anti-dumping duties, and that a common definition and code on subsidies be negotiated to lower substantially the use of countervailing duties. These proposals were unsuccessful, however, as the Americans were unwilling to go beyond the GATT rules at that time and insisted on maintaining their trade remedy laws. Ultimately, they showed no interest in having U.S. domestic law supplanted by a new body of international law.

To break the resulting deadlock in negotiations, the Americans put forward an interim solution whereby the existing judicial review of AD/CVDs by U.S. courts would be replaced with reviews by binational panels comprising trade specialists from both countries. The resulting Article 1906 of the FTA stipulated that the binational panel system would be a temporary measure (five to seven years) pending the development of a new, common AD/CVD regime. Furthermore, Article 1907 called for the parties to set up a working group to develop more effective rules and disciplines concerning the use of government subsidies and the application of unfair transborder pricing practices.

None of these alternative approaches saw the light of day, as the existing binational panel system became a permanent feature of NAFTA (Chapter 19). Moreover, the working group identified in the FTA's Article 1907 was dropped – it was agreed that rules on dumping and subsidies would be dealt with in the Uruguay Round of GATT negotiations[16] – and instead the parties agreed to regular, general consultations on a new AD/CVD regime. In some quarters, however, continuation of the status quo was seen as a significant Canadian victory in view of existing concerns about sovereignty in the U.S., which had taken the form of considerable Congressional pressure to downgrade or completely dismantle the Chapter 19 process.[17]

Ultimately, Canada (and Mexico) did not receive the exemptions from U.S. AD and CVD laws that they were seeking, as shown by the punishing duties on Canadian exports of softwood lumber. Nor did they meet their objectives of crafting a set of uniform trade laws. As a number of witnesses pointed out, free trade with the U.S. has not provided Canadians with the assured access to the American market that they were seeking. Both countries can use their countervailing and anti-dumping laws as they see fit, and can change their trade remedy laws whenever appropriate.[18]

Instead, the parties to the FTA and NAFTA had to settle for access to dispute resolution mechanisms that assess the proper application of NAFTA member country trade legislation. Thus, Canada's only recourse is to ensure that the U.S. trade remedy law is applied correctly. These dispute resolution mechanisms are reviewed in the next chapter.

16 In the end, the Uruguay Round did not result in the hoped-for changes to existing AD and CVD regimes.

17 Gilbert R. Winham, "Dispute Settlement in NAFTA and the FTA," in Steven Globerman & Michael Walker, eds., *Assessing NAFTA: A Trinational Analysis*, The Fraser Institute, Vancouver, 1993, p. 270.

18 In fact, the U.S. did so shortly after it lost a NAFTA challenge to Canadian softwood lumber pricing and allocation policies. The amendments to its trade remedy legislation were designed to reverse the most controversial aspects of the binational panel's decision in favour of Canada.

B. Exploring Made-In-North America Solutions

One has to wonder whether the U.S. would ever curtail its right to use such trade remedies as countervailing and anti-dumping duties on internal NAFTA trade. Given the central role that these tools play in U.S. trade policy, and how hard the Americans have fought to retain these tools in trade talks, it seems difficult to envision the U.S. entirely giving up its right to impose countervailing tariffs and duties. The Honourable Roy MacLaren (former Minister of International Trade) observed that there is currently no incentive for the U.S. to forgo its trade remedy practices. Lawrence Herman (counsel, Cassels, Brock & Blackwell LLP) remarked that the Americans saw their vigorous trade remedy process, necessary to deal with what they view as unfair foreign trade practices, as "an article of faith."

Not all are of this view, however, as one observer of North American integration argued that the Americans "might be receptive within an overall goal of North American economic security."[19] Thomas d'Aquino noted that there was no place for trade remedies in the bilateral relationship. He thought that the best way to capture Americans' attention on trade remedies would be to come up with a "strategic bargain" that would result in the removal of trade remedies, a goal not achieved fifteen years ago.

However, MacLaren dismissed this option outright, noting that the U.S. Congress had never shown any willingness to remove the trade remedy arsenal at its disposal. His desired alternative was for Canada to continue to concentrate on the current multilateral negotiations.

For his part, the Honourable Pierre Pettigrew (Minister of International Trade) told the Committee that there needed to be a firm commitment to bringing trade remedy practice in line with the growing integration of the shared North American economic space. He cited the steel industry as a case in which the use of trade remedies was counterproductive.

The Committee believes, however, that little can be done on an economy-wide basis within the NAFTA to correct this problem. Establishing a common North American anti-dumping and countervailing duty regime is a non-starter in the short term. Moreover, the "strategic bargain" approach referred to above holds little promise, as the U.S. is not likely to dispense with its domestic trade remedy laws. The proposal of the Canadian Council of Chief Executives to exchange Canadian action for trade-remedy relief and negotiate a comprehensive resource security pact with the Americans, designed to settle the thorny issues of resource pricing and subsidies once and for all, is unlikely to be feasible and would involve too great a loss of Canadian sovereignty. As John Helliwell told the Committee in Vancouver, it is dangerous to move further along the integration path, simply because Canada did not obtain what it was seeking in previous attempts to integrate.

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19 Wendy Dobson, *Shaping the Future of the North American Economic Space: A Framework for Action*, The Border Papers, *C.D. Howe Institute Commentary*, Number 162, April 2002, p. 21.

One option worth exploring, as several witnesses suggested, is the use of bilateral sectoral tariff agreements (e.g., in the steel sector) to "disarm" the use of trade remedies within the economic sectors under consideration. Lawrence Herman informed the Committee that the three NAFTA governments had agreed to open preliminary discussions on a possible set of trade rules to govern the steel industry. He felt that this development should be encouraged, since it could lead to the removal of trade irritants and private law remedies in that industry. In meetings in early February with U.S. Secretary of Commerce Don Evans, Minister Pettigrew broached the possibility of limiting each country's ability to impose anti-dumping or countervailing duties in trade disputes within such a highly integrated industry such as steel. Kathleen Macmillan saw potential in applying a possible steel agreement to other sectors of the economy, most notably agriculture. The Committee, swayed by all of these arguments, recommends:

RECOMMENDATION 4

That Canada and the United States initiate negotiations to achieve substantial trade remedy (e.g., anti-dumping, countervail, safeguards) relief in economic sectors (e.g., steel) in which producers would favour such action.

C. Seeking Progress At The WTO

Canada should also aggressively seek progress on the trade remedy file at the WTO. As Jon Johnson (Partner, Goodmans LLP) told the Committee, the advantage that the WTO has is that it has a definition of "subsidy" and stringent rules regarding the conduct of anti-dumping and countervailing actions. Therefore, he felt that the WTO represented our best chance of dealing with U.S. trade remedy laws.

According to Gilbert Gagné (Professor, Department of Political Studies, Bishop's University), the answer lies in (a) clarifying existing WTO provisions on the definitions of subsidy and dumping, and (b) tightening the WTO conditions under which dumping and countervail action can be taken. He argued that U.S. trade remedy investigations are often launched in the absence of strong evidence of subsidization, dumping or injury, resulting in forced "compromises" to avoid costly litigation and maintain trade access. Canada should continue to insist that the WTO provisions require sufficient and stronger evidence for the launching of trade remedy investigations.

In Washington, William Lash III (Assistant Secretary of Commerce for Market Access and Compliance, Department of Commerce) also urged Canada to obtain subsidies reform at the WTO. He argued that continually retrying the same cases, as is being done in softwood lumber, is counterproductive and that reforming the WTO could "get to the heart of the issue."

The Committee heard additional testimony that anti-dumping abuses have become an increasingly serious problem for the international trading system, as more and more countries have implemented their own anti-dumping legislation. The problem is that not all of these countries (largely developing countries) have interpreted WTO rules (i.e., the 1995 WTO Anti-Dumping Agreement) in the same manner, and disputes have occurred. Bringing greater clarity and openness to anti-dumping rules is now seen as an urgent priority.

These issues are on the agenda of the current round of negotiations at the WTO and are being actively explored at the FTAA talks. In November 2001, WTO Members agreed to initiate negotiations aimed at clarifying and improving disciplines under the Anti-Dumping Agreement and the Agreement on Subsidies and Countervailing Measures, while preserving the basic concepts, principles and effectiveness of these instruments. Claude Carrière (Director General, Trade Policy Bureau, Department of Foreign Affairs and International Trade) informed the Committee that the WTO's Rules Negotiation Group was considering ways to reduce abuse in the application of trade remedy laws and to impose stricter requirements before anti-dumping and countervailing cases can be launched. According to Carrière, Canada's objective is to constrain the abusive use of anti-dumping and countervailing measures against us by the U.S. and other countries. To that end, it is seeking to raise the current 25% threshold for industry participation in a petition for AD or CVD action.

Some witnesses pointed to the uncertain prospects for success of the WTO Doha Round, in which the above changes would have to be made. Rolf Mirus and Donald Barry noted that the prospects for the Doha Round were not good at this point since substantive progress on agricultural issues had not yet occurred. Achievement of such progress would require European concessions on agriculture; as Barry mentioned, those concessions might be obtained as the process of EU expansion causes the Europeans to come to grips with their own agricultural support policies. Minister Pettigrew cautioned the Committee not to have too high expectations regarding WTO progress on the question of trade remedies.

Notwithstanding this negotiating uncertainty, the Committee is acutely aware of the need to overhaul existing WTO trade remedy provisions to curtail the incidence of protectionist abuse. Along with agricultural reform, curbing the use of trade remedies must be viewed as the most critical objective for Canada in the current WTO negotiating Round. The Committee recommends:

RECOMMENDATION 5

That in the Doha Round of WTO trade negotiations, the Government of Canada give top priority to obtaining a WTO agreement to:

a) clarify and improve upon existing provisions on subsidy and dumping definitions;

b) tighten existing WTO provisions governing the use of trade remedies (e.g., anti-dumping, countervail, safeguards) so as to restrain protectionist abuses; and

c) avoid continental trade conflicts.

IMPROVING DISPUTE SETTLEMENT MECHANISMS

Since it has proven impossible thus far to eliminate the threat of U.S. protectionism, it is important for a country as widely exposed to the large American market as Canada to have access to a comprehensive and effective dispute settlement system through which the most problematic and damaging cases of unilateral protectionism can be dealt with directly, fairly and quickly. Indeed, Canada entered the FTA negotiations intending to emerge with a mandatory, rules-based dispute settlement system that would govern the implementation of the agreement and serve as a secure route for Canada to challenge U.S. protectionist actions without having to endure the influence of powerful U.S. interests in the process.

Regrettably, the dispute settlement system that Canada obtained through the North American free trade agreements is only partly rules-based. Some of the rules leave room for political intervention, and as a result, Canada (and now Mexico under NAFTA) is still susceptible to the adverse effects of U.S. political decisions and power.

While the Chapter 19 binational panel system (discussed below) is in many ways a rules-based dispute settlement system, it is based on a hybrid set of substantive law: the domestic anti-dumping and countervail law of the three NAFTA member countries. Although the rules tend to work most of the time, highly politicized disputes involving major economic interests (e.g., the softwood lumber dispute) continue to demonstrate the shortcomings of the Chapter 19 system and its inevitable susceptibility to political pressures.

Key dispute settlement provisions under NAFTA include the Chapter 19 state-to-state binational panel process for the review of anti-dumping and countervailing measures; the Chapter 20 state-to-state dispute settlement procedures covering all NAFTA issues other than those contained in Chapters 19 and 11; and the Chapter 11 investor-state mechanism that enables foreign investors to bring a claim against the country in which it has invested. All three of these dispute resolution mechanisms will be described in greater detail below.

Where rights and obligations under the WTO are at issue, NAFTA parties also have the option of employing WTO dispute settlement procedures as an alternative to those found in NAFTA. As was already mentioned, the WTO has now become "the forum of choice" for the settlement of disputes. For example, His Excellency Paul Cellucci (U.S. Ambassador to Canada) noted that the U.S. tends to resolve its trade issues through multilateral treaties contained within the WTO-led international trading framework and that these treaties trump U.S. trade laws.

The Committee has already registered its unhappiness with the current NAFTA dispute settlement system. Increasingly, disputes that are North American in nature are being resolved in Switzerland. Surely there are benefits to both Canada and the U.S. in improving the existing dispute resolution arrangement and making it more timely and effective.

A. NAFTA Chapter 19 Dispute Resolution

Prior to the FTA, AD/CVD disputes originating in the United States were decided by U.S. agencies, and the only internal avenue of appeal was resort to judicial review of governmental decisions by domestic courts. The FTA and subsequently NAFTA's Chapter 19 provided a system of binational panel review as an alternative to judicial review for decisions made on anti-dumping and countervailing duty matters. These agreements set out procedures for the establishment of panels, time limits for the panel to come to a resolution and certain consequences in case of non-compliance with panel decisions. Donald McRae (Professor, Business and Trade Law, University of Ottawa) described the Chapter 19 panel review process as an important improvement over what was in place prior to the FTA.

According to both Jon Johnson and Michael Kergin (Canada's Ambassador to the United States), the FTA dispute resolution system was also a substantial step forward compared with the General Agreement on Tariffs and Trade. There was no dispute settlement procedure in the GATT, and the losing party could block adoption of reports. In contrast, that could not happen under the FTA.

A fundamental feature of the Chapter 19 dispute settlement system is that binational panels do not create or apply new law, nor do they apply substantive legal rules on AD/CVD;[20] they simply review the application of the domestic law of the importing country to ensure that it was correctly applied. Thus, in the case of U.S. action against Canadian policy, a dispute settlement panel would review the U.S. government agencies' actions only to ensure their consistency with U.S. domestic trade law. NAFTA's Chapter 19 binational panel review process is, therefore, quite limited in that it only ensures that each country's domestic trade law is properly applied rather than setting standards of its own.

This binational panel system has generated substantial commentary and has been a key element of several major disputes, including the softwood lumber and steel disputes. Over eighty percent of the disputes under NAFTA have related to AD and CVD and have thus come under Chapter 19.

How successful has the binational panel review process under Chapter 19 been? According to Gilbert Gagné, who has written extensively on these matters, even though benefits have accrued from the Chapter 19 provisions, "fundamental problems have remained, which all have proved highly detrimental to Canadian trade interests. These relate to the limited nature of FTA/NAFTA provisions, the problems and delays encountered in the panel review process, the maintenance of the most troublesome aspects of US trade laws and practices, including the ability to modify these in a restrictive way, the persistence of harassment tactics leading to the need for "compromises" to avoid further litigation, and, finally, US attitude seeking national interest with a disregard for international trade rules."[21]

Lawrence Herman argued that the key deficiency with the NAFTA dispute settlement system is that the panels were ad hoc in nature and that there was no true permanent NAFTA arbitration or panel institution. He suggested that a permanent NAFTA court be established that would not alter the jurisdiction of the panels, but would provide for a permanent set of judges. Such a court could deal with all of the cases under Chapters 19, 20 and 11. However, the Committee is of the view that the establishment of a permanent North American Court on Trade and Investment to resolve disputes is a second-best alternative to progress at the WTO level (see below).

Sharon Bomer-Laurentsen (Deputy Assistant U.S. Trade Representative for Agricultural Affairs) agreed with the need to invigorate the Chapter 19 process. Dispute resolution panels needed to come to decisions in a more timely and effective fashion.

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20 As was previously mentioned, these do not exist.

21 Gilbert Gagné, "North American Free Trade, Canada, And US Trade Remedies: An Assessment After Ten Years," *The World Economy*, January 2000, p. 90.

Other reviews of the dispute settlement system have been more favourable, especially when it comes to lower-profile cases. Indeed, a recent study makes the case that Chapter 19 "has been quite effective in curbing what Canadians believe to be the overzealous enforcement of AD and CVD laws by U.S. authorities."[22] The study's author, Patrick Macrory, notes that "only six Canadian products other than softwood lumber are currently subject to AD and/or CVD orders, and in most cases the volume of trade involved is small and the current duty level low."[23] He also emphasizes that following the implementation of NAFTA, "imports from Canada and Mexico have been subject to far fewer investigations and orders than imports from other parts of the world, perhaps as a result of the increased integration of their economies with that of the United States."[24] A previous study also concluded that the binational panel process for reviewing appeals of US and Canadian trade remedy cases had worked "reasonably well" and that final decisions had been issued much faster than those of the US Court of International Trade.[25]

Fred McMahon told the Committee much the same story: the free trade agreements that Canada has entered into have lowered the incidence of trade irritation; Europe and Japan have been the targets of more U.S. trade actions than Canada has; and Canada has done well at trade panels under the FTA and NAFTA. Jon Johnson observed that the binational panel process had been quite useful, as panels had been objective in their work. Peter Clark pointed out that Canada had fared rather well in the early days of Chapter 19 dispute settlement, but that there was little in the way of current activity. Claude Carrière also thought that the Canadian record in Chapter 19 cases was positive.

Even with its flaws, a number of witnesses commented on the importance of retaining, at the minimum, the Chapter 19 process for NAFTA trade within the ongoing FTAA negotiations. For example, Gagné noted that although the Americans might resist such a development in view of the enforceable nature of NAFTA panel decisions, including a mechanism similar to the one in Chapter 19 should be considered a minimum requirement for Canada. The Committee recommends:

22 Patrick Macrory, "NAFTA Chapter 19: A Successful Experiment in International Trade Dispute Resolution," *C.D. Howe Institute Commentary*, Toronto, 2002.

23 *Ibid.*, p. 2.

24 *Ibid.*

25 William J. Davey, *Pine & Swine: Canada-United States Trade Dispute Settlement – The FTA Experience And Nafta Prospects*, The Centre for Trade Policy And Law, 1996, pp. 286-287.

RECOMMENDATION 6

That during FTAA negotiations on the introduction of an effective hemispheric dispute resolution system, the federal government seek to retain, as a minimum, the NAFTA Chapter 19 dispute settlement process as an option for NAFTA trade.

B. Chapter 20 Dispute Settlement

Chapter 20 is the dispute resolution system used for the general interpretation of NAFTA. Regrettably, NAFTA Chapter 20 procedures do not represent an effective dispute settlement mechanism and have been used only three times since NAFTA's inception. A number of witnesses saw Chapter 20 as only useful in rare cases when disputes could not be taken to the WTO because they involve NAFTA-only rights and obligations.

Improvements to be considered include speeding up panel selection; providing the NAFTA process with greater institutional support; implementing an effective appeal process; and making Chapter 20 decisions binding. However, as Donald McRae pointed out, implementing changes to the Chapter 20 process would not likely make it more attractive to the parties.

In particular, Chapter 20 suffers from a major flaw in that its dispute settlement mechanisms are not binding on the parties to the dispute. Dispute settlement mechanisms can play a major role in preventing new disputes, but for this to happen, the mechanisms must be seen as enforceable.

When a dispute arises, the first step in the process involves consultations between the parties. If the consultations do not resolve the dispute, a meeting of the NAFTA Commission, a political body composed of ministerial-level representatives from each party or their delegates, is held. It is at this point that diplomacy and power-based negotiations can derail the rules-based focus of the system. If the NAFTA Commission is unable to resolve the dispute, the parties can request that an arbitral panel be established. The panel, composed of independent trade specialists from each country, hears from each party and then releases a report with recommendations that are not automatically binding on the parties. By the very nature of the process, the final decision on the dispute remains in the hands of the parties and is susceptible to diplomacy and power politics. There is no appellate body.

It is important to point out that these shortcomings do not exist in the dispute settlement procedures under the WTO. There, panellists have to be citizens of third parties and panel selection is improved; there is no equivalent to the politically oriented NAFTA Commission and the WTO has institutional support; the appeal process is better than NAFTA's ad hoc arbitration; the dispute settlement system is more transparent; and reports by review panels are binding. It is difficult to characterize the Chapter 20 dispute resolution system as effective since it does not possess the capacity to actually settle disputes.

C. Achieving Progress at the WTO

The WTO Dispute Settlement Understanding (DSU) is a multilateral, rules-based process that is, according to Lawrence Herman, the best we have had in international law in centuries. It is generally viewed as a fair and effective process for settling disputes between WTO Members. The DSU provides for consultations as a first step towards resolution of a dispute; if the dispute cannot be resolved, then a panel is formed to rule on whether a WTO Member has violated its WTO obligations. The decision of these panels can be appealed to the standing WTO Appellate Body.

A product of the Uruguay Round of trade negotiations in the mid-1990s, the WTO system of resolving trade disputes contains a number of features that make it superior to the NAFTA dispute settlement process. Witnesses made the point that the WTO provided a much more level playing field for the settling of disputes than any bilateral or regional trade agreement, and that it currently represents Canada's best hope for dealing with the application of U.S. trade remedy laws. Already, there is evidence that NAFTA member countries are increasingly resorting to WTO procedures rather than the Chapter 19 process. Donald McRae remarked that the use of Chapter 19 was less frequent under NAFTA than it had been under the FTA.

Jon Johnson provided the Committee with valuable information on the key features of the WTO system. Of primary importance is the fact that the WTO dispute settlement process tests countries' trade remedy actions against its own rules on the use of dumping and countervail actions. The WTO agreement on anti-dumping contains an improved anti-dumping code, and there is a definition of "subsidy" within the WTO Agreement on Subsidies and Countervailing Measures. Moreover, the losing party cannot block the adoption of a report, and panel selection proceeds expeditiously. Unlike the NAFTA panels, the ones constituted at the WTO have a secretariat to draw on and obtain considerable institutional support. A standing appellate body is also in place; according to Johnson, this has brought much consistency to WTO law.

It stands to reason, then, that the best way of making progress in the area of dispute settlement lies in improving the WTO dispute settlement system. Johnson informed the Committee that there is no real dispute with the fundamental structure of the system, in that most of the suggestions for reform deal with the technical operation of the dispute settlement system.

However, one key issue does exist: non-compliance with panel or Appellate Body decisions at the end of the WTO process. When a WTO Member is found to be in violation of its WTO obligations, it is given a "reasonable period of time" to bring itself into conformity. If no conformity is achieved, the Member may face retaliatory action from the complaining party or, alternatively, the offending Member may wish to provide compensation (e.g., trade liberalization in another sector or industry) as a temporary response pending compliance.

Claude Carrière made the point that retaliation was a rather blunt instrument and one whose effectiveness has not been demonstrated. The Government of Canada has not yet come up with a practical alternative, he noted.

Richard Ouellet (Assistant Professor, Faculty of Law, Laval University) and Armand De Mestral (Professor, Faculty of Law, McGill University) both argued that the implementation of dispute-settlement decisions is becoming more and more problematic. A number of stages are now required before the parties to a dispute can agree on implementation. Referring to the Canada-U.S. dispute over periodicals, Gilbert Gagné noted that the reports of the WTO panels and the appellate body give very little indication as to the amount of leeway a country has to pursue the goals of invalidated programs. In such cases, political pressure has become more important than first anticipated. Both Ouellet and De Mestral[26] thought it would be far better to have a quasi-judicial institution determine how to settle disputes than to have political and economic pressure exerted in the situation in question.

Canada should be at the forefront of changing existing dispute settlement mechanisms (both WTO and NAFTA Chapter 19) to ensure smoother resolution of disputes with a minimum amount of political friction. Indeed, Canada has submitted proposals in this area.

Other shortcomings of the WTO dispute settlement mechanism indicated to the Committee include the need for greater transparency, the need for tighter timelines for expedited resolution of disputes, the need for movement to a fixed semi-permanent roster of panellists, resolution of the sequencing issue in implementing decisions, the need to reform the third party process, and the need to abolish the interim review stage. However, the Committee heard evidence that implementing these changes was not critical for the success of the Doha Round and that, at any rate, progress in changing the dispute settlement regime was not likely. In March 2003, Claude Carrière told the Committee that there was absolutely no chance that the review of the WTO dispute settlement system would be completed by the May 2003 deadline.

26 According to De Mestral, the International Joint Commission (IJC) was not the answer. Although the IJC is very good at providing reports, facts and recommendations, it does not provide final decisions. He felt that citizens and firms should be able to raise these issues before the domestic courts.

D. NAFTA's Chapter 11

The principal objective of NAFTA's controversial Chapter 11 is to facilitate the flow of investment among its member countries through the creation of rules designed to shelter foreign investors from discriminatory measures (i.e., measures that discriminate between domestic and foreign investors) and market-distorting measures taken by host country governments. The chapter is not original in its design, but rather draws heavily from the provisions of existing bilateral investment treaties such as the foreign investment protection agreements (FIPA) between Canada and a number of other countries. With respect to these bilateral agreements, participating foreign investors can already submit claims to the International Centre for Settlement of Investment Disputes (ICSID). The Chapter 11 provisions, however, go further than the investment provisions in the original FTA.

The most controversial component of Chapter 11 is the investor-state dispute settlement process, which enables private foreign investors to bring an arbitral claim against one of the NAFTA member governments if they are of the view that a host government has breached its investment obligations under Chapter 11. Article 1110 of Chapter 11 states that a NAFTA government may not take measures "tantamount to nationalization or expropriation" of an investment, unless it does so for a public purpose, on a non-discriminatory basis, in accordance with due process of law, and only if it pays compensation to the foreign investor. If a foreign investor is of the view that government decisions have damaged the firm's business interests (i.e., profits or expected profits) in an unfair and discriminatory manner, they can access a process of legal review and possible compensation.

The arbitral process is governed by international commercial arbitration rules. The investor and the government each choose one arbitrator and the third is selected together or by a neutral third party. The results of the arbitration are binding on each party, and there are limited provisions for review or appeal of such awards. NAFTA tribunals are not permitted to recommend that a government change its offending laws, regulations or policies.

The investor-state provisions under Chapter 11 were originally drafted to protect corporations and investors from arbitrary regulation and back-door trade protectionism, particularly as they would affect their investments in Mexico. As such, these provisions were essentially designed to preclude foreign investors from being made to comply with more stringent rules than apply to domestic companies. Investment promotion and protection remain their overarching purpose.

Set against this need to promote and protect investment and the rights of private investors, however, is the expressed need for public control over governmental policy-making. In this context, some have argued that the investor-state provisions have imposed a "regulatory chill" on government. In other words, they have restricted the ability to regulate. Is this a valid criticism?

NAFTA critics maintain that what started out as a defence mechanism for investors against foreign governments seems to have become an aggressive tool in the hands of certain corporations to challenge the right of government to introduce regulations. They argue that corporations are now dictating public policy. Dennis Deveau (Government Liaison, Legislative Department, United Steelworkers of America) questioned whether foreign owners of capital should enjoy greater rights than corresponding Canadian interests. Steven Shrybman (Lawyer, Sack Goldblatt Mitchell) told the Committee that providing foreign firms with the right to take Canada to international tribunals that can award damages against us is an extraordinary development in international law. Investor-state disputes should be dealt with in domestic (i.e., Canadian) courts, not in international tribunals. He also expressed concern about access to Chapter 11 proceedings and the lack of transparency.

On the flip side of the argument, it bears noting that the first eight years under the NAFTA produced a mere 23 Chapter 11 complaints overall (and only five cases decided), at a time when investment in North America was growing rapidly. With relatively infrequent exceptions, North American governments have generally been successful in adopting regulations genuinely designed to protect health and the environment and not aimed at disallowing the business operations of an individual foreign company. There is no doubt that Chapter 11 makes it more difficult for governments to freely pass protectionist regulations intended to destroy legitimate businesses. However, it has not stopped governments from doing what they want – with the proviso that they have to compensate the business interest in question if a panel decides that the action they have taken was not carried out in a non-discriminating manner. As Donald McRae argued before the Committee, it is not unreasonable to require a government not to act arbitrarily or discriminatorily.

Whatever one's views on the merits of including investor-state provisions within the NAFTA, it is clear that the Chapter 11 investor-state dispute resolution mechanism could be improved by tightening the scope of the existing expropriation provision (this has been a focus of the federal government for some time now and was also recommended by Robert Friesen, President, Canadian Federation of Agriculture); by making the dispute settlement system more transparent; and, as McRae suggested, by providing the Chapter 11 process with an institutional base together with the incorporation of a WTO-based appellate process that would correct tribunal errors and provide the process with consistency and predictability.

On the issue of transparency, the actual arbitration proceedings are closed to the public unless the parties agree that they be open. However, each NAFTA country has now agreed to make publicly available all documents submitted to or issued by a Chapter 11 tribunal, with a number of limited exceptions. McRae told the Committee that to improve transparency of Chapter 11 cases even more, the NAFTA parties just had to agree that the proceedings would be open to the public in the same way that claims launched by domestic investors are. He noted, however, that whereas Canada and the U.S. appear to be in favour of this suggestion, the Mexicans are less inclined to make this change.

ARE NEW INSTITUTIONS REQUIRED TO MANAGE NORTH AMERICAN TRADE?

Within NAFTA, there is no evidence of common institutions governing economic relations, apart from the labour and environment commissions that have been created. The trade agreement itself has no associated supranational institutions. NAFTA was supposed to evolve but never did. There is no real NAFTA institution to effect changes, and the U.S. is reluctant to commit to supranational institutions. Are improved, or even new, institutions required or desirable to manage the existing level of trade and investment in North America? Alternatively, is the existing system of fixed rules combined with a dispute settlement system within the NAFTA framework adequate?

For his part, Minister Pettigrew has indicated his preference for making changes in the bilateral relationship (e.g., making progress on border issues) using the existing institutional framework. Two of his senior officials, Claude Carrière and Marc Lortie (Assistant Deputy Minister (Americas), Department of Foreign Affairs and International Trade), felt that there was a noticeable absence of interest, especially within the U.S., in creating common institutions governing trade. Lortie made the point that of the three NAFTA parties, Mexico was the most active and innovative in proposing institutional change.

Steven Shrybman noted that as far as supranational institutions were concerned, the European situation is different since balance exists there (e.g., UK, France, Germany are somewhat similar in economic size), whereas in North America, a lopsided situation exists because the U.S. is so powerful.

On the more positive side, Armand De Mestral argued that while supranational institutions would never be acceptable, existing institutions such as the NAFTA Commission could be strengthened. Other witnesses also urged the federal government to explore the possibility of strengthening bilateral institutions or creating new ones to effectively manage the Canada-U.S. trade relationship. Lawrence Herman favoured the establishment of a permanent NAFTA Commission with a permanent NAFTA free trade secretariat, as opposed to the current situation, where officials meet in the three capitals but have no permanent or juridical status (i.e., it is not a true trilateral body). This group could be given the task of issuing reports, collecting data and providing service to the three governments on key trade issues. Herman also advocated the establishment of a permanent NAFTA court, with a permanent set of judges, to replace the current ad hoc system. The jurisdiction of the panels would not change under the new arrangement.

Richard Ouellet also expressed a desire for change in North American institutions, either through a review of NAFTA or the negotiation of an FTAA. He noted that the NAFTA institutions were under-utilized in many respects. For example, the NAFTA Commission should be put to better use, even though its mandate is currently not very broad. Moreover, the labour and environmental Commissions are also under-utilized, and the various NAFTA Committees, while doing good work, are not visible, transparent and active enough. Public access to all of these institutions could be made easier.

Laura Macdonald recommended that a serious examination of trilateral institutions, including existing institutions such as the labour and environment commissions and the North American Development Bank (NADB), be initiated. The NADB, of which Canada is not a member, could be used to help finance economic development of disadvantaged regions of Mexico. Regrettably, the Bank has been neither effective nor efficient, a factor which has dampened Canadian enthusiasm regarding participation in the institution.

For his part, William Dymond proposed that the Government of Canada examine the International Joint Commission (IJC) to see if it could be adapted to serve a larger relationship between Canada and the United States.

After carefully deliberating on all of these suggestions, the Committee has concluded that a problem-solving and trade policy entity is required within the NAFTA framework. Ten years ago, the NAFTA provided for a Secretariat to serve the Free Trade Commission and, while the agreement's provisions are sufficiently flexible to establish this body, it was not created. Ideally, the institution would consist of senior trade officials from all three countries, who could work together on an ongoing basis to reduce the number of items on the NAFTA trade dispute/irritant list and provide critical advice to the three governments on medium- and long-term trade policy issues and on developments within the WTO. We recommend:

RECOMMENDATION 7

That Canada, Mexico and the United States implement NAFTA Article 2002 calling for the establishment of a permanent NAFTA Secretariat and provide this Secretariat with the following mandate:

a) **To examine means by which trade disputes and irritants can be resolved within the NAFTA rather than at the WTO, and to help expedite the resolution of these trade conflicts;**

b) **To examine medium- and long-term trade policy issues and to generate reports including recommendations for action by NAFTA partners; and**

c) **To review developments within the multilateral trade system and their relationship to the NAFTA trade framework.**

RESOLVING EXISTING TRADE DISPUTES AND IRRITANTS

The bilateral trading relationship between Canada and the United States is the largest in the world. Each day, the two countries exchange goods valued at over $1.5 billion, and over 95% of Canada-U.S. trade takes place incident-free. However, from time to time certain trade irritants and disputes arise. This chapter addresses the key disputes and irritants that Canada faces over softwood lumber and agricultural goods.[27]

A. The Canada-U.S. Softwood Lumber Dispute

Softwood lumber exports from Canada to the United States, valued at roughly $10 billion annually, have caused the most trade friction over the past two decades. The U.S. has initiated trade action against Canada over softwood lumber four times in the past twenty years, and any resolution of the dispute during that period has proven to be temporary (refer to Appendix 1 for details on these disputes).

Softwood lumber typically comes to the attention of the U.S. Department of Commerce when Canada's share of the U.S. market exceeds thirty percent and when the U.S. industry is suffering. The lumber industry exhibits a cyclical nature driven by market demand, and in recent years, mill closures have occurred on both sides of the border because of decreased lumber prices. U.S. lumber manufacturers are a relatively small but high-profile group whose interests are aggressively advanced by the Coalition for Fair Lumber Imports in Washington.

Regarding the current dispute, in April 2001 the U.S. initiated trade action that resulted in an average combined antidumping and countervailing duty rate of 27.22% applied to Canadian softwood lumber sold to the United States. This action represents yet another blatant attempt by the U.S. industry to protect its domestic market from the Canadian product.

The dispute has varying regional impacts. The majority of softwood lumber exports originate from British Columbia (54% of exports) and Quebec (20%), with smaller quantities from Ontario and Alberta (9% and 7% respectively). B.C.'s economy is the most reliant on softwood lumber exports, as lumber exports to the U.S. in 2001 made up 16% of B.C.'s total exports. In her report to the Committee on the prestigious PriceWaterhouseCoopers 16th Annual Global Forest Industry Conference, Committee member and the Minister responsible for the FTA negotiations in the mid-1980s the Honourable Pat Carney revealed the havoc that the softwood war and a global oversupply of wood have wrought on the province during the past five years: permanent closure of 27 mills, job losses of the order of 13,000 forest company employees, a one-third drop in provincial forestry revenues, and the loss of the industry's leading position in the B.C. economy.

27 In Washington, two concerns about U.S. access to the Canadian market were also brought to the Committee's attention: the issue of insufficient patent protection as it applies to pharmaceuticals, and the perceived low level of personal duty exemptions for U.S. travellers.

In contrast, lumber sales to the U.S. made up less than 3% of Quebec's exports and less than 0.5% of Ontario's exports worldwide. Producers in the Atlantic provinces (Newfoundland, Nova Scotia, Prince Edward Island and New Brunswick) were exempted from the countervailing duty investigation, but face an anti-dumping duty of 8.43%.

1. The Essential Nature of the Dispute

The softwood lumber dispute revolves around differences in the structure of the forestry sector in the U.S. and Canada. In this country, 90% of forested land is provincial Crown land, and most provinces lease Crown land to forest companies and charge "stumpage fees" for the right to harvest timber from that land. The provinces use a variety of administrative tools to determine appropriate stumpage fees, with these varying within each province by tenure type. In contrast, 70% of the forested land in the U.S. is privately owned and accounts for the majority (90%) of the timber harvest. On U.S. forested land that is regulated by the government, harvesting rights are auctioned off to logging companies.

The complex, very different nature of forest management in Canada makes Canadian softwood lumber an easy target for subsidy charges. From the U.S. perspective, provincial timber pricing policies have given Canadian lumber producers access to subsidized timber that gives them an advantage over U.S. lumber producers. The U.S. believes that auction-based sales of timber reflect fair market value, whereas the Canada's system of administratively determined prices with limited auctioning results in timber prices that are far below market-value rates. The U.S. contends that these below-market prices enable Canadian producers to undercut U.S. producers in the American market.

The Coalition for Fair Lumber Imports has also alleged that lumber producers have dumped lumber into the U.S. market for less than market value. Unfortunately for the Coalition, a number of witnesses told us that the anti-dumping duties have had unintended consequences: they have forced the most efficient producers to simply ramp up their output and lower significantly their unit costs, the cause of U.S. complaints in the first place. As Senator Carney outlined in her report to the Committee, these actions have caused lumber exports to remain constant or grow while prices and profits have seen steep declines.

British Columbia is the principal target of U.S. investigations. In that province, obligations associated with some forest tenures include the expectation that timber should be milled near the logging site and that a minimum harvest rate must be maintained regardless of economic conditions. U.S. producers argue that these policies distort the market and that the long-term tenures typical in B.C. restrict fair access to the resource. Furthermore, the province restricts raw log exports from Crown land to promote economic growth through increased local manufacturing and job creation. Even though the U.S. imposes export restrictions on logs from its own public land, American producers argue that this practice in Canada depresses the price of logs remaining in the domestic market, thus conferring a subsidy on the industry.

What is perhaps less well known is that the trade action on softwood lumber imposes a sizeable cost burden on U.S. lumber consumers. U.S. companies such as Home Depot and associations representing lumber-consuming interests[28] have expressed opposition to the trade action because of the associated increase in lumber prices and its effect on home-building costs.[29] Further, it is estimated that the number of employees in lumber-dependent industries exceeds the number in the lumber-producing industries by a factor of 18 to 1. However, these consumer pressures have clearly not been as effective as those of the powerful U.S. lumber producers lobby.

Canada, in turn, defends its forest management regime and denies that it subsidizes the lumber industry. The stumpage fees charged more than pay for the costs associated with the forest industry. For example, the B.C. government showed that in 2001, revenues from stumpage fees and other fees exceeded the government's costs related to the management, development, maintenance, and selling of timber by over $500 million. Furthermore, public forests in Canada are managed for multiple uses, not just timber production, and stumpage fees in Canada take into account the many obligations undertaken by forest companies that win the right to harvest Crown timber. These obligations include road-building, reforestation, and measures to protect biodiversity and ecosystems. In the U.S., these forest management concerns are the responsibility of the U.S. Forest Service.

28 In Washington, the Committee heard the concerns of the following groups and businesses on the softwood issue: American Consumers for Affordable Homes, National Association of Home Builders, American Homeowners Grassroots Alliance, Consumers for World Trade, International Mass Retail Association, and Home Depot.

29 The duties have added US$1,000 to $1,500 to the price of a home.

From Canada's perspective, the basis for U.S. trade action lies in protectionism, not in unfair practices on the Canadian side. As Les Reed (Forest Policy Consultant) told the Committee, the United States' key motivation for doing battle with Canada is its sizeable deficiency in timber, both in volume and in the quality of the products derived from it. Moreover, the fact that U.S. mills have closed in recent years has less to do with Canadian stumpage practices than with the general economic malaise facing the industry. Of the 73 mills that closed permanently in North America between 1995 and 2000, approximately 38% were in British Columbia. It is clear that the entire North American lumber market has suffered.

2. The Federal Government's Two-Track Strategy to Resolve the Dispute

a. Legal

The Government of Canada has adopted a two-track strategy to end the softwood lumber dispute. The first track is legal. U.S. authorities have now produced final determinations of dumping, subsidy and injury, and all three decisions have been challenged by Canada under both the NAFTA binational panel review and WTO dispute resolution processes. Panels are currently examining the proper application of U.S. trade remedy law and will decide the cases between now and the fall.

Gary Horlick (American Consumers for Affordable Homes) provided the Committee with the following expected outcomes of the NAFTA and WTO panels: a positive result for Canada on the countervail challenges; a mixed scorecard on the dumping challenge: and considerable uncertainty regarding the injury cases. Indeed, on Canada's countervail challenge the WTO has issued an interim ruling stating that the U.S. erred in imposing duties on softwood lumber exports in that it had not adequately proven the existence of a subsidy. A final ruling on the U.S. subsidy determination is expected in July. Horlick also observed that NAFTA law requires the duties to be refunded, whereas at the WTO there are no guarantees that one would get the money back. For details on the timelines and panel findings for the various NAFTA and WTO proceedings, please refer to Appendix 2.

On the subsidy question, Canada's contention that the findings of the Department of Commerce in the CVD and AD cases are inconsistent with U.S. obligations at the WTO has been upheld. Notably, the use of "cross-border" (U.S.) prices rather than Canadian prices as a benchmark for determining whether stumpage rates confer a benefit was inappropriate. In the past, the U.S. Department of Commerce had rejected the use of cross-border comparisons because of the significant differences in species composition, size, quality, density and accessibility of the timber resource. Stumpage rates vary significantly both within and between regions, and the correct economic price for timber in Canada is not necessarily the same as in the United States. The use of U.S. prices by the Department of Commerce to establish the alleged subsidy rate for Canada was a significant departure from past practice. Canada also objected to numerous other aspects of the findings of the Department of Commerce and the International Trade Commission.

Jon Johnson informed the Committee that in an earlier challenge on the preliminary determination of subsidy, a WTO panel had ruled that stumpage was a financial contribution but that, indeed, the U.S. had used an improper cross-border methodology to determine if the use of stumpage fees in Canada had benefited lumber producers. Since the existence of a benefit could not be verified, the panel decided that the U.S. had no basis for determining that stumpage was a countervailable subsidy.

There are concerns, however, that even if Canada successfully pursues the legal track, the U.S. will change its investigation methods and trade laws, and subsequently initiate new investigations. Furthermore, pursuing dispute resolution through legal avenues is very time-consuming. For example, NAFTA panel rulings can take as long as 315 days from the request for review, and those rulings can then be appealed; as a result, a lifting or lowering of the duties on the basis of the legal process alone should not realistically be expected before 2005 at the earliest. Meanwhile, the imposition of duties decreases the competitiveness of Canadian lumber in the U.S. market, and the resulting strain on lumber producers affects employment levels and company profits. Furthermore, Canadian lumber producers risk losing market share as foreign competitors and substitute products become attractive alternatives to duty-ridden Canadian lumber. As a result, the legal track becomes politically more difficult over time, particularly in more forestry-dependent regions of Canada, and pressure for a negotiated solution to the dispute mounts.

b. Negotiated Settlement

While pursuing the legal track, Canadian governments and the industry that they represent have also been involved in periodic discussions to arrive at a durable, long-term negotiated settlement. In the past, Canada and the U.S. have typically resolved softwood lumber disputes (albeit temporarily) through such negotiation. However, as John Melle (Deputy Assistant U.S. Trade Representative for North America) pointed out, past disputes have disregarded the underlying problems between the two sides, and litigation alone cannot solve the softwood problem since the WTO does not force sovereign states to change policy.

Regarding the current dispute, Canada has been intermittently negotiating with the U.S. since mid-2001. The U.S. Coalition for Fair Lumber Imports has clearly had a role behind the scenes in the negotiations, submitting in January 2002 (at the request of the U.S. Trade Representative) a proposal for potential forest reforms that could result in a more acceptable, market-based system for timber sales in Canada. The proposal included significant revisions to tenure policies, timber pricing systems and laws mandating minimum cuts or requiring that mills remain open. Canada considered U.S. industry demands excessive, and the U.S. government was unwilling to lean on its industry to develop a reasonable basis for negotiations. Talks ceased shortly after the submission was presented.

In the summer of 2002, the Under Secretary for International Trade at the U.S. Department of Commerce, Grant Aldonas, indicated a willingness to review and revoke the countervailing duty orders, province by province, on the basis of changed circumstances determinations. He undertook to issue a policy bulletin that would form the underpinnings of such determinations.

More recently, the Province of British Columbia raised the possibility of a bridging agreement, proposing that the duties be replaced by a lumber-price-sensitive interim border tax while forest-practices-based negotiations take place. It was planning to undertake a number of market-based policy changes unilaterally in any event, and saw these changes as the basis of an "exit strategy" from the costly duties.[30]

The draft Policy Bulletin entitled "Proposed Analytical Framework, Softwood Lumber from Canada" (January 2003) of the U.S. Department of Commerce suggests that reform of Canadian forest practices to ensure market-based pricing of timber would resolve the long-standing dispute. To achieve appropriate market-based prices for timber, the U.S. Department of Commerce made the following main recommendations:

- The current system for determining the prices charged for timber (stumpage) should be replaced by an auction-based system;
- Requirements for minimum annual harvests and timber processing should be eliminated; and
- Restrictions on log exports should be removed.

30 On March 26, 2003, the Province of British Columbia announced sweeping changes in its forest management practices, including a new requirement that would force major licensees to give up 20% of their long-term forest tenures to an auction process. After adding existing log sales and sales to private lumber, a full one quarter of the total provincial harvest would be priced by market forces. Ontario has since followed suit with its own policy reforms, and Quebec is considering changes as well.

With respect to the first recommendation, while the U.S. would prefer that all timber be sold through auctions, it has indicated that it would accept a system in which a portion of the harvest would be sold at auction and the resulting prices would be used to administratively establish rates for the remainder of the harvest. Similarly, if the amount of forest land available to private owners or First Nations were to increase, sales from those lands could also provide a basis for pricing timber on Crown land.

Each of the three proposed policy changes is significant. The first – to auction off timber – is problematic because it would require changes in the timber tenure system that would leave provincial governments liable to pay compensation to tenure holders. The second recommendation addresses issues arising from measures to promote economic stability in timber-producing communities. Removal of those requirements would likely cause economic hardship for some communities due to the relocation of processing activity and reduced employment when lumber markets are low. The third main recommendation, relating to log export restrictions, is contentious because of the widely-held belief that timber resources should be processed in Canada. Log exports are popularly associated with "exporting Canadian jobs." There is also an underlying concern that the conditions of any negotiated settlement would be an unwelcome imposition on Canada's ability to determine its own forest resource management.

During its fact-finding mission to Washington, the Committee was informed that Aldonas, the senior Department of Commerce official responsible for the softwood lumber file, would be releasing the final Policy Bulletin shortly. Sage Chandler (Director for Canadian Affairs, U.S. Trade Representative's Office) mentioned that he was pleased with the proposed reforms announced by B.C. and Ontario, and that he was waiting for Quebec's response before publishing the Bulletin.

The publication of the Bulletin would then trigger a thirty-day period of public review, after which the Department of Commerce would likely undertake "changed circumstances" investigations as the provinces demonstrate that they have met the agreed conditions. The investigation, which could be initiated at a province's request at any time and only covers countervail, would determine if the original basis for the subsidy charge remains. If not, the CVD duties would be revoked on a province-by-province basis. This process would be similar to that of the CVD investigation and could be quite time-consuming and resource-intensive. As Gary Horlick told the Committee, it could also end up in court.

The problem with the "changed circumstances" review process is that it would only dispense with the countervail duties once the forest policy changes are implemented; this process could take up to three years, according to Doug Waddell (Assistant Deputy Minister, Trade, Economic and Environmental Policy, Department of Foreign Affairs and International Trade). Furthermore, the anti-dumping component of the dispute would remain. It is for these reasons that British Columbia stakeholders initiated negotiations on a "bridging agreement" to be used as a transitional measure while a long-term solution to the dispute was worked out.

This interim agreement would essentially restrict the amount of trade until changes could be made in provincial forest management to reform what the U.S. perceives as subsidy-causing policies. The possibility of a sliding-scale border tax was discussed as a temporary measure to replace the countervailing and antidumping duties while these forest policy reforms were implemented in each province.[31] Other issues up for discussion included the disposition of the over $1 billion in duties already collected and the possible repeal of the Byrd Amendment[32] (see below); the future of the anti-dumping duties; and the potential withdrawal of Canada's WTO and NAFTA litigation.

The negotiations broke down in February of this year. At the PriceWaterhouseCoopers conference held shortly thereafter, Aldonas presented three reasons for the ending of bilateral negotiations on the interim arrangement: the lack of agreement on the forest policy changes required to settle the dispute, the future of the NAFTA and WTO litigation, and the sizeable gap between the two sides over the substance of a potential interim border tax arrangement.[33] On the first point, the B.C. government introduced the Forest Revitalization Act the day after the end of the conference. The legislation, now passed, addresses many of the U.S. Department of Commerce's concerns, including the call for a meaningful volume of lumber (20%) to be made available for auction and the removal of a number of government requirements of the industries.

No actions appear to be forthcoming on the remaining two significant stumbling blocks, however. The level and design of the interim border tax is viewed as probably the most significant obstacle to an agreement, as there is a wide gap between the positions of the U.S. industries and the Canadian stakeholders.

During the February-May period, both sides in the dispute continued to examine alternatives on how to structure the tax. In mid-May, the Americans presented a new interim export tax proposal for negotiation, designed by the Coalition for Fair Lumber Imports, that linked the levels of the proposed tax to market share and not to prices, as was the case earlier. At a market share of 29%, an export tax of 18% would be applied on softwood shipments to the U.S. The tax would rise by 3 percentage points for each percentage point above 29%, and it would fall by 4 percentage points for each percentage point below 29%. The tax would disappear entirely if Canada's market share was below 24%. The proposal would also have the U.S. industry retain two thirds of the duties already collected, and it would impose a tax on all provinces, including those in Atlantic Canada currently exempt from the application of CVD. International Trade Minister Pierre Pettigrew was quick to publicly reject this latest proposal. Since then, other proposals for attaining an interim agreement have surfaced as well.

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31 The Committee received evidence in Washington that during the discussions on an interim agreement earlier this year, a Canadian industry representative had even proposed a return to the quota system. Officials on both sides of the dispute are, however, wary of this suggestion.

32 On this point, the U.S. Administration is of the view that the Byrd Amendment should be the final issue to be resolved, once a comprehensive interim agreement is realized.

33 There is also the critical issue of the return of the duties already collected.

3. Where Do We Go From Here?

Given the unsuccessful conclusion of the recent negotiations, Canada is continuing with the legal track. The NAFTA dispute settlement system is binding on the parties, and the panels will either uphold U.S. decisions or send them back to the U.S. agencies for action consistent with the panels' decision. The only avenue for appeal, the Extraordinary Challenge Committees, comes into play in the event of gross misconduct, conflict of interest, procedural error, bias, or abuse of power on the part of the panel. However, as stated above, past experience suggests that even the successful pursuit of legal options would be unlikely to resolve the dispute in the long term.

At the WTO, once the panels make their rulings the U.S. has an opportunity to appeal, extending an already lengthy litigation process. Assuming Canada's position prevails at the WTO, ultimately the U.S. would have to correct its actions or, if a satisfactory resolution of the dispute were not reached, Canada would be given the opportunity to retaliate.

Most of the witnesses who commented on the softwood dispute felt that Canada should continue the legal fight, even if some of them also advocated that we not abandon the negotiated settlement route. Among those who stridently opposed a negotiated resolution of the dispute was Les Reed, who argued that nationwide support of existing legal challenges was critical to avoid a "divide and conquer" scenario and that Canada was in a strong position regarding the legal challenges that have been made. He also remarked that any settlement along the lines of the Proposed Analytical Framework put forward by the Department of Commerce would be very intrusive in terms of the B.C. government's sovereignty over forest decision-making.

Frank Dottori (Co-President, Free Trade Lumber Council) is confident of legal victory and is concerned that the negotiation of a settlement would not be in the industry's best interests. In line with Reed's thinking, he also expressed resentment at the U.S. intrusion into Canadian forestry policy. Since then, other proposals for attaining an interim agreement have surfaced as well, including the Minister's proposal for a quota system covering over 90% of Canadian softwood exports and an export tax applied to any above-quota exports.

Susan Petnunias (American Consumers for Affordable Homes), the official spokesperson for a diverse group of lumber-consuming organizations in the U.S. urged Canada to continue with its promising WTO and NAFTA legal cases to increase the chances of a favourable outcome to the dispute and "to take some of the steam" out of the efforts of the Coalition for Fair Lumber Imports. The other consumer groups appearing with her before the Committee had similar messages. A number of the groups bemoaned the application of an export tax in any interim arrangement that would be negotiated, arguing that from their perspective this was no solution.

Taking a more moderate position, Richard Ouellet noted that if there were reasonable grounds for a settlement, Canada should go that route, but at the present time the U.S. position is not fair and reasonable. Therefore, we should keep up the battle at the WTO. Steven Shrybman and Donald Barry also supported the use of international rules to obtain a resolution of this issue, as did Billy Garton (Partner, Bull, Housser & Tupper), who saw the upcoming WTO decisions as strengthening the Canadian position in the negotiations.

The Committee also heard discussion about the appropriate choice of legal forum (i.e., NAFTA versus the WTO). Armand de Mestral pointed out that the WTO dispute settlement process was stronger and the preferred choice. John Helliwell claimed that the WTO is the arena to deal with the softwood issue, but that it is probably unrealistic to expect WTO action to resolve our trade problems with the Americans in the near future. Donald McRae suggested that Chapter 19 should not be held responsible for not resolving the softwood lumber dispute. The dispute is over what the rules ought to be, not whether U.S. law was applied properly.

The call for a negotiated end to this dispute was loudest from the B.C. forest product industry witnesses directly hurt by the dispute and from Atlantic Canada producers, who have not escaped anti-dumping charges.

Ken Higginbotham (Vice-President, Forestry and Environment, Canfor Corporation) supported the federal government's two-track strategy but would welcome a negotiated settlement that would ultimately provide free access to the U.S. market. He expressed support for the market-based forest policy changes proposed by British Columbia. He was in favour of an interim agreement containing a border tax, but only if there was a clear "off-ramp" leading to the revocation of the CVD orders and if there was agreement to drop the AD case.

Bob Flitton (Manager, Real Estate and Governmental Affairs, Doman Industries Limited) outlined Doman's support for an interim Canadian border tax, prompted by the lengthy (270 days) maximum period surrounding DOC's changed circumstances review. He did, however, point to several "problematic" elements of a possible settlement: the structure of the tax, the fate of the duties already collected, the nature of the forestry reforms to be undertaken, the future of the anti-dumping duties, and the ultimate status of Canadian legal action. Flitton cautioned the Committee that even if our legal challenges were successful, nothing would stop the U.S. industry from filing another petition the very next day.

David Larsen (Vice President, Government and Public Affairs, Weyerhaeuser) and John Allan (President, British Columbia Lumber Trade Council) were also strong supporters of a negotiated resolution of the dispute. Allan argued that if Canada were to stay the legal course, it would be involved in this litigation until at least 2007. Another point in favour of the negotiated approach is that the Province of British Columbia has proceeded to a market-based forest policy, which is in keeping with DOC's Policy Bulletin.

Kim Pollock (National Director, Public Policy and Environment, Industrial, Wood and Allied Workers of Canada) outlined that union's two-part proposal to resolve the dispute: the introduction of a sliding-scale, provincially administered lumber tax to allow the industry on both sides of the border to change their forest practices, and the development of a joint bilateral strategy to market lumber and wood products throughout the world.

Diana Blenkhorn (President and Chief Executive Officer, Maritime Lumber Bureau) noted that in this round of negotiations there appeared to be more emphasis on achieving a long-term, durable solution to the dispute. Both sides in the dispute, she observed, had suffered from the ongoing trade battle: her estimate of the Canadian side's contribution to the Washington legal community since 1986 was a staggering US$800 million!

The Committee also heard from the lumber remanufacturers component of the industry, which is anxious to see a settlement in the dispute. Russ Cameron (Independent Lumber Remanufacturers Association) argued that his members could not afford to wait for the litigation process to end and called for an exclusion or zero-rating of remanufactured products of independent remanufacturers not possessing any forest tenures. Their position was clear: since they do not own tenure, there can be no link with any possible subsidies.

Several other areas of concern need to be highlighted. The issue of whether or not to link one sector with another when considering trade disputes (e.g., energy and softwood lumber) was discussed by a number of Committee witnesses. In Calgary, we received evidence from energy-sector experts and participants that the option of linking trade issues or sectors (e.g., energy with softwood lumber) should be rejected outright. Pierre Alvarez (President, Canadian Association of Petroleum Producers) remarked that such a strategy would be ineffective and could cause an upward spiral in trade problems. Donald Barry and Ambassador Kergin were also opposed to linkage. Philip Prince (President, Canadian Energy Research Institute) noted that it would be very difficult to link one sector with another in that each is very complex and unique. Given the inherent risk associated with a linkage strategy, the Committee finds these arguments compelling and would like to see Canada exercise caution when contemplating linking different economic sectors in any consideration of how to resolve certain trade disputes or irritants.

Another issue brought to the attention of Committee members was the Continued Dumping and Subsidy Offset Act of 2000 (the Byrd Amendment), which entitles domestic producers supporting petitions for anti-dumping and countervailing duty investigations to receive duties collected as a result of these investigations.

Canada, along with many other WTO Members, challenged this legislation at the WTO and received a favourable Appellate Body finding in January 2003. Claude Carrière mentioned that the U.S. had stated that it would implement the WTO ruling by dealing with the legislation. The U.S. will be given a "reasonable period of time" to comply with the Appellate Body's findings. The problem, though, is that there is stiff opposition in the U.S. Senate to repealing the Amendment, and Congressional approval is required for the U.S. to comply with its international trade obligations.[34]

After carefully reviewing the evidence that it received on softwood lumber, the Committee has concluded that Canada should continue its legal battle at the WTO and under the NAFTA dispute settlement regime. If advantageous to Canadian interests, it should work to achieve a long-term solution and provide unfettered access for Canadian forest products in the U.S. marketplace. However, we should not cave in to pressure from the Americans to quickly settle this dispute on their terms, thereby totally altering traditional Canadian forest policy and practices. The litigation should be stayed only if Canada is certain of a negotiated result that provides free access to the U.S. market. We recommend:

RECOMMENDATION 8

That the Government of Canada, in association with affected provinces, maintain as its objective a permanent arrangement with the United States that provides for an unrestricted market for softwood lumber. In the interim, any short-term agreement to allow time to complete this permanent arrangement should not surrender Canada's right to obtain the judgements of the WTO and NAFTA panels or the processes under NAFTA Chapter 11 and should require that:

a) anti-dumping duties against Canadian softwood lumber producers be dropped; and

b) all countervailing and anti-dumping duties already collected be returned to Canada.

34 A U.S. Senate bill co-sponsored by Senator Olympia Snowe (R-Maine) aims to repeal the Byrd Amendment and divert duties collected in AD and CVD cases to a new program providing federal grants to communities negatively affected by trade.

On the question of federal government assistance, the aid provided by the government has gone to addressing the industry disruption affecting the approximately 250 Canadian communities dependent on the softwood lumber industry. This assistance has included such measures as funding for displaced workers, community adjustment and economic development, softwood lumber research and development, market expansion initiatives and advocacy efforts. The Committee heard testimony that additional assistance should be provided, specifically that the federal government should direct the Export Development Corporation (or the Business Development Bank of Canada) to provide loan guarantees to help those companies requiring them to continue the legal battle against U.S. trade harassment. We do not support this option, as we are quite sensitive to the fact that any direct government support to the industry would be perceived by the U.S. forest products lobby as simply an additional subsidy conferred on the industry.

Finally, the Committee heard evidence of the difficulties encountered in both government and industry in forging a common approach to the softwood lumber issue. One answer was suggested by Dottori: a more formal system of federal-provincial cooperation, incorporating private-sector input, should be developed to deal with future major bilateral disputes, such as the softwood lumber case, that involve a blend of provincial and federal interests.

B. Agricultural Issues

Canada's agricultural industries, apart from having been victims of U.S. trade remedy action (e.g., countervail and dumping investigation into live cattle exports to the U.S. beginning in 1998; the initiation of a new countervail and dumping challenge on wheat exports in addition to a host of previous U.S. trade challenges on the Canadian Wheat Board), also stand to be adversely affected by provisions of the U.S. Farm Bill (e.g., country-of-origin meat labelling, increase in domestic support). Key current issues of concern to these industries will be described here, in addition to the potential threat from U.S. bioterrorism legislation already described (see the chapter on border issues).

1. The Dispute Over the Canadian Wheat Board

Founded in 1935, the Canadian Wheat Board (CWB) is a central marketing agency responsible for selling all wheat and barley produced in Western Canada. The Wheat Board represents a form of collective action taken by grain producers – and legislated by the federal government – to help farmers maximize returns on their crops and at the same time enable them to compete with large, multinational grain trading companies operating in the Unites States and other countries. Essentially a marketing cooperative, the CWB is among the world's largest sellers of wheat and barley, selling over 20 million tonnes of those grains annually to more than 70 countries. CWB sales revenues average between $4 billion and $6 billion annually, accounting for about 20% of the world market.

In the U.S., grain producers sell their harvest directly to multinational grain trading companies which, acting as intermediaries, sell that grain to consumers. Since Canadian grain is sold by the Wheat Board on behalf of farmers, there is no such "middle man" in Canada. The U.S. alleges that this lack of market-based intermediary, combined with the CWB's use of its international market power to extract higher prices for Canadian farmers, provides those farmers with an implicit subsidy and thus an unfair advantage over U.S. farmers. According to the Honourable Ralph Goodale (Minister Responsible for the Canadian Wheat Board), Americans also falsely claim that Canada is dumping vast quantities of wheat into the U.S. market and that we offer no reciprocal market access. Minister Goodale argued that instead of dumping product at the low end of the market, the CWB actually markets wheat and barley at the top end of the market as a differentiated, high-quality product.

For its part, Canada argues that low international grain prices, and not Canadian marketing policies, are creating hardship for U.S. farmers. It maintains that these low prices are caused in part by heavy agricultural subsidies in the U.S., the European Union (EU) and Japan. The Government of Canada's position is that the CWB's practices are entirely consistent with its international trade obligations; indeed, both Minister Goodale and Ian McCreary (Canadian Wheat Board) informed the Committee that the CWB neither provides nor obtains government subsidies. Instead, the net returns that the CWB attempts to maximize from its sales are passed through to farmers, after all costs have been deducted, and farmers determine cropping decisions based on strictly market signals derived from U.S. commodity markets. Moreover, the CWB does not attempt to underprice in the U.S. market. U.S. International Trade Commission investigators found in 2001 that the price of Canadian durum wheat sold in the U.S. was higher than the price of American durum in all but one of sixty months examined. Finally, STEs are currently permitted under international trade law, provided they operate according to commercial business practices. However, the issue of STEs is on the agenda at the current round of World Trade Organization (WTO) agriculture negotiations. The U.S. position is that STEs should be outlawed.

a. Legal Challenges

On ten separate occasions since the introduction of the FTA, the U.S. has investigated Canada's wheat trade policies and practices. Charges against the Wheat Board have included subsidization, dumping and price discrimination (charging higher prices in some markets – in Canada, for example – and using the proceeds to offset lower prices in other markets, such as the U.S.). In all cases, no evidence of these activities was found. The list of previous U.S. investigations into the CWB is contained in Appendix 3.

The most recent trade challenge was initiated in September 2002 by the North Dakota Wheat Commission (NDWC). This challenge was based on a February 2002 report published by U.S. Trade Representative (USTR) Robert Zoellick which alleged that special monopoly rights and privileges granted to the CWB gave it competitive advantages over U.S. wheat farmers. At the time, the USTR indicated that it would explore a variety of actions against Canadian wheat policies and the CWB's practices, including the possibility of a WTO challenge. McCreary noted that the USTR decided to pursue additional trade action even after the release of a report by the U.S. ITC contradicting allegations of CWB underpricing and dumping in global markets. His conclusion was that the facts in the case once again were pushed aside by political interests and that new trade rules were required to lower the incidence of trade harassment based on sheer protectionism.

In September 2002, the NDWC, along with the U.S. Durum Growers Association and the Durum Growers Trade Action Committee, used the above-mentioned USTR report as the basis to file a complaint with the U.S. Department of Commerce (DOC) charging that the CWB was dumping wheat at unreasonably low prices into the U.S. market. Petitions were filed seeking the imposition of both anti-dumping and countervailing duties against hard red spring wheat and durum wheat imports from Canada. In October 2002, the U.S. International Trade Commission initiated the requested investigations and in March 2003, the DOC found evidence of two countervailable subsidies (the CWB's financial guarantees, and rail transportation programs) out of a number of government programs examined. Provisional duties of 3.94% were announced for imports of Canadian durum and hard red spring wheat. The Government of Canada has rejected the DOC's preliminary findings.

On May 2, 2003, the DOC announced its affirmative preliminary determinations in the anti-dumping duty investigations. The Department has preliminarily found that imports of certain durum wheat and hard red spring wheat were sold at less than fair value, with dumping margins of 8.15% and 6.12% respectively. The Government of Canada contests these findings, arguing that wheat prices in North America are determined by North American supplies, not by alleged Canadian dumping. The final countervail and anti-dumping determinations are scheduled for mid-July, and the consideration of injury for August. Ted Menzies (President, Canadian Agri-Food Trade Alliance) and Kenton Ziegler both mentioned that legal defence costs associated with this latest trade challenge are estimated at $10 million.

The U.S. has also challenged Canadian wheat sector policies at the WTO. In March 2003, a panel was formed to examine (a) the CWB's operations in relation to Canada's obligations under GATT Article 17 – State Trading Enterprises, and (b) Canada's treatment of imported grain. The federal government is frustrated by these latest legal challenges and intends to defend its wheat sector policies, yet again, against what it considers to be unsubstantiated allegations against the CWB.

b. Evidence Heard

The Committee heard a number of suggestions regarding the CWB and state trading enterprises. Robert Friesen and Ian McCreary both called on the federal government to aggressively promote WTO rules that clearly confirm the right of countries to employ the services of the Canadian Wheat Board in marketing Western Canadian wheat and barley, to operate a single-desk selling agency and to pool returns in a non-trade-distorting manner. A draft released recently by chief WTO negotiator Stuart Harbinson would see STEs such as the Wheat Board phased out. It generally adopts the U.S. position that STEs have no place within a free trade environment. According to McCreary, the federal government should work aggressively to ensure that the current sections in the Harbinson draft dealing with these issues are rejected.

Other viewpoints were also heard. U.S. Representative Earl Pomeroy expressed the concerns of North Dakota farmers that the fact that wheat pricing does not occur in the open market and that the provision of subsidies by the Board is resulting in an unfair competitive advantage for Canadian wheat farmers in third-country markets.

David Usherwood called on the Committee to recommend that the Government of Canada eliminate the monopoly position that the CWB currently holds with respect to wheat and barley sales. He thought that defusing the monopoly issue would eliminate the ongoing trade battles with the Americans over the Board's operations. Both he and Douglas McBain (President, Western Barley Growers Association) favour the introduction of competition to the CWB.

According to the Canadian Wheat Board, however, either there is a single selling desk or there is not. One cannot have a voluntary system since one would then encounter a free-rider problem. To deal with certain farmers' unhappiness with the Board's monopoly status, the CWB has developed a number of options to provide price flexibility as well as other measures.

Another issue to consider is the impression remaining in certain U.S. quarters that the Canadian Wheat Board is an arm of the federal government. However, as Minister Goodale reminded the Committee, the CWB is very different from what it was four years ago. It is no longer a Crown corporation, and it is run by a modern corporate-style board of directors, the majority of whom are farmers elected directly by other farmers. Currently, only five of the CWB's fifteen directors are appointed by the federal government, including the head of the CWB. The CWB's power and authority lie in the hands of farmers, therefore, and not with the federal government. Furthermore, McCreary remarked that additional legislative changes designed to reduce any formal linkages that are still fuelling this perception are being considered.

Finally, McCreary and Dennis Laycraft (Executive Vice-President, Canadian Cattlemen's Association) advocated the amendment of WTO rules on anti-dumping to narrow the definition of dumping to deal specifically with predatory price discrimination. Because of the cyclical nature of agricultural commodity prices, there are many periods where prices are below the cost of production through no fault of the producer, and producers can subsequently fall victim to anti-dumping action. The current anti-dumping rules are thus inappropriate for agricultural trade. Kenton Ziegler (Chair, Alberta Canola Producers Commission) also supported action in this area.

The Committee is convinced of the CWB's usefulness as a subsidy-free marketer of high-quality wheat and barley. Every effort should be made at the WTO to retain the Board as a legitimate trading enterprise and to modify the WTO's anti-dumping rules regarding agriculture. We recommend:

RECOMMENDATION 9

That the Government of Canada:

a) Work with like-minded countries to remove from the WTO's draft agriculture negotiation document any proposal to phase out state trading enterprises or such farmer-controlled enterprises as the Canadian Wheat Board; and

b) Direct its efforts at tightening the WTO's anti-dumping rules to give the agricultural sector special consideration, in view of the frequency of externally driven commodity price movements that cause prices to decline below costs (a trigger for anti-dumping action).

2. The U.S. Farm Bill

The 2002 *Farm Security and Rural Investment Act*, commonly known as the Farm Bill, was signed into law by U.S. President Bush on May 13, 2002. The Farm Bill is an omnibus, multi-year piece of legislation that covers a wide range of laws related to U.S. federal agricultural and food policies. It serves as a replacement for the 1996 Farm Bill, the provisions of which were to have expired in September 2002. As with the 1996 Bill, the current legislation has a six-year lifespan. It will expire in 2007.

All things considered, the Farm Bill is an extraordinarily complex piece of legislation, the long-run implications of which are as yet unclear. Although the Bill is commonly associated with subsidy payments to U.S. farmers, the legislation in fact covers a wide range of agricultural issues and concerns, including provisions on trade, foreign aid, conservation and the environment. However, the controversy generated by the Bill has centred on the substantial increase in agricultural support payments. The 2002 Farm Bill will add an estimated US$51.7 billion to farm support programs in the U.S. during the 2002-2007 period, over and above existing measures contained in the 1996 Farm Bill. Total projected spending measures in the latest Bill, including for initiatives outside the traditional farm program areas, are estimated at US$273.9 billion. Rory McAlpine and Ted Menzies told the Committee that U.S. farm subsidies that had previously been provided in an ad hoc way would now be locked in for a six-year time period.

The Farm Bill was motivated at least in part by the desire to protect U.S. farming interests from heavily subsidized farming operations in Europe and Japan. Preliminary estimates for 2001, before the Farm Bill was passed, indicate that transfers from consumers and taxpayers were equivalent to 21% of gross farm receipts in the U.S. By contrast, transfers were equivalent to 35% of farm receipts in the European Union (E.U.) and 59% in Japan. In Canada, producer support was a comparatively low 17% of gross farm receipts.

a. The Farm Bill and the WTO

The U.S. insists that it remains committed to the eventual elimination of agricultural subsidies. However, it maintains that in the face of significant market-distorting crop production subsidies in other countries, it must protect its own agricultural interests by "levelling the playing field" and not sacrifice the U.S. farmer to subsidized production overseas. In Washington, a number of witnesses essentially told the Committee the same story: that the U.S. Farm Bill was designed to put pressure on the EU, Japan and other countries to lessen the provision of agricultural subsidies. Representative Pomeroy even went so far as to call the Farm Bill approach the trade equivalent of an arms race designed to prompt subsidy relief in the enemy camp.

This past fall, the U.S. tabled its proposal for agricultural subsidy reduction at the WTO. According to the proposal, the U.S. agrees to eliminate its subsidies, but would only begin doing so once European and Japanese subsidies have been lowered to the current levels in the U.S. Testimony received by the Committee suggests that the Europeans have so far been reluctant to act.

Despite increasing production support for domestic farmers, the U.S. insists that the Farm Bill is compatible with its WTO commitments. Under current WTO regulations, the U.S. is limited to providing US$19.1 billion in price-linked or production-linked agricultural subsidies per annum. According to analysts in the European Community (E.C.), it is very likely that the Farm Bill's subsidy provisions will cause the U.S. to exceed this commitment.

Although the long-run impacts of the U.S. Farm Bill are at this stage far from clear, increased agricultural subsidies in the U.S. are, in general, of significant concern to Canada and other countries. Among the specific worries is the fact that the Farm Bill could jeopardize progress towards agricultural reform during the current round of WTO negotiations. Canada and many other countries have been pressing for the elimination of agricultural subsidies. Although the U.S. maintains that it is committed to the same goal, the Farm Bill's contribution to domestic farm support is widely believed to represent a step in the opposite direction. Furthermore, many countries view the Farm Bill as compromising U.S. credibility in future agriculture negotiations.

b. The Farm Bill's Impact in Canada and Elsewhere

Critics of the Farm Bill are concerned that the increase in production-based subsidies to U.S. farmers, by keeping production artificially high, will exert further downward pressure on international crop prices. Subsidies are considered damaging because they create a vicious cycle of hardship and dependence. They encourage farmers to continue to produce crops which would, in the absence of the financial support, not be profitable. The introduction of guaranteed counter-cyclical payments in particular is expected to have a distorting effect on world grain prices. As a result, the Farm Bill may exacerbate the difficulties facing farmers worldwide.

Canada is concerned that these developments will damage Canadian farmers, particularly those in the Prairie provinces. Canadian crop farmers are among the least subsidized in the industrialized world. An increase in subsidies to the U.S. widens the income support gap between farmers in the two countries and makes it all the more difficult for Canadian farmers to remain competitive.

In addition, subsidized production in the industrialized world is believed to be a significant impediment to economic growth in developing countries. Poor countries without the economic resources to be significant agricultural producers are unable to export their products because of high tariffs and low international prices, driven down by subsidized production in wealthy countries.

c. Country-of-Origin Labelling

Although subsidies have garnered much of the international attention surrounding the Farm Bill, other aspects of the legislation are causing concern as well. In particular, the Bill includes country-of-origin labelling (COOL) provisions that could have serious implications for Canadian producers and exporters, particularly in the livestock sector. Overturning this legislation is a top priority of both the federal government and the Canadian agri-food industry.

Beginning in September 2002, a voluntary system of labelling was introduced for the retail sale of meat, fish, fruits and vegetables, and peanuts. Food service establishments such as restaurants are exempt. Labelling will become mandatory in September 2004 unless the legislation is altered. The guidelines for voluntary labelling, which will likely form the basis for the mandatory labelling requirements in 2004, are very specific. In the case of meat products, for example, only animals born, raised and slaughtered in the United States may be labelled "Product of the U.S." Labels on other products must include all countries involved in the production process. Countries must be listed in descending order according to their contribution to the final product by weight.

Country-of-origin labelling requirements were intended to allow U.S. consumers to differentiate between domestically-grown agricultural products and those produced – in whole or in part – outside the country. Some Canadian farmers and ranchers are concerned that this will require complicated labels and expensive tracking systems – particularly since many animals spend time in both the U.S. and Canada between birth and processing – and thus constitute a significant barrier to trade for Canadian producers. For the Canadian red meat industry alone, the cost of segregation and other COOL regulations is an estimated $1 billion to $2 billion.

COOL would also likely impose considerable costs on the U.S. market. According to a U.S. Department of Agriculture report, the cost to U.S. consumers of identifying domestic beef alone will be around $2 billion.

Finally, critics have observed that the new labelling requirements are curious in that the U.S. has been adamant in its opposition to the E.U. proposal to require the labelling of Genetically Modified Organisms (GMOs). The U.S. position regarding GMO labelling has been that such labels, and their associated regulation, may constitute a barrier to trade.

In Washington, the Committee was apprised of the complexity of the COOL regulations and the resulting unwillingness of the U.S. meat packing industry to label. Sharon Bomer-Laurentsen (Deputy Assistant U.S.T.R. for Agricultural Affairs) mentioned that the U.S. Department of Agriculture wanted the regulations to have the least possible restrictive effect on trade. U.S. Senator Craig Thomas (R-Wyoming) expressed surprise at existing worries about COOL and stated that any difficulty in administering the program should be viewed as a U.S. concern.

On the Canadian side of the border, the Committee heard that the Government of Canada should not hesitate to initiate WTO and NAFTA challenges to Country of Origin Labelling requirements should those requirements not remain voluntary, if that is in the best interests of Canada. The government will continue its advocacy efforts in the U.S., to urge that the provision be repealed.

C. U.S. Subsidies for the Proposed Alaska Natural Gas Pipeline

Canadian officials have two primary concerns regarding the development of a pipeline carrying Alaska North Slope natural gas through Canada to U.S. markets in the "lower 48 states." The fact that the bulk of the pipeline will be situated within Canada provides Canadians with a certain degree of leverage when discussing energy policy matters.

First, proposed U.S. legislation would inject subsidies into the project. The U.S. Senate Energy and Natural Resources Committee has debated an energy bill providing for accelerated depreciation, loan guarantees (for up to US$18 billion), and tax credits when wellhead gas prices in Alaska fall below US$1.35 per thousand BTUs.

Both the Canadian and U.S. governments wish to see pipeline decisions based strictly on market forces. In other words, the private sector should ultimately decide on the nature and timing of the pipeline. From the Canadian perspective, any assistance provided would distort energy markets and adversely affect Canadian projects in the Mackenzie Delta. Ambassador Kergin told the Committee that the pipeline bill would indeed harm the Mackenzie Delta Project. Paul Frazer bemoaned the lack of an effective dialogue on the pipeline issue and urged Canadians to seriously examine the proposed legislation. The Government of Canada appears to be principally opposed to the tax credits in the U.S. legislation. For its part, the Bush Administration is attempting to resist any Congressional effort to include subsidies in the final version of the legislation.

The second concern is that the Alaskan pipeline could strand gas reserves in the Mackenzie Delta. However, both the Canadian and U.S. Ambassadors told the Committee that if the Mackenzie project proceeds first – and there are positive signs that this will happen – then the stranded gas issue is no longer a concern.

IMPROVING CANADIAN OFFICIAL PRESENCE, INFORMATION FLOWS AND ADVOCACY IN THE U.S.

Three other key issues discussed before the Committee were (a) the adequacy of Canada's official presence in the U.S., particularly at the local and regional levels; (b) the provision of information to U.S. decision-makers on the state of the bilateral trade relationship and Canadian security actions that have been taken; and (c) the amount of advocacy work being undertaken in the U.S. with respect to Canadian trade interests (e.g., softwood lumber, agriculture) and border issues. On the first point, the Committee heard from a number of witnesses that a greater presence is required in the U.S., especially in regional centres outside Washington. In the 1990s, resource cutbacks had reduced manpower in these locations, hampering efforts to gather market intelligence, develop commercial policies and engage Americans at the local, regional and state levels.

The February 2003 budget attempted to alleviate this problem, allocating $11 million to enhance Canada's representation in the regions. It is anticipated that the increased funding will be used by DFAIT to open between five and seven new consular offices, in addition to the fourteen diplomatic and trade offices that it currently has in the U.S., to promote trade, especially in strategic regions such as the U.S. Southwest. Even with the proposed addition, the total number of regional offices would still only add up to just over one half of Mexico's 38, a level which the Committee finds unacceptable.

Ambassador Kergin suggested that while a higher budget would always be welcome, the Canadian Embassy in Washington was reasonably well endowed financially and that the real need was to develop greater regional representation.

Paul Frazer concurred, pointing to the different demographic and regional composition now in place in the U.S. and the need for new consulates in high-growth regions of the country. However, he called for appropriate staffing of these consulates in addition to the injection of new funding for the regional offices.

William Lash III was of the view that Canada required a higher profile in the U.S. and additional regional offices. Injecting greater provincial representation in the U.S. would also be helpful.

Not all of the witnesses shared the view that more resources were needed in the United States. Roy McLaren, for one, made two key points against such action. First, the private sector in Canada is more than capable of servicing the U.S. market; it does not require additional government assistance. Second, investing additional resources in the U.S. will increase our trade dependence on that single market even further. He argued that government resources should, alternatively, be invested outside the U.S., in order to help Canada diversify its trade relationships.

While the Committee wholeheartedly accepts the need for trade diversification – this topic will, in fact, be addressed in greater detail below – it also accepts the fact that Canada is not adequately represented in key regions of the United States, such as the South and Southwest. New offices need to be established in those locations, and their principal mandate should be to boost sales of Canadian products and services in the important economic regions of the U.S and, as Laura Macdonald (Professor, Carleton University) told the Committee, to make Canadian interests and concerns well known outside Washington. Less emphasis should be placed on the traditional diplomatic services typically offered in consular offices, and use should be made of honorary consuls in the event of budgetary restrictions.

Another issue involves the transmission of adequate information to Americans on the current security and trade situation between the two countries. According to Donald Barry, Canada is receiving unfavourable reviews in the U.S. media and the American legislative community, and those negative public and legislative perceptions need to be rectified. He suggested that Canada should be spreading the message throughout the U.S. that it is a reliable security partner (i.e., we are not a security threat), that it is a vital economic partner – indeed, Canada is the leading merchandise export market for 39 of the 50 states – and that it is the largest foreign supplier of oil, natural gas and hydroelectricity to the American market. The Committee has already recommended (see Recommendation 1) that an information campaign covering security issues be launched.

Barry observed that the task of altering perceptions of Canada will be a difficult one because Americans feel so vulnerable on security issues and because security is such a vital current priority. He felt that we should be working together with U.S. officials to help destroy these perceptions. Several other witnesses remarked that negative security incidents involving Canada seem to be magnified by the media while positive progress (e.g., the Border Action Plan) receives no coverage.

In Washington, Theresa Cardinal Brown (Co-Chair, Americans for Better Borders Coalition) urged Canadians to educate the U.S. Congress on our immigration policies to reverse the current perception that they are weaker than those of our neighbours to the south. William Lash III called on Canadian politicians to "wake up" their U.S. counterparts to the Canada-U.S. trade reality.

Finally, improving the advocacy of Canadian interests in the U.S. was also on the minds of some of the Committee's witnesses. In May 2002, the Government of Canada decided to devote $20 million to an advocacy campaign, with the majority of that funding ($17 million) provided in the form of a grant to the Forest Products Association of Canada to help advocacy efforts in the area of softwood lumber. During his appearance before the Committee, Minister Pettigrew stressed the need for an expansion of Canada's advocacy program in the United States. With additional funding, the federal government could intensify efforts to inform U.S. legislators about the Canadian position on the softwood lumber dispute and the price that American consumers are paying as a result of the duties imposed on Canadian forest products.

Barry also noted that Canada's impact on the U.S. is mostly felt at the sectoral and regional levels. Perceptions are rarely aggregated at the national level, except for a general view that is not well informed. Sectoral and regional voices often hold sway, and Canada has to find allies to counter the pressures coming from those sources. Holding regular meetings between Canadian premiers and U.S. governors would be a useful development in that regard, according to Frazer.

Laura Macdonald commented that Canada had to learn how to aggressively and effectively lobby the U.S. Congress on key issues and concerns, and it needed to devote greater financial resources to the lobbying effort in the U.S. as a whole.

Another Committee witness, Rolf Mirus, pointed out that marketing Canada in the U.S. is not an easy job. Personal relations at the regional political level are starting to evolve, and Thomas Ridge and John Manley enjoy a good working relationship. To raise Canada's profile in the U.S., we need to change our policies (e.g., strengthen our military) instead of spending money on advertising in newspapers.

Finally, Richard Harris mentioned that a key area to work on is the political relationship between the two countries. Solidifying this bilateral relationship can have a very important feedback effect on the two countries' commercial relationships. In Washington, the Committee heard from a number of witnesses about the importance of engaging legislators on both sides of the border in a meaningful dialogue on the bilateral relationship. The existing Canada-U.S. Parliamentary Group has been active in this area for many years, and greater interaction between the various legislative committees in Washington and in Ottawa should also be encouraged.

The Committee concurs with Minister Pettigrew that advocacy efforts need to be intensified, and is cognizant of the need to foster excellent relationships with both the executive and legislative branches of government in the United States. To make progress in each of the three areas covered in this chapter of the report (Canadian official presence, information flows and advocacy in the U.S), the Committee recommends:

RECOMMENDATION 10

That the federal government:

a) **Substantially increase the number of consulates in the United States from its current planned level. The new consular offices should be designated as trade and investment offices and staffed with appropriate and experienced professional personnel;**

b) **Immediately initiate a focused campaign to inform U.S. decision-makers of the importance of the bilateral trade relationship;**

c) **Increase its funding of efforts to promote Canadian trade and investment interests in the U.S., and make its advocacy strategies in that country more effective; and**

d) **Strengthen bilateral relationships at the executive and legislative levels of government. Strategies should be formulated to more effectively engage and regularly interact with the U.S. Senate and House of Representatives on issues and concerns of importance to both countries, and appropriate budgetary resources should be provided. To this end, the government should establish a Parliamentary Office in Washington to assist Canadian Parliamentarians in their interaction with U.S. legislators and other key U.S. decision-makers.**

PART 3: CANADIAN TRADE POLICY IN THE LONG TERM: CLOSER INTEGRATION OR TRADE DIVERSIFICATION?

The Canadian and U.S. economies have become increasingly integrated over the past forty years, and the pace of integration has increased since the launch of the FTA in 1989. How much of this increased integration, in the form of greater cross-border trade and investment flows, can be attributed to trade liberalization and how much to other factors such as exchange rate movements? Would this integration have occurred even without the FTA and NAFTA? Should measures be adopted to achieve even closer formal integration with the United States? Alternatively, should an aggressive policy of trade diversification be pursued to lessen Canada's vulnerability to U.S. security and trade actions? These are questions that, we believe, must be given serious consideration by Canadian decision-makers.

THE DIMINISHING RETURNS FROM TRADE LIBERALIZATION

Discussions of free trade between Canada and the US relate to the period beginning with the launch of the Canada-U.S. Free Trade Agreement (FTA) in 1989. The FTA certainly opened up new business opportunities and caused an industrial restructuring that exists to this day. NAFTA's impact on Canada-U.S. trade has been considerably smaller, and it is safe to say that the returns for Canada from trade liberalization have been diminishing. Rather, the effects of NAFTA have been most widely felt on trade between Canada and Mexico.

The North American Free Trade Agreement (NAFTA), involving Canada, the United States and Mexico, came into effect in January 1994. Designed to expand trade and investment between the three member countries, the agreement took aim at both tariff and non-tariff barriers and contained provisions on how business was to operate within the free trade area. Since NAFTA was largely modelled after the FTA, it did not significantly affect the trading relationship between Canada and the United States. The tariff reduction schedule between the two countries was unchanged – tariffs on virtually all goods of Canadian or U.S. origin disappeared on January 1, 1998[35] – and most elements of the earlier bilateral agreement were absorbed into the NAFTA. One of the few significant exceptions to this was that NAFTA broadened the coverage of the FTA to include virtually all aspects of cross-border trade in services. As de Mestral pointed out to the Committee, NAFTA has worked well in removing barriers to trade in services.

35 Exceptions include certain Canadian supply-managed farm products (e.g., dairy and poultry) as well as American goods such as sugar, dairy products, peanuts, and cotton.

A. The FTA and Trade Growth

Canada has witnessed an explosion in trade with the U.S. since the process of tariff elimination under the FTA was launched in 1989. Exports to the U.S. grew by 250% from 1988 to 2001, while imports increased by 153% over the same period.

Supporters of the FTA, including the federal government, have frequently stressed that the agreement has been a resounding success for the two member countries.[36] They maintain that the agreement has promoted strong economic growth, led to increased investment and trade between Canada and the U.S. and contributed to historically low levels of unemployment. According to Pierre Alvarez, the FTA and the deregulation of energy markets in the 1980s were very successful public policy initiatives and rival the Auto Pact in terms of impact. Access to the U.S. market has resulted in a significant increase in sales.

It would be difficult to argue that the Canada-U.S. Free Trade Agreement has not had a positive effect on trade flows between the two countries. Since the implementation of the FTA, Canada has seen a shift in economic structure and orientation. The Canadian economy has become more export-oriented and at the same time has become more integrated into a collective North American economy. As William Dymond (Executive Director, Centre for Trade Policy and Law) remarked to the Committee, entire Canadian economic sectors have been restructured on a north-south basis.

John Helliwell, certainly no big fan of the bilateral agreement, informed the Committee that the FTA had caused north-south trade to expand twice as much as predicted by the model that he was using. Industries that had been concerned about free trade (e.g., textiles and clothing, furniture, wine) ended up being big winners.[37]

Other empirical work comparing trade growth in products liberalized by the agreement with trade growth in goods which were already exchanged tariff-free also supports the point that the FTA has contributed to an expansion of the Canada-US trade relationship.[38]

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36 See, for example, Canada, Foreign Affairs and International Trade Canada, *NAFTA at Seven: Building on a North American Partnership*. 2002.

37 On the negative side, per capita income increases were smaller than anticipated, as the large economies of scale that had been expected did not materialize.

38 This methodology was employed in Schwanen, Daniel. *Trading Up: The Impact of Increased Continental Integration on Trade, Investment and Jobs in Canada*. Commentary 37. C.D. Howe Institute, Toronto, 1997a.

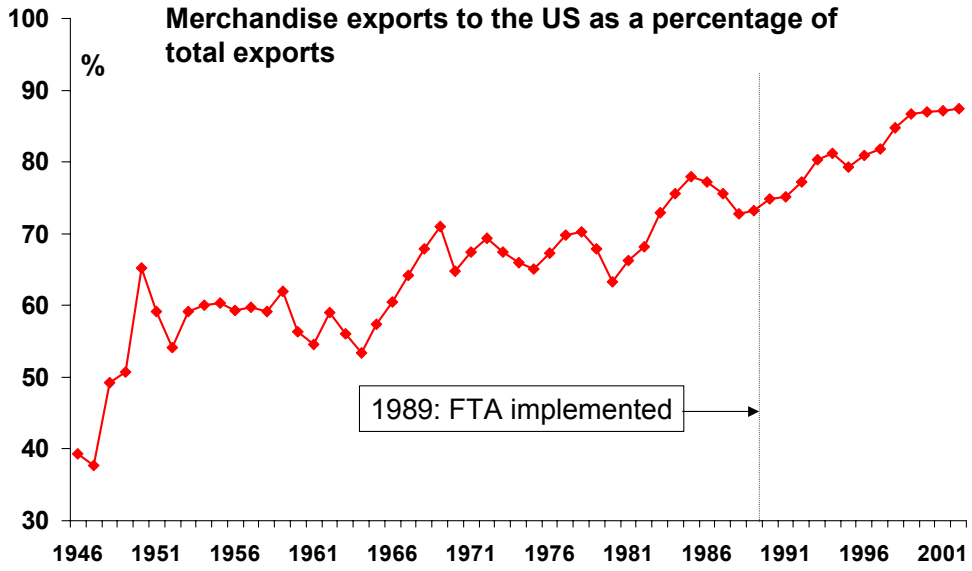
B. Other Factors Influencing the Canada-US Trade Relationship

This optimistic assessment of the FTA's impact on trade must be tempered by the reality that a number of factors other than the trade liberalization brought about by the agreement have affected trade between the two countries. Although there has been considerable growth in trade between Canada and the U.S. since the implementation of the FTA in 1989, it would be misleading to suggest that this growth was exclusively the outcome of the trade liberalization brought about by the FTA (and the NAFTA that followed it). While agreements such as the FTA undoubtedly improve the conditions for trade by lowering tariff barriers and creating an environment of stability and security for trade and investment, they are only one of several factors that influence the exchange of goods and services between countries in any given year.

Certainly, much of the bilateral trade had already been liberalized before the agreement was implemented. When the FTA was signed in 1989, many products were already being traded between Canada and the U.S. in a tariff-free environment, most notably automobiles and parts, which were liberalized by the Auto Pact in 1965. In addition to automobiles and auto parts, tariffs on aircraft and related parts, pulp, paper and wood products, and crude oil, petroleum and natural gas – some of Canada's most significant export products – were unaffected by the FTA. In all, it has been estimated that a full 35% of Canada-U.S. trade was tariff-free prior to the implementation of the FTA.[39] Other tariff lines were at low levels owing to successive rounds of GATT tariff reduction.

39 Marcel Côté, "Is Free Trade Good for Canada? Ten Years Later the Balance is Positive," *Cité Libre*, April/May 1998, p.48.

The US Share of Canada's Merchandise Exports has been Rising Steadily for Decades

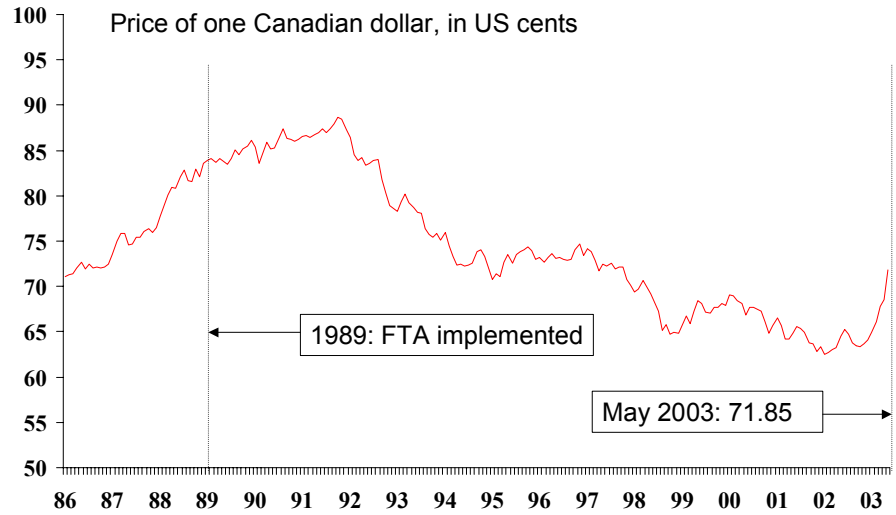


Source of data: Statistics Canada

As Tim O'Neill (Executive Vice-President and Chief Economist, BMO Financial Group) told the Committee, the FTA was the culmination of the trade liberalization between Canada and the U.S. that had been going on over a forty-year period. The reduction in tariffs arising from the FTA was, in the overall scheme of things, actually rather small. It stands to reason that a significant part of the growth in bilateral trade since 1989 could be attributed to the improved trading environment that had already been established prior to the launch of the FTA. In his brief to the Committee, Jim Stanford noted that two "liberated" sectors alone – energy and automotive – accounted for a full 40% of export growth under the FTA. In neither of these sectors did the FTA enhance access to the U.S. market.

While the FTA improved Canada's access to the U.S. market, two macroeconomic factors independent of the trade agreement also affected trade between Canada and the U.S. in the post-FTA period. They not only influenced growth in trade between the two countries during the 1990s, but also had a significant effect on the balance of trade. Much of the growth in exports to the U.S. since the onset of NAFTA can be attributed to (a) weakness in the exchange rate between the two countries, and (b) higher growth rates experienced south of the border (higher growth in the U.S. absorbed our exports).

Canada-US Exchange Rate: 1986 to 2003



Source: Bank of Canada

The first of these factors is the performance of the Canadian dollar, shown in the above chart. After rising sharply in the year immediately preceding the launch of the FTA in 1989 – the dollar's value rose to the 85 cent mark in that year – the currency continued to appreciate relative to the US dollar, rising to almost 89 cents in 1992.

Between 1992 and 2002, however, the Canadian dollar fell steadily, which lowered the price of Canadian export products in the U.S. market and at the same time made U.S. goods more expensive to purchase in Canada.[40] This placed downward pressure on import growth in Canada while at the same time making Canadian products more competitive in the U.S. market, which pushed exports to higher levels.

John Helliwell informed the Committee that the U.S. strong-dollar policy during the 1990s has been the most significant influence leading to the rise in Canadian exports to the U.S. during that decade. The share of our exports going to the U.S. has risen from 77% before the FTA to 87% now, the change in the exchange rate being the major factor. O'Neill concurred, pointing out that if one examines the change in the volume of trade in the 1990s, the big effect would have been the dramatic decline in the value of the Canadian dollar from a near 90-cent dollar to a 65-cent dollar. Fred McMahon also argued that the devaluation of the Canadian currency was the principal reason for the large trade surplus between Canada and the U.S.

Adding to the effect of the Canadian dollar was the fact that following the recession of the early 1990s, the U.S. entered one of the longest periods of uninterrupted economic expansion in its history. A combination of factors, including

40 In 2003, the Canadian dollar has rebounded sharply owing to pronounced weakness in the U.S. currency.

productivity growth, falling commodity prices, equity market gains and a strong U.S. dollar, allowed the economy to expand, creating jobs, raising incomes and attracting investment, all without triggering inflationary pressures. As Americans' wealth increased, so too did consumption levels, buoying demand for Canadian goods. Since the Canadian economy did not perform as well, Canadian demand for U.S. goods did not grow as quickly, and as a result, Canadian exports to the U.S. outpaced imports from that country.

As a final point, the FTA may have caused some of the existing Canadian trade to be diverted from other destinations to the U.S. market. Exports may have been rerouted from other countries to the U.S., and trade between Canadian provinces may have been deflected to the United States. As Helliwell pointed out to Committee members, some of the gains in north-south trade have occurred at the expense of trade with the rest of the world, and there was no gain for Canada in that development. Whereas the creation of trade yields economic benefits for Canadians, the diversion of trade from other countries in response to differential tariff rates may simply lead to economic inefficiencies.[41]

C. The Diminishing Gains From Trade Liberalization Under the NAFTA

It is also worth noting that the gains in tariff reduction between Canada and the United States, by far the two largest economies within NAFTA, were realized not under NAFTA but rather under the FTA. By the time NAFTA came into force in 1994, tariffs between Canada and the U.S. were already low or non-existent.

Thus, it should not come as a surprise that there was no NAFTA-induced explosion in bilateral trade. Indeed, a 1997 U.S. report on NAFTA's economic impact revealed that total U.S. trade with non-NAFTA countries increased by about the same percentage immediately following the agreement's implementation (11% rise in 1994; 14% in 1995; 5% in 1996) as did total Canada-U.S. trade (15% in 1994; 12% in 1995; 7% in 1996).[42]

As this same report further concluded, "Most of the international specialization that could have been expected from trade liberalization had already occurred when the NAFTA went into effect."[43] While the agreement did stimulate some further cross-border specialization in manufactured products, it should be properly viewed as an

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41 There is an extensive debate in the economic literature over whether regional free trade agreements are beneficial to the long-run goal of global free trade. Proponents of regional agreements maintain that agreements like the FTA and NAFTA simplify multilateral negotiations by reducing the number of players at the global level. Critics believe that regional agreements are artificially trade-distorting because they may divert trade from outside the regional bloc to within the bloc for non-economic reasons.

42 Arlene Wilson, "NAFTA's Effect on Canada-U.S. Trade and Investment," CRS Report for Congress 97-889, 26 September 1997

43 *Ibid*., p. 5.

incremental step forward in the process of North American economic integration that was occurring anyway. Indeed, most of the gains to Canada from freer trade in North America were achieved following the introduction of the Canada-U.S. Free Trade Agreement, the NAFTA having added little since then.

ASSESSING THE MERITS OF CLOSER INTEGRATION

If the economic returns from integration have already been largely exploited, as the previous chapter of our report suggested, why is closer integration being contemplated? The Committee received a mix of views on the merits of adopting closer formal economic ties with the Americans. This Chapter reports on the evidence heard and assesses a number of distinct policy proposals that have been put forward.

John Helliwell informed the Committee that the argument to get closer to the Americans hinges on obtaining more per capita income from the relationship. However, this will not occur as there is simply not much left to be tapped. In addition, the subjective well-being research that he has conducted suggests that Canada's separateness and independence produces greater subjective well-being. Therefore, he predicts that there would be net costs to the adoption of policies that would increase the intensity of the bilateral linkage. Helliwell also thought it dangerous to think that because we have not been able to get what we want – namely to obtain easier access to the U.S. market and to be exposed to less danger from U.S. trade remedy action – we should go further along the integration path to get to where we want to be.

Theodore Cohn (Professor, Department of Political Science, Simon Fraser University) was of the view that Canada should emphasize multilateralism in its trade relations with the U.S. since (a) it emphasizes the rule of law and therefore limits the ability of larger partners to seek side payments; (b) the U.S. will only be willing to make changes in agricultural trade and contingent trade measures (countervail, anti-dumping) in those multilateral venues; and (c) Canada benefits from the existence of a range of plurilateral groups such as the Quad.

Bob Keyes (Vice-President, International, Canadian Chamber of Commerce) felt it was unrealistic to expect that any of the proposed models of integration along this continuum (convergence and harmonization, customs union, common market, total economic integration, dollarization, expansion of NAFTA, a new North American governance framework, and continental political institutions) would happen right away, as they raise political and sovereignty issues. This was a view heard with some frequency during our hearings. At the same time, he thought that this extensive menu of integration proposals was worthy of analysis and discussion.

Other witnesses thought that closer ties with the U.S. would help lower the risk associated with U.S. security or trade actions. Rolf Mirus, while agreeing with John Helliwell that most of the gains from trade liberalization have already been realized, was nevertheless concerned that the economic gains from North American integration may be at risk if another terrorist attack occurs on U.S. soil or if the Americans become even

more inward-looking. Therefore, it was important to sit down with the Americans, work together on common interests (e.g. security, natural resources) and move forward along the integration path (e.g., customs union).

Thomas d'Aquino has adopted a similar approach to risk management, while abandoning any new formal integration arrangements such as a customs union. This approach is embodied in the NASPI proposal already discussed in the report's chapter on border issues. In order to prevent the Americans from imposing their security needs (e.g., Code Red alert at the border), d'Aquino concluded that Canada should develop a North American strategy that takes the national interest into account and then attempt to sell that strategy to the U.S. He recognized that strong political leadership and a firm national consensus would be required.

Still others argued that closer integration would be in Canada's best interests regardless of any risk assessment. The Honourable Perrin Beatty (President and Chief Executive Officer, Canadian Manufacturers and Exporters) advocated the development of a vision of what a new North American community could look like. There are many items to consider in developing such a vision: trade remedies, softwood lumber, agriculture, the simplification of rules of origin, regulatory cooperation, the need for intergovernmental cooperation to keep terrorists from entering North America, the planning of continental trade corridors to speed up the transportation of products to their markets and the protection of the continental environment. Beatty concluded that stronger North American integration was bound to happen in any event, either by default or by design, and that now was the time for Canadians to engage in this discussion.

Richard Paton (President, Canadian Chemical Producers' Association) also arrived at the same conclusion: integration of the North American economy is inevitable. The question for Canada is whether to position ourselves to benefit from it or lose out on investment and growth opportunities. A strategy on North America is required. Fred McMahon suggested that a key element of a longer-term integration strategy was the development of a deeper bilateral trade agreement with the U.S. that would have a more certain and quicker dispute settlement mechanism.

The Committee has carefully considered the competing arguments presented on the question of closer Canada-U.S. economic integration. We have indicated that the management of risks at the land border would be best dealt with through existing mechanisms (i.e., the Border Action Plan) and that "strategic bargains" would not be in Canada's best interest. We have concluded that Canada has already faced diminishing returns from past efforts to integrate and are swayed by John Helliwell's position that the gains to be had from even closer economic integration with the U.S. are rather limited. Accordingly, we believe that any attempts to develop closer formal Canada-U.S. ties in the form of a customs union, common market or single currency should be resisted. Efforts to cooperate on regulatory matters and to deal incrementally with other concerns in the bilateral trade relationship could be assessed, however.

A. The Customs Union Option

At the present time, many goods circulating within the NAFTA economic space are either produced wholly or in part outside the free trade area, and rules of origin are needed to determine what is free of duty and what is not. Without these rules, firms would have an incentive to route imports into the integrated North American marketplace through the country possessing the lowest external tariff.

Rules of origin impose an administrative and compliance burden on business. With all three NAFTA countries having different tariffs with the rest of the world, goods shipped across internal NAFTA borders must be extensively documented so that each country can apply its own tariffs to products generated outside NAFTA. It has been estimated that reducing the need for border inspections and lowering the amount of paperwork required could result in efficiency cost savings of a not inconsequential 2% to 3% of NAFTA GDP.[44] The potential cost savings are meaningful, since over 85% of Canada's exports flow to the United States. An added advantage is that border resources now devoted to goods inspection could be freed up to enhance cross-border security.

Minister Pettigrew has recognized the need to realize additional liberalization in the NAFTA rules of origin, to make it easier for firms to comply with the rules in the case of certain products. In a recent speech to a Canadian-American business gathering, in which he outlined a six-point agenda for North America, he stressed the need to accelerate Canadian efforts "to further reduce transaction costs and make it easier for companies to do business and benefit from our integrated economies."[45]

Another option would be to remove these rules of origin entirely, through the creation of a customs union. Under this option, participating countries undertake to eliminate all restrictions on mutual trade and adopt a common external tariff for outside countries. Rules of origin are dispensed with since imports into the customs union would face the same tariffs anywhere in the union. Once the item had been cleared for entry into the North American economic space, it could then be shipped between participating countries without the need for complex customs inspections. Removing these rules of origin should result in administrative cost savings at the border and efficiency gains, although Tim O'Neill cautioned the Committee that the increased economic benefits from a customs union narrowly defined as a common tariff structure might not be all that substantial. Moreover, inspecting items crossing the border for security purposes would still likely be required.

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44 Richard G. Harris, *North American Integration: Issues and Research Agenda*, Micro-Economic Policy Analysis, Industry Canada, Discussion Paper Number 10, April 2001, p. 11.

45 Department of Foreign Affairs and International Trade, Notes for an Address by the Honourable Pierre Pettigrew at the 8th Annual Canadian-American Business Achievement Award and International Business Partnership Forum, "The Canada We Want In The North America We Are Building", Toronto, October 16, 2002, p. 6.

Proponents of a customs union apprised the Committee of the benefits that such a policy measure could generate. Armand De Mestral stressed the importance of removing customs barriers to the free movement of goods at the border. David Adams informed the Committee that the elimination of the tracing requirements (i.e., tracing of the origins of certain products) would be very useful for the automotive industry. Rolf Mirus, with the most detailed presentation on the customs union concept, envisaged its implementation as lowering the significance of the internal border for the commercial movement of goods and services between the two countries (Mexico might be added later). Cumbersome rules of origin would be phased out, agriculture and other sensitive sectors set aside and transition periods established. According to Mirus, a customs union with zero common external tariffs as trade liberalization at the WTO continues could be accomplished in an incremental way without redoing NAFTA.

Other witnesses advocated the creation of sectoral customs unions within those sectors of the economy that are highly integrated already. For example, David Goffin (Secretary-Treasurer and Vice-President, Business and Economics, Canadian Chemical Producers' Association) argued that the rules of origin are quite complex for chemicals and that his group would favour movement towards a sectoral customs union. However, it was pointed out by Peter Clark that these sectoral arrangements would not be WTO-consistent.

The trade-off for the economic gains that might be realized is the loss of policy independence that additional linkages with the United States would entail. In a customs union, the participating nations have to surrender policy freedom – by adopting a common external tariff and a common external trade policy – to achieve economic benefits associated with the elimination of the need for rules of origin.

With respect to tariffs with the rest of the world, Canada's external tariffs are, on average, nearly double those of the United States. Adoption of a synchronized tariff schedule with the U.S. would thus probably imply lowering Canadian tariffs to American levels.

The second aspect of the sovereignty issue to consider is the harmonization of external trade policy between the members of the customs union. In the European Union (EU), the European Commission (EC) represents EU members in international trade negotiations such as the WTO and FTAA. It seeks European consensus to do so, an often difficult task. Like the EU, a Canada-U.S. customs union (or one encompassing all three NAFTA countries) would probably also operate as a bloc in future international trade negotiations. Under this scenario, Canada and the U.S. would have to arrive at internal consensus on positions for trade negotiations, or at least achieve a substantial reduction in their differences, and make adjustments in their existing trade arrangements (e.g., bilateral free trade agreements). A member country's ability to act independently in its external trade policy would therefore be affected.

As witnesses informed the Committee, the question then becomes to what extent would Canada be able to influence the direction of the region's trade policy. Another way to state this is precisely how much of this trade policy – in particular, the

establishment of the external tariff code – would be set in Washington. It is difficult to imagine at this point that Canada's interests would dominate in any regional trade discussions or negotiations. Moreover, Gilbert Gagné wondered what would happen to multilateralism in Canadian foreign economic policy if Canada were to move beyond free trade.

While there may be economic benefits to be derived from movement to a customs union (e.g., reduction in border transactions resulting from the removal of rules of origin), the costs (e.g., adopting U.S. tariffs on products from third countries, having trade policy made in Washington) are too onerous for closer integration to be considered. Moreover, several witnesses expressed doubt about the feasibility of a customs union, particularly in view of U.S. reluctance to enter into such an agreement. For example, Thomas d'Aquino's group decided, after three years' effort, that it was no longer tactically desirable to formally advocate the idea. Even Mirus noted that the size discrepancy between Canada and the United States would reduce the prospects for negotiating the customs union.

It is also hard to imagine, as a number of witnesses also concluded, that the U.S. would give up its cherished access to trade remedies within such a customs union. Keyes also noted that other issues such as non-tariff barriers in the form of health inspections and safety requirements and restrictions on the cross-border movement of people would remain untouched.

After seriously examining both sides of the issue, the Committee has concluded that upgrading NAFTA to a customs union would not be in Canada's best interests. We are not prepared to make the sacrifices in Canadian sovereignty that would be required to realize the economic benefits of a customs union, and recommend:

RECOMMENDATION 11

That the Government of Canada refrain from entering into any discussions on the establishment of a customs union with the United States.

B. A Common Market

The introduction of a common market in North America would take economic integration to a point on the spectrum even further along than the customs union. According to the normal definition, a common market would remove all barriers to the movement of goods, services, capital and people within the NAFTA market. In Europe, as Armand De Mestral pointed out to the Committee, the free movement of those four entities is already guaranteed constitutionally.

A key advantage of the common market is the improvement in labour mobility that it would bring about. As Bob Keyes reminded the Committee, there continues to be considerable unfinished business associated with the labour mobility chapter of the NAFTA (Chapter 16). Immigration authorities are resistant to change, for example, and as a result, significant mobility barriers still exist.

Another key benefit of a common market is worth mentioning. George MacLean (Professor, Political Studies, University of Manitoba) argued that the establishment of a common market would enhance Canada's access to the U.S. market, especially if it included standard regulations for subsidies and competition between the two countries to curb the use of trade remedies. He saw the North American common market serving as the basis for one that would eventually cover all of the Americas. This does not mean that the NAFTA would disappear.

Richard Harris felt that a common market with the U.S. would remove border and softwood-type problems, but that it would be a tough sell with the Bush Administration. Having Mexico on board would help provide necessary leverage, but there was no guarantee of success. While three years ago he had recommended a common market, the events of September 11 had completely changed the situation. With the terrorist threat still in place, U.S. authorities would be unlikely to go along with what would essentially be the removal of the border. Rolf Mirus, the keen proponent of the customs union, is also not recommending a move to a common market. The Committee agrees that in the current situation, in which the Americans are extremely security-conscious, the notion of creating a common market in North America is not feasible.

C. A Common Currency

Although very little testimony was received on this issue, witnesses appearing before the Committee indicated little enthusiasm for a common currency with the United States. Kathleen Macmillan observed that while there were strong arguments on both sides of the common currency debate (e.g., a reduction in transactions cost on the positive side; a decline in monetary sovereignty on the negative side), the general consensus was that the time was not ripe for abandoning the Canadian dollar. On balance, maintaining the status quo was the preferred option as far as she was concerned.

Minister Pettigrew remarked to Committee members that achieving a common currency regime would imply effectively adopting the U.S. dollar and giving up Canadian monetary policy, since it would be virtually impossible to convince the Americans to get rid of their currency. Moreover, the domestic exchange rate's capacity to absorb the adverse economic impacts that significant outside shocks (e.g., the Asian financial crisis) would have on this country would be lost.

For his part, Perrin Beatty noted that the low Canadian dollar, while good for exporters, had also driven the costs of imports up. However, it was important for Canadian policy-makers to focus on the productivity gap between the two countries, not

the currency value gap. Owing to the low value of the currency, there has been less investment in machinery, and as a result, Canadian SMEs have older machinery than do U.S. plants.

The Committee is concerned that the costs associated with abandoning the domestic currency would overwhelm any decrease in transactions costs that monetary integration could produce. However, a more in-depth review of the single currency issue would need to be performed before any conclusions could be ventured.

D. Lessening Regulatory Duplication

Although market and production systems are becoming increasingly integrated in North America, businesses operating on this continent continue to face three separate sets of production standards (e.g., health and safety, packaging, electrical standards, emission controls, food testing, language), regulations and labelling requirements. Owing to this regulatory situation, a product may have to be modified physically or relabelled or have its origin and components certified before it can cross an internal NAFTA border.

This complexity, which stems from the fact that the marketplace has often moved ahead of the regulatory system under which it operates, can impose a tangible burden on firms conducting regional trade. This can take the form of delays in shipping products throughout the NAFTA marketplace and resulting higher financial costs. According to David Adams (Vice-President, Policy, Canadian Vehicle Manufacturers' Association), true economies of scale can only be realized in North America if a manufacturer can produce a product designed according to a set of common standards. This is especially important for a small country. He urged the Committee to recommend that, where possible, standards and regulations among NAFTA countries be harmonized and mutual recognition agreements (see below) be adopted unless an extensive cost benefit analysis shows that separate standards should be kept. Various witnesses from the agricultural sector also saw the merits of greater harmonization.

As Claude Carrière informed the Committee, Canada could examine ways to reduce differences in standards and product regulations while continuing to meet the regulatory objective (e.g., safety standards). Cooperating on regulatory matters could facilitate intra-industry trade, lower transaction costs for shippers, reduce the disincentives for investors, lessen the scope for disputes, and provide benefits to Canadian consumers. It should be recognized, however, that establishing closer cooperation in the regulatory area would reinforce Canada's dependence on the U.S. market, which is almost everyone's current concern.

There are essentially three ways to resolve this problem: common policies, harmonization and mutual recognition. The first of these options is self-explanatory: the three NAFTA partners would adopt common regulatory policies. While this option would achieve the most certainty for business, it is doubtful that it would receive much support in the three countries in question.

Second, the countries could begin to harmonize their regulatory approaches in such sectors as transportation, telecommunications, financial services, energy, agriculture and pharmaceuticals. While the policies would not be identical, in contrast to the first option, exporters, importers and businesspeople in general would face a considerably more predictable regulatory environment. As in the case of common policies, however, political support for this option may be lacking.

That leaves mutual recognition as perhaps the regulatory option with the most potential. Under this option, if a good met the standards of Country A, then it could enter Country B without restrictions, as long as Country A also accepts goods produced according to the standards of Country B. Appearing before the House of Commons Standing Committee on Foreign Affairs and International Trade during its hearings on North American integration, a representative from the Canadian Chamber of Commerce saw the advantages of mutual recognition as follows: "it requires us to say we recognize your standards as appropriate standards and you recognize our standards as appropriate standards. That doesn't mean you have to change your standards or we have to change our standards. I think that is potentially much more politically feasible, and it doesn't require us to harmonize to the U.S. standard. That's a potential way of moving this relationship forward and ensuring more secure access to the U.S. market while avoiding this issue of requiring harmonization."[46] Mutual recognition of laboratory accreditation, approvals or certification could lower the cost of regulation.

The adoption of mutual recognition is not without precedent. In Europe, for example, efforts to harmonize regulations were found initially to be expensive and inefficient. They were replaced with an agreement that each government would recognize the regulations put in place by the other governments.

Here at home, Minister Pettigrew recently advocated greater regulatory cooperation between the three NAFTA members, arguing that in many areas the three countries had "similar regulatory systems that work for similar goals and produce similar results. Yet each country often demands that products imported from the other go through costly testing procedures to meet domestic requirements. Why not acknowledge the similarity of our systems and agree that once these products are tested in one country, they are acceptable in the other? Can we not move to the principles of mutual recognition and the elimination of duplication?"[47] In his appearance before the Committee, he noted that any examination of mutual recognition would have to be done on a sector-by-sector basis.

During his appearance before the Committee, Bob Keyes suggested that Canada and the U.S. should examine their own regulatory processes and standards. He observed that the existence of parallel, overlapping, duplicate systems of regulatory approval leads directly to delays and an increase in business costs and that regulatory

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46 House of Commons Standing Committee on Foreign Affairs and International Trade, *Evidence*, 7 May 2002, Meeting No. 77, p. 94.

47 Foreign Affairs and International Trade Canada (2002), pp. 4-5.

cooperation would not mean simply adopting U.S. standards. Two or three sectors could be targeted to start the process of moving to mutual recognition.

Richard Paton also advocated the adoption of mutual recognition, with agreement on testing criteria approaches. However, it would be difficult to get an agreement with the Americans on the development of common testing procedures since our market is so much smaller than theirs. There would be no incentive for them to change since they are the larger entity. One way to deal with this problem is to reach a bilateral agreement on the lower-risk areas and keep decision-making separate in the higher-risk areas.

The Committee questions why, in view of the integrated nature of the North American market and the similarities in many product standards, there continues to be a need for a duplication of approval and testing processes in all areas. We recommend:

RECOMMENDATION 12

That the Government of Canada carefully investigate the impact that regulatory differences with the United States have on the Canadian economy, and release its findings to the public. The government should seriously examine the concept of mutual recognition of each country's regulatory standards and procedures, under which standards would be tested and inspection and certification would be carried out only once within the Canada-U.S. market. Moreover, the government should identify those sectors in which the U.S. and Canadian regulatory systems are similar and the mutual recognition approach could be applied.

THE NEED TO DIVERSIFY CANADA'S TRADE

The federal government has attempted to promote hemispheric, transpacific and transatlantic free trade in order to diversify Canada's trade. Minister Pettigrew told us that much of this country's trade promotion effort is aimed at markets outside the U.S., the objective being to strengthen Canada's trade position around the world. The use of Team Canada and other, more modest trade missions was cited as proof that the current government takes the trade diversification objective seriously.

A number of witnesses told the Committee that because of the vulnerable position that Canada is in regarding possible U.S. security and trade actions, it makes sense to diversify trade as much as possible. To mention but one example, Dennis Laycraft noted that the Canadian cattle industry has already formulated a long-term objective to export 50% of its products outside the U.S. by 2010.

Meeting the diversification challenge will require considerable effort. Kathleen Macmillan reminded Committee members that although efforts to diversify Canada's trading patterns have been made over the years, our dependence on the U.S. economy has continued to rise. She pointed to a number of reasons for the close Canada-U.S. relationship: geographic proximity, language, similar institutions, and a good understanding of each other's market. Tim O'Neill cautioned the Committee not to set its expectations too high concerning diversification.

Other witnesses, however, noted that Canadian efforts to diversify its trade could be improved. Bob Keyes argued that Canada appears to be entering into trade agreements and trade liberalization agreements primarily with smaller countries and regions, such as Costa Rica, Central America, the Andean Community and Singapore. He noted that these are small markets and that some of the trade agreements are being entered into for political rather than trade reasons. Other countries such as Mexico have been considerably more aggressive in seeking out expanded trade relationships with larger entities. Many witnesses pointed to Europe and Asia as regions where Canada has not enjoyed much success in terms of forging a closer trade connection.

John Wiebe (President and Chief Executive Officer, Asia-Pacific Foundation of Canada) thought that the Canadian focus on the U.S. had had the unintended consequence of diverting our attention from other, important regions of the world. The Canadian government should be encouraging other free trade agreements to enhance our overall trade relationship.

Finally, Bruce Campbell (Executive Director, Canadian Centre for Policy Alternatives) called on the federal government to examine past efforts to diversify, determine why they failed, and attempt to design an improved strategy to achieve a different outcome. He placed considerable emphasis on the achievement of a genuine trade agreement with the European Union (EU).

The Committee is convinced of the importance of a strong trade relationship with the U.S. but is also of the view that Canada would be better off if its trade dependence on its single largest market to the south was reduced. This does not mean that our trade with the U.S. should stop growing but rather that trade with other countries should expand at a higher rate. The Committee is struck by the current efforts of other countries to enter into bilateral trade agreements and encourages the Government of Canada to aggressively seek out comprehensive free trade agreements in Europe and Asia.

A. Achieving a Comprehensive Free Trade Agreement with Europe

While the European Union is Canada's most important trade and investment partner after the U.S., our trade is not increasing as quickly with that area as with other parts of the world, and the EU's share of our total exports and imports has been declining over the past decade. Merchandise exports now total $21.2 billion, or 5.2% of Canada's total exports, while imports equal $36.1 billion. The figures for services are $9.9 billion and $10.6 billion respectively. Moreover, several bilateral trade issues stand out: market distortions in the agricultural sector stemming from export subsidies and domestic support; protective tariffs in certain sectors; and EU import bans and restrictions, especially in the agriculture and natural resource sectors, for health, environmental and consumer protection reasons.

Whereas trade has been declining (in percentage terms), the real success story regarding Europe has been the two-way investment relationship. The stock of Canadian investment in the EU was $99.9 billion in 2002, and the Europeans had invested $94 billion in Canada.

In view of the deteriorating trade situation with Europe, it is regrettable that Canada has not yet been successful in entering into a comprehensive free trade agreement with the EU. The planned addition of ten new countries by May 2004 will turn the EU into a single market of over 480 million people and a GDP of around $13.7 trillion, compared with NAFTA's 412 million and roughly $15.7 trillion. Europe is a continent clearly on the move, and yet Canada is only one of eight economies worldwide that does not have some form of preferential trading relationship with the EU. The Committee heard that seeking closer formal economic ties would be a positive development. Donald Barry informed the Committee that a study carried out by the Department of Foreign Affairs and International Trade showed that a Transatlantic Free Trade Agreement (TAFTA) would generate significant gains on both sides of the Atlantic. Both the EC and DFAIT agreed to undertake surveys of the business community on free trade. The Canadian survey, released in November 2002, was positive, but the European survey has not been released. The EU Trade Commissioner (Pascal Lamy) seems to have changed his tune on the merits of a TAFTA: previously he was willing to consider the business case, but now he maintains that market access issues need to be resolved in the WTO Doha Round. Barry also pointed to the inertia within the European Commission on this topic. The Commission appears to view Canada as a small market with few benefits for the EU.

Roy MacLaren identified the EU as the top priority in any Canadian diversification strategy, and favoured the pursuit of a Transatlantic Free Trade Agreement (TAFTA) with the EU and one with the European Free Trade Association (EFTA), which consists of Norway, Switzerland, Iceland and Liechtenstein. Regarding the EU, he speculated that the Europeans would prefer to deal with the U.S. as opposed to us and commented on the doubtful success of the WTO Doha Round, on which the Europeans have pinned all their hopes. On EFTA, he is disappointed that Canada's shipbuilding subsidy program has been allowed to disrupt free trade negotiations.

Other witnesses also pointed out additional roadblocks to a TAFTA. Theodore Cohn stressed that no economically developed country outside Europe has a free trade agreement with the EU. One can have an associate agreement with the EU only if one is a developing or European country, neither of which applies to Canada. Cohn was not optimistic that Canada would obtain a special link with the EU.

Richard Harris noted that since formal trade barriers between Canada and Europe are not high, there is not much to eliminate. In addition, the trade that we now have with the U.S. (time-sensitive delivery in intermediate goods and manufacturing) will just not happen between Canada and Europe. Canada will be trading in energy, natural resources, finished products, and agriculture instead. He is optimistic that there could be some improvement in that trade, but it certainly will not be an engine of economic growth for Canada, even if a TAFTA were to be signed.

Rolf Mirus thought it would be unproductive for Canada to negotiate with the Europeans, especially since the trade negotiations are so complex (e.g., we try to export agricultural products there and they erect barriers). He did not foresee any gains for Canada in negotiating with the Europeans separately (i.e., separately from the Americans).

Thomas D'Aquino identified three problems with Europe: we are not important to the EU and they are preoccupied with expansion; they see us as tied to the Americans; and there is the thorny problem of agriculture to resolve. He doesn't think a deal with Canada would be entered into unless the Americans were also part of it. Support for such a trilateral approach to transatlantic trade liberalization, with Canada and the U.S. facing joint market access barriers in Europe, was expressed to the Committee in Washington by both William Lash III and Representative Earl Pomeroy.

Bob Keyes argued that Canada should forget about its comprehensive free trade proposal and move forward in a practical way to remove non-tariff barriers such as regulatory impediments to trade. At any rate, the Europeans are waiting for progress at the WTO.

Claude Carrière informed the Committee that Canada and the EU are currently working to define the content of a Canada-EU Trade and Investment Enhancement Initiative. Though not as comprehensive as a TAFTA, this important new initiative should prove useful in harmonizing or cooperating on technical standards, labelling requirements and the certification of professionals; this will improve the existing regulatory framework governing the two-way movement of goods and services.

Minister Pettigrew has started consulting with Canadians on what should be in the new agreement and the barriers to the European market that should be addressed in the WTO negotiations. The plan is for the two sides to propose designs for the new agreement in December 2003 and then negotiate the deal in 2004, with the targeted completion date to be established once the results of the Doha Round are known.

The Committee has, for many years and with limited success, advocated the implementation of a comprehensive free trade agreement with Europe. Such an arrangement, apart from significantly improving access to the European market, would send a strong signal to business on both sides of the Atlantic that a less restrictive trade and investment climate was in place for transatlantic commerce. While any initiative to enhance the Canada-EU relationship should be viewed as a positive development, the long-term goal of achieving a broadly-based free trade deal should remain intact. The Committee recommends:

RECOMMENDATION 13

That, noting the valid objective of engaging in regulatory cooperation with the European Union within the proposed Canada-EU Trade and Investment Enhancement Initiative, the federal government retain as a goal the successful negotiation of a comprehensive Transatlantic Free Trade Agreement.

B. Strengthening Trade Ties with Asia-Pacific

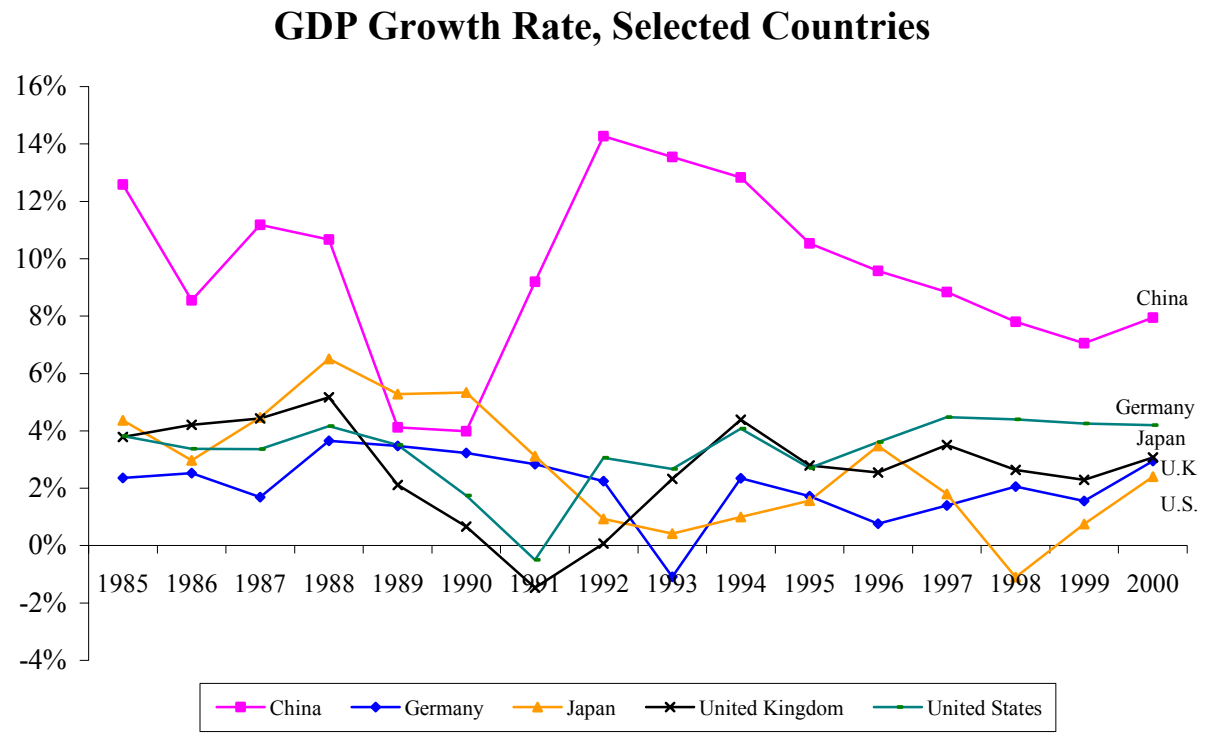
During his appearance before the Committee, John Wiebe made a compelling case to expand Canada-Asia-Pacific trade. This section largely presents the evidence that he provided.

Why Asia-Pacific? Because it is recovering from the 1997 financial crisis, because it accounts for two thirds of the world's population and 40% of the world's trade, and because it has the fastest growing economies in the world. Canada's trade with Asia-Pacific totals $70 billion annually, second only to trade with the U.S. However, we run a $30 billion deficit with that region, so there is a considerable economic opportunity there. On the negative side, Canada is losing market share in Asia as trade growth is not keeping up with economic growth in the region. In the short term, the current SARS situation may also serve to dampen the economic relationship.

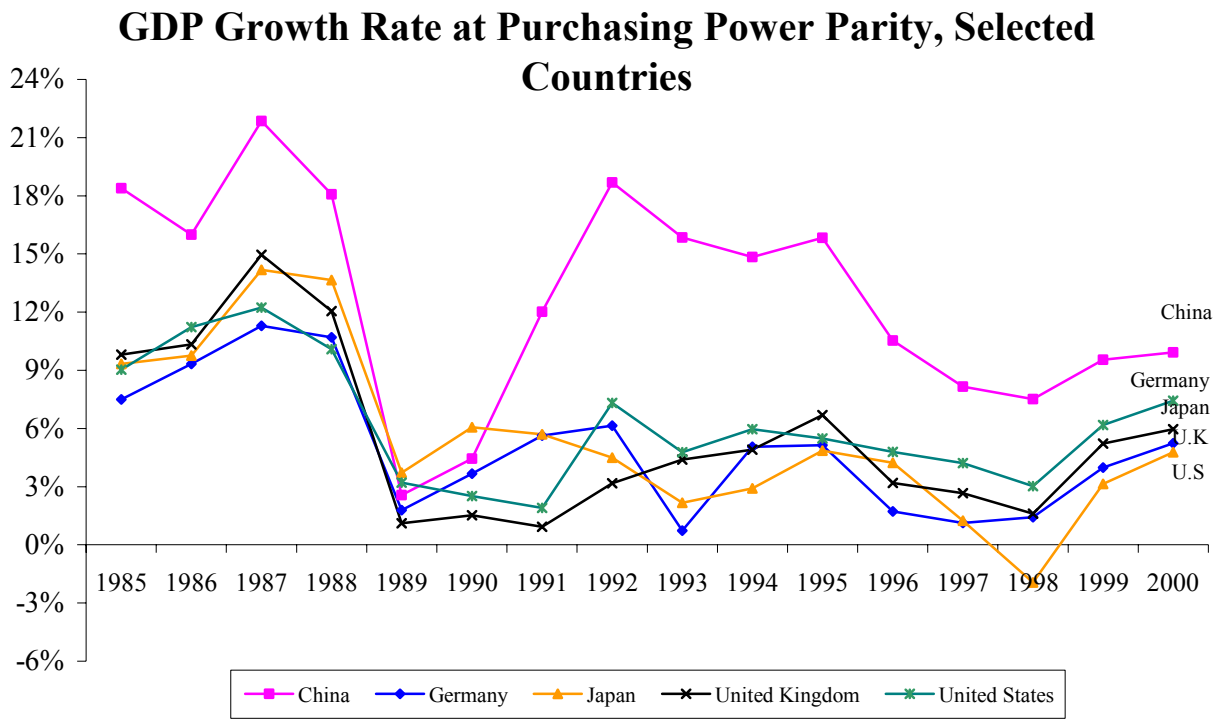
Northeastern Asia (China, Korea, Japan) accounts for the bulk of Canada's commercial interactions with Asia-Pacific. Add India for its economic potential and one would have a short list of where Canada's priorities ought to be.

China is the one economy that is worthy of close examination; Canada ignores it at its peril. China's economy, the sixth largest in the world, is undergoing a thorough transformation that is affecting the entire NE Asia region. Its growth rate, officially 8%, is very high (see the graphs below on GDP growth rates in selected countries), and it continues to specialize in low-wage manufacturing. China has also become a significant consumer and has now surpassed the U.S. as the world's leading destination for investment ($53 billion). Canadian trade with China has been rising at an annual rate of 10% to 15%.

Japan is Canada's second largest trading partner and is still the number-two economy in the world (with 13.5 % of the world's GDP), even though its economy has been stagnant lately. Its potential as a consumer economy is still enormous, although it is not opening up as much as China.48 Wiebe believes that Japan is on the verge of a major transformation, both economically and politically, one that will be important for Canada.



(48) Japan's two-way trade is only 16% of GDP vs. Canada's 60% and China's 40%.



Two other Asian countries are worth mentioning. Korea has rebounded strongly following the financial crisis of the late 1990s. Per capita income last year exceeded US$10,000, and the country is becoming an opportunity for Canada. Canada's current trade with India is only $2 billion but is growing quickly – it was $900 million in 1991. Services are the most dynamic sector there for Canada to exploit.

According to Wiebe, Canada needs to do the following. First, Asia is becoming increasingly inward-looking regarding trade, and it behooves Canada not to be left out of the action. Like the U.S. and Mexico, which are both trying to negotiate FTAs there, we should be actively engaged in bilateral discussions with key countries in the region.

Second, Canada should promote investment in Asia. Assets are cheap there now (discounted from the 1997 crisis), so it is a good opportunity to buy. Opportunities for trade will be created if we invest there (i.e., trade follows investment).

Third, Canada needs to develop a better "brand" (i.e., image) in the region. We are viewed as a friendly, clean country with lots of clean natural resources and a willingness to tolerate diversity. We are not seen as a high-tech company or provider of high-quality industrial goods and services. Here, reality does meet perception, as our exports are dominated by natural resource products and unfinished goods.

Finally, government leadership is required for trade facilitation, tariff reduction, the signing of mutual recognition agreements and other initiatives. Coordination and cooperation between governments, communities and businesses will be required for trade with Asia to grow.

To maximize economic opportunities in Asia, Canadian trade policy will have to become more focused on that region and more aggressive and innovative in its approach. Like the U.S. and Mexico, which are both trying to negotiate free trade arrangements there, Canada should be actively engaged in bilateral discussions with key countries in the region. The federal government should also find new ways to augment the awareness of Asian economic opportunities within the Canadian business community, assist firms in improving direct business ties with Asian companies and develop a better "brand" for its products. The Committee recommends:

RECOMMENDATION 14

That the Government of Canada make free trade with Asia a priority and initiate trade-liberalization negotiations with China, Japan, South Korea, India and members of the Association of Southeast Asian Nations (ASEAN). The federal government should also develop new strategies to increase the interest of Canadian businesses in Asian markets, help Canadian firms construct durable partnerships with Asian companies and establish a better image for Canadian products in Asia.

C. The FTAA and Hemispheric Trade Ties

Canada, along with the 33 other democratic countries of the hemisphere (excluding Cuba), is negotiating a Free Trade Area of the Americas (FTAA); the conclusion date is set for January 2005. If one excludes our NAFTA partners, the FTAA region pulls in $3.8 billion of our exports and $67.4 billion of our direct investment, which represents 17.3% of Canada's total foreign direct investment.

The Committee did not receive a great deal of evidence on strengthening hemispheric economic ties. George McLean, the most active proponent of the witnesses we did hear on this matter, called for Canada to seek out an enhanced role in the hemisphere. However, Canada needs to maintain a balance between paying close attention to bilateral relations with the U.S. and moving the hemispheric agenda forward. Nevertheless, it is his belief that Canada's commitment to economic multilateralism in the hemisphere benefits its strategic trade relationship with the United States.

McLean is of the view that the FTAA appears to be a logical offshoot of the NAFTA. He prefers the FTAA approach in that it brings together 34 different countries into a single entity. Increased integration in the hemisphere could provide benefits to FTAA members while offsetting regionalism in other parts of the world. Canada may not benefit much economically, but being a part of the deal may protect the NAFTA benefits we already have.

In Washington, William Lash III expressed optimism regarding the prospects for a hemispheric trade deal. He noted that people have tended to underestimate the new Brazil and that the U.S. and Brazil, two of the key countries in the FTAA negotiations, are now actively communicating with each on important trade issues.

On the negative side of the ledger, McLean admitted that enthusiasm for the FTAA had dimmed and that countries had adopted strategies aimed at achieving bilateral trade liberalization. His pessimism was shared by Kathleen Macmillan, who observed that the FTAA negotiations were not showing much promise of reaching a meaningful outcome, and Roy MacLaren, who suggested that prospects for the FTAA have deteriorated as economic problems persist in South America. He thought that this development had made it hard for Brazil to negotiate (as part of MERCOSUR) from a position of strength. A somewhat pessimistic view was also expressed by Gwyneth Kutz (Counsellor and Alternate Representative of Canada to the Organization of American States), who remarked that the 2005 FTAA target had been made more difficult to attain by U.S. action on farm subsidies and steel imports and by the lack of readiness on the part of the countries in the hemisphere for comprehensive trade liberalization.

STRENGTHENING FEDERAL LONG-TERM ANALYTICAL CAPACITY

While in Vancouver, the Committee heard compelling evidence that, with the elimination of the Economic Council of Canada (ECC) in the 1980s, the federal government lost its capacity to undertake medium- to long-term analyses of key economic issues such as those considered in this report.

Richard Harris pointed out that the demise of the ECC left research on long-term economic issues in the hands of “think tanks”, which have their own agenda, and the rather limited academic community. John Helliwell observed that the ECC had been a net contributor to Canadian economic thought, while Theodore Cohn suggested that the ECC had provided critical long-term, comprehensive analysis that is currently missing.

It is difficult to disagree with the informed views of these august experts. The Committee recommends:

RECOMMENDATION 15

That the Government of Canada establish a Trade and Investment Council to conduct comprehensive analytical research on external trade and investment issues.

RECENT HISTORY OF THE CANADA-U.S. SOFTWOOD LUMBER DISPUTE

While the history of lumber-related disputes between Canada and the U.S. dates back to the 19th century, the disputes of the last 20 years have the most relevance to the present trade dispute.

In 1982, the U.S. forest industry petitioned the government to undertake a countervailing duty investigation of Canada's softwood lumber industry, alleging that Canadian forest management practices subsidized manufacturers, producers and exporters of softwood lumber. The U.S. Department of Commerce completed its investigation and concluded that Canada's stumpage programs did not confer a countervailable subsidy.

The U.S. forest industry petitioned the Department of Commerce again in 1986. In its preliminary determination, the Department of Commerce found that Canada's stumpage programs provided lumber producers with an average subsidy of 15%. Canada negotiated a Memorandum of Understanding (MOU) with the U.S. to resolve this dispute. Under the MOU, Canada agreed to collect a 15% tax on all softwood lumber exports in exchange for the termination of the countervailing duty investigation. The MOU also allowed for the removal of the border tax if forest management "replacement measures" were implemented in the provinces. Through this provision of the MOU, B.C.'s border tax was eliminated and Quebec's charge was reduced in stages to approximately 3%. Once the replacement measures were in place, Canada terminated the MOU on the basis that recent stumpage rate increases made the export tax unnecessary.

Following Canada's termination of the MOU, the U.S. Department of Commerce in 1991 initiated another countervailing duty investigation and imposed a temporary bonding requirement on all Canadian softwood lumber exports to the United States. The investigation found that forest management programs in B.C., Quebec, Ontario, and Alberta and B.C.'s log export restrictions constituted countervailable subsidies and that the subsidies injured U.S. producers. The ultimate result of the investigation was the imposition of a 6.51% countervailing duty on all softwood lumber imports from Canada. The Atlantic provinces were excluded from the determination. Canada appealed the U.S. decisions to a binational panel established under the Canada-U.S. Free Trade Agreement. The panel found that there was insufficient evidence or legal basis for the U.S. decisions, and sent the decisions back to the U.S. Department of Commerce twice before it accepted the binational panel's finding and cancelled the countervailing duty order.

The U.S. Trade Representative initiated an Extraordinary Challenge Committee under the Free Trade Agreement, on the premise that the two Canadian panellists on the binational panel were in conflict of interest. The Extraordinary Challenge Committee rejected this charge. As a result, the U.S. refunded all countervailing duties collected from Canadian exporters (approximately US$800 million).

In 1994, Canada and the U.S. undertook consultations to find a solution to the ongoing dispute. They finalized a 5-year agreement on May 29, 1996. Under the Canada-U.S. Softwood Lumber Agreement, Canadian softwood lumber exports that exceeded a pre-determined quota were subjected to a border fee that was remitted to the provinces in proportion to their share of national shipments, and the U.S. agreed to forgo any further trade action for the 5-year term of the agreement. The Softwood Lumber Agreement applied only to exports from B.C., Alberta, Ontario, and Quebec. Despite the agreement, disputes still arose between Canada and the U.S. over classification of certain lumber products and changes in the stumpage system in British Columbia.

When the Canada-U.S. Softwood Lumber Agreement expired on March 31, 2001, the U.S. Coalition for Fair Lumber Imports submitted a petition to the U.S. Department of Commerce requesting countervailing duty (CVD) and antidumping (AD) investigations. The Coalition alleged a subsidy rate of approximately 40% and antidumping rates ranging from approximately 23% to 73%. The U.S. Department of Commerce initiated the investigations on April 23, 2001, exempting Atlantic Canada from the countervailing duty investigation but not the antidumping investigation. It determined that “critical circumstances” were present in the case due to an alleged increase in softwood lumber shipments following the termination of the Softwood Lumber Agreement. To offset this increase in shipments, the U.S. Department of Commerce required the collection of bonds or cash deposits on softwood lumber shipments to the U.S. while the investigations were underway. These bonds were later cancelled following the International Trade Commission’s finding that Canadian lumber shipments posed a threat to U.S. producers but had not actually caused material injury. A decision to collect duties on an “entered value” basis rather than the usual “first mill” basis meant that lumber duties were collected on the value of the lumber as it entered the U.S., not on its value as it left the primary sawmill. This decision adversely affects Canadian remanufacturers because duties have to be paid on the full value of the remanufactured product.

The final determination of subsidy by the Department of Commerce in March 2002 resulted in the imposition of a countervailing duty of 18.79% on all softwood lumber shipments from Canada (excluding the four Atlantic provinces and 20 companies producing lumber from private sources only). Shortly thereafter, the Department of Commerce determined an average dumping rate of 8.43%. Individual company rates ranged from a low of 2.18% for West Fraser to a high of 12.44% for Abitibi.

Canada, the provinces (not including Atlantic Canada), and forest industry representatives have requested a NAFTA Chapter 19 review of the "critical circumstances" finding and the final determinations in the countervailing duty and antidumping investigations. In addition, Canada has filed numerous challenges at the WTO (see Appendix 3).

Source: Department of Foreign Affairs and International Trade website at :

http://www.dfait-maeci.gc.ca/eicb/softwood/chrono-en.asp.

CANADA-U.S. SOFTWOOD LUMBER DISPUTE – CHALLENGES AT THE WTO AND NAFTA

WTO CHALLENGES

Canada has undertaken the following WTO challenges relating to the softwood lumber dispute:

1. *Export restraints* – A WTO panel ruled in favour of Canada on June 29, 2001, regarding the U.S. claim that log export restrictions confer subsidies. The WTO panel ruled that log export controls do not provide a financial contribution, and therefore do not confer countervailable subsidies. The WTO Dispute Settlement Body adopted the panel's final report on August 23, 2001.

2. *Preliminary determination of subsidy* – On November 1, 2002, the WTO Dispute Settlement Body adopted the a WTO panel's final report that the U.S. did not live up to its WTO obligations (erred) in its preliminary determination of subsidy in the countervailing duty investigation.

    - The panel found that the U.S. incorrectly used U.S. benchmark prices in calculating the benefit to lumber producers conferred through Canadian stumpage programs. While the panel found that provincial stumpage programs were a "financial contribution" under the WTO Subsidy Agreement, it also concluded that the U.S. had no basis for determining that stumpage is a countervailable subsidy since the existence of a benefit was unknown.
    - The U.S. wrongly presumed that benefits from harvesting subsidized timber would be passed through in sales from producers of log or lumber inputs to all downstream producers of lumber.
    - The U.S. should not have applied "critical circumstances" measures following a preliminary critical circumstances determination. These measures allow for a limited retroactive imposition of duties if there has been more than a 15% increase in imports during the period examined, and should only be applied with respect to a final determination.

- The U.S. had an unfulfilled obligation to provide expedited reviews. The U.S. is now complying with this direction from the WTO panel and conducting expedited reviews for Canadian producers that have requested one.

The U.S. has decided not to appeal the WTO panel decision on the preliminary determination of subsidy.

3. *Final determination of subsidy* – On October 1, 2002, a WTO panel was established to investigate Canada's claims concerning the final determination of subsidy. The panel process is expected to take 9 to 10 months to complete, so the final report can be expected in July 2003.

4. *Final determination of dumping* – A WTO panel was established on January 8, 2003, to investigate Canada's claim that the U.S. Department of Commerce:

   - Improperly initiated the anti-dumping investigation;
   - Used methods inconsistent with the WTO;
   - Failed to establish an appropriate product scope for investigation.

5. *Final determination of threat of injury* – On December 20, 2002, Canada requested consultations with the U.S. concerning the International Trade Commission's (ITC) final determination of threat of injury in the softwood lumber case. Canada believes there is no basis for the ITC's finding of threat of injury, and that the ITC failed to:

   - Properly apply anti-dumping and countervailing duties;
   - Demonstrate that circumstances would change such that injury was clearly foreseen and imminent;
   - Properly consider all factors relevant to a threat-of-injury finding;
   - Consider the effects of imports on the domestic industry and whether they would injure or threatened to injure; and
   - Include sufficient detail, reasoning and relevant considerations.

OTHER WTO CHALLENGES

The following WTO challenges also indirectly affect the softwood lumber dispute:

1. *The Byrd Amendment* – On September 16, 2002, a WTO panel found that the "Byrd Amendment" (which allows for the redistribution of antidumping and countervailing duties to affected domestic producers) violates the U.S.'s WTO obligations. The panel suggested that the U.S. repeal the Byrd Amendment. The U.S. appealed the panel's decision. On January 16, 2003, the Appellate Body confirmed that the Byrd Amendment violates WTO rules. The U.S. has since indicated that it will comply with the WTO decision against the Byrd Amendment.

2. *Section 129 (c)(1) of the Uruguay Round Agreements Act* – Where the WTO finds that the imposition of duties on foreign companies is inconsistent with WTO rules, this section of the United States' Uruguay Round Agreements Act precludes the U.S. from refunding the duty deposits collected in certain circumstances. The final report on this issue was adopted by the WTO on August 30, 2002. The WTO panel did not address the substantive issue raised by Canada, finding that the U.S. is not required to apply the legislation as indicated by Canada. However, the WTO panel did not rule out the possibility that Section 129(c)(1) could violate WTO rules if applied. Thus, Canada has the option of challenging at the WTO any future application of this legislation by the United States.

NAFTA CHALLENGES

Under Chapter 19 of the NAFTA, binding binational panels can be established to review final determinations in trade remedy cases. These five-person panels examine determinations to assess whether they are consistent with trade laws of the investigating country. Panel rulings must be made within 315 days of the request for review. The following three NAFTA challenges are currently underway:

1. *Final determination of subsidy* – The Government of Canada formally requested a NAFTA panel review of the U.S. final subsidy determination on April 2, 2002. The panel for this review was selected on July 30, 2002. To date, Canada has filed a 31-count complaint and first submissions to the NAFTA panel regarding the final determination of subsidy.

2. *Final determination of injury* – Canada requested a review of the International Trade Commission's final injury determination on May 22, 2002. Canada filed complaints on June 21, 2002.

3. *Final determination of dumping* – The six mandatory respondents in the anti-dumping investigation requested a NAFTA panel review of the dumping determination on April 2, 2002. They have since submitted complaints and first submissions respecting the final dumping determination.

Panel rulings for all three reviews are expected in mid-2003. In addition, three forest companies (Canfor Corporation, Doman Industries and Tembec) have announced that they intend to sue for damages under Chapter 11 of the NAFTA.

Source: Department of Foreign Affairs and International Trade websites:

http://www.dfait-maeci.gc.ca/eicb/softwood/wto_challenges-en.asp;
http://www.dfait-maeci.gc.ca/eicb/softwood/nafta_challenges-en.asp.

Backgrounder

PREVIOUS U.S. INVESTIGATIONS INTO THE CANADIAN WHEAT BOARD

There have been nine U.S.-instigated investigations since 1990, none of which have concluded that any practices of the Canadian Wheat Board (CWB) constitute unfair subsidies or violate international trade agreements.

• In February 2002, the U.S. International Trade Commission (ITC) Section 332 investigation (as part of U.S. Trade Representative's Section 301) examined the Canadian and American wheat sectors and found that Canadian wheat was being sold at prices comparable to U.S. wheat prices in the U.S. market. Canadian durum wheat was found to be priced generally higher than U.S. durum wheat.

• In October 1999, the U.S. Department of Commerce concluded that CWB pricing policies for feed barley to Canadian cattle for export did not constitute a subsidy. The petition had been filed by a U.S. lobby group, R-CALF, in December 1998.

• In October 1998, a U.S. General Accounting Office (GAO) report entitled, *U.S. Agricultural Trade, Canadian Wheat Issues*, found no evidence that Canada or the CWB had violated any international agreement. It noted that the CWB operated like other private-sector grain companies, which are not obligated to reveal their sales prices as this would violate confidentiality agreements with customers.

• In June 1996, a GAO report entitled *The Potential Ability of Agricultural State Trading Enterprises to Distort Trade* reviewed the Canadian Wheat Board, the Australian Wheat Board and the New Zealand Dairy Board, and did not allege that the CWB or Canada violated international trade rules. The GAO also recognized that the CWB was unlikely to cross-subsidize wheat export sales from domestic sales due to the relatively small domestic market. The report had been requested by 18 U.S. congressmen.

• In July 1994, an ITC Section 22 investigation found that some harm to U.S. programs was attributed to imports of Canadian wheat and the U.S. decided to initiate action under the General Agreement on Tariffs and Trade (GATT) Article XXVIII. This GATT action, after a 90-day consultation period, would have allowed the U.S. to impose a tariff rate quota for wheat and barley imports; however, binational discussions led to the Memorandum of Understanding on Wheat, which limited Canadian exports of wheat to 1.5 million tonnes in the 1994-1995 fiscal year.

• In January 1994, an independent auditor found that the CWB complied with its Canada-United States Trade Agreement obligations on durum wheat sales on 102 of 105 contracts in the 43-month period between January 1, 1989, and July 31, 1992. The three violations occurred during the six-month period after January 1, 1989, when the Canada-U.S. Free Trade Agreement (FTA) was being implemented.

• In February 1993, a binational dispute settlement panel agreed with Canada's interpretation of FTA Article 701.3 regarding the definition of "acquisition price" for durum wheat and the costs to be included in determining this price. The panel concluded that the acquisition price includes only the initial payment; or, in the event of an upward adjustment, the acquisition price for goods sold after the adjustment is the initial payment plus such adjustment.

• In June 1992, a GAO report on marketing boards, *Canada and Australia Rely Heavily on Wheat Boards to Market Grain*, failed to find evidence of unfair trade practices as alleged by some U.S. trade officials.

• In June 1990, an ITC Section 332 investigation, Durum Wheat: Conditions of Competition Between the U.S. and Canadian Industries, found that the prices paid for Canadian durum were not significantly different from those paid for U.S. durum. The ITC also found that the subsidized portion of Canadian freight rates, while reflecting a decreased cost to the producer shipping the grain, did not appear to have a significant effect on the delivered price of Canadian durum in the United States. Subsidized freight rates were subsequently eliminated in 1995.

Source: Agriculture and Agri-Food Canada.

SMART BORDER ACTION PLAN

STATUS REPORT

December 6, 2002

In December 2001, Deputy Prime Minister John Manley and Governor Tom Ridge signed the Smart Border Declaration and associated 30-point Action Plan to enhance the security of our shared border while facilitating the legitimate flow of people and goods. The Action Plan has four pillars: the secure flow of people, the secure flow of goods, secure infrastructure, and information sharing and coordination in the enforcement of these objectives.

On September 9, 2002, Prime Minister Chrétien and President Bush met to discuss progress on the Smart Border Action Plan and asked that they be updated regularly on the work being done to modernize our common border. This report is the first update since the meeting of the Prime Minister and the President.

1. BIOMETRIC IDENTIFIERS

Canada and the United States have agreed to develop common standards for the biometrics that we use and have also agreed to adopt interoperable and compatible technology to read these biometrics. In the interest of having cards that could be used across different modes of travel, we have agreed to use cards that are capable of storing multiple biometrics.

Our countries have begun to integrate biometric capabilities into new programs being deployed. For example, the NEXUS-Air pilot program will evaluate iris scanning technology and the new Canadian Permanent Resident Card is biometric-ready.

2. PERMANENT RESIDENT CARDS

Since June 28, 2002, Permanent Resident Cards have been issued to all new immigrants arriving in Canada, replacing the IMM 1000. On October 15, 2002, Canada began processing applications for the Permanent Resident Card, for the purposes of travel, from immigrants with permanent resident status already in Canada. Effective December 31, 2003, the IMM 1000 will no longer be recognized as a document valid for travel.

The Canadian permanent resident card contains features that make it one of the most fraud-resistant documents in the world. The card has been recognized by the International Card Manufacturers Association, winning the Elan Award for Technical Achievement.

3. SINGLE ALTERNATIVE INSPECTION SYSTEM

NEXUS is functional at Sarnia-Port Huron (since November 2000), at Pacific Highway-Blaine and Douglas-Blaine (since June 26, 2002) and Boundary Bay-Point Roberts (since July 29, 2002). NEXUS will be operational at both the Windsor-Detroit and Fort Erie-Buffalo bridges on January 23, 2003, and at the Windsor-Detroit tunnel in March 2003. NEXUS will be expanded to the Queenston-Lewiston Bridge, the Rainbow Bridge and to the Whirlpool Bridge by Spring 2003. NEXUS will also be expanded to all other high-volume crossings between the two countries by the end of 2003. NEXUS enrollment centres opened in Windsor-Detroit and in Fort Erie-Buffalo on October 24, 2002.

Canada and the United States are also working to implement a joint NEXUS - Air program for air travellers. NEXUS - Air will be piloted at Ottawa and Dorval International Airports. Enrollment will begin in April 2003.

4. REFUGEE/ASYLUM PROCESSING

Canada and the United States have made significant progress on a Statement of Mutual Understanding (SMU) which will allow them to more effectively exchange information on immigration-related issues. The two countries are also very close to an agreement which will permit the systematic sharing of information relating to asylum seekers. This will help each country identify potential security and criminality threats and expose "forum shoppers" who seek asylum in both systems. This exchange of information will be in accordance with the privacy laws of both countries.

5. MANAGING OF REFUGEE/ASYLUM CLAIMS

Canada and the United States have signed a Safe Third Country Agreement that allows both countries to manage the flow of individuals seeking to access their respective asylum systems. The Agreement will cover asylum claims made at land border ports of entry.

The Agreement is bound by the principle of family re-unification in determining whether an individual would be exempted from the requirement of making a claim in the first country of arrival. The Agreement also clearly identifies that individuals making a claim in either country would not be removed to another country until a determination of that person’s claim has been made.

Both countries will now finalize the regulatory framework and standard operating procedures necessary to implement this Agreement.

6. VISA POLICY COORDINATION

Canada and the United States have agreed to enhance cooperation between our respective Embassies overseas, which will allow our officials to more routinely and more efficiently share information on intelligence and specific data concerning high-risk individuals. The two countries have also agreed to formally consult one another during the process of reviewing a third country for the purpose of either a visa imposition or visa exemption.

Canada and the United States are also continuing to work together to identify countries that pose security concerns with a view toward further cooperation on visa policy. In February 2002, the United States announced that nationals of Argentina would require a visa to travel to the United States. In September 2002, Canada announced that citizens of Saudi Arabia and Malaysia would require visas to travel to Canada. Canada and the United States currently have common visa policies for 144 countries.

7. AIR PRECLEARANCE

The in-transit preclearance project in Vancouver, suspended as a result of the events of September 11, was re-instated on February 14, 2002.

In support of the preclearance program, the two countries signed "The Agreement on Air Transport Preclearance between The Government of Canada and The Government of the United States of America" on January 18, 2001. It allows for the expansion of in-transit preclearance to other Canadian airports and also has provisions that modernize the regime governing preclearance.

U.S. government agencies are seeking the authority from Congress to offer reciprocal authorities and immunities for Canadian customs and immigration officials in the United States.

8. ADVANCE PASSENGER INFORMATION / PASSENGER NAME RECORD

Canada and the United States have agreed to share Advance Passenger

Information and Passenger Name Records (API/PNR) on high-risk travelers destined to either country. Canada implemented its Passenger Information system (PAXIS) at Canadian airports on October 8, 2002 to collect Advance Passenger Information. The automated Canada-U.S. API/PNR data-sharing program will be in place by Spring 2003.

9. JOINT PASSENGER ANALYSIS UNITS

Canada and the United States have agreed to a co-location of customs and immigration officers in Joint Passenger Analysis Units to more intensively cooperate in identifying potentially high-risk travelers.

Pilot joint passenger analysis units became operational at the Vancouver and Miami international airports on September 30, 2002, staffed with Canadian and U.S. officials.

The pilot sites will be evaluated at the end of six months to determine the feasibility of expanding the units to other locations.

10. MARITIME SECURITY AND FERRY TERMINALS

We have completed a marine benchmark study to enhance Canadian and U.S. border security at seaports aimed at improving security and contraband interception. Agencies have begun to make improvements based on this study.

11. COMPATIBLE IMMIGRATION DATABASES

Canada and the United States have begun discussions towards developing parallel immigration databases to facilitate regular information exchange. The United States is studying the feasibility of duplicating Canadian intelligence gathering software at six pilot sites. Other examples of information exchange include lookouts from our respective databases and automating existing exchanges.

12. IMMIGRATION OFFICERS OVERSEAS

Canada and the United States have begun deploying new immigration officers overseas to deal with document fraud, liaison with airlines and local authorities, and work with other countries to ensure intelligence liaison and to interrupt the flow of illegal migrants to North America.

In the past year, Canada has deployed additional officers for this purpose, bringing to 74 the total number of officers engaged in these areas. In 2002 and 2003, the United States will deploy 85 new temporary officials with 40 new officials being deployed permanently.

Working together, Canada and the United States will continue to strengthen their capacity to ensure the integrity of their immigration programs, to combat document fraud, and to interdict irregular migrants.

13. INTERNATIONAL COOPERATION

Canada and the United States have worked together to provide technical assistance to developing countries to deal with threats to our shared security. These cooperative efforts will continue. Joint interdiction exercises and joint training programs will assist other countries to combat document fraud and irregular migration. Such assistance includes improving document integrity, providing expertise on border controls, and joint training.

In addition, Canada and the United States conducted a joint presentation to the European Community CIREFI (Immigration Center of the Council of the European Union) meeting in June, regarding the immigration items in the Smart Border Action Plan.

14. HARMONIZED COMMERCIAL PROCESSING

Canada and the United States have established a joint program for low-risk companies that will expedite the movement of low-risk shipments in either direction across the border. The program, known as Free and Secure Trade (FAST), will be available at the following high-volume border crossings:

- Douglas, British Columbia / Blaine, Washington (December 31, 2002)
- Sarnia, Ontario / Port Huron, Michigan (December 16, 2002)
- Windsor, Ontario / Detroit, Michigan (December 16, 2002)
- Fort Erie, Ontario / Buffalo, New York (December 16, 2002)
- Queenston, Ontario / Lewiston, New York (December 31, 2002)
- Lacolle, Quebec / Champlain, New York (December 31, 2002)

Canada and the United States are working to align other customs processes for all commercial shipments by 2005.

15. CLEARANCE AWAY FROM THE BORDER

Canada and the United States are developing approaches to move customs and immigration inspection activities away from the border to improve security and relieve congestion where possible.

Canada and the United States have completed a joint analysis of the operational benefits that could be achieved with the implementation of small and large shared facilities located in one country or the other. Both governments continue to explore approaches to the legal challenges that flow from border inspection services of one country operating in the other.

We are considering innovative procedures to improve rail enforcement activities and at the same time facilitate the flow of rail traffic, such as conducting rail enforcement activities before the border and trade compliance processes at the destination.

16. JOINT FACILITIES

Canada and the United States have agreed to consider the following locations for joint or shared facilities pending the outcome of feasibility studies:

- St. Stephen, NB / Calais, ME
- River de Chute, NB / Easton, ME
- Bloomfield, NB / Monticello, ME
- St. Croix, NB / Vanceboro, ME
- Morses Line, QC / Morses Line, VT

- Highwater, QC / North Troy, VT
- Winkler, MB / Walhalla, ND
- Northgate, SK / Northgate, ND
- Snowflake, MB / Hanna, ND
- West Poplar River, SK / Opheim, MT
- Chopaka, BC / Nighthawk, WA
- Rykerts, BC / Porthill, ID

17. CUSTOMS DATA

Canadian and U.S. Customs agencies have extended the scope of information they share through:

- the Cooperation Arrangement for the Exchange of Information for the Purposes of Inquiries Related to Customs Fraud, signed in December 2001; and

- an agreement, reached by our customs agencies, on the principles to be included in the exchange of information related to NAFTA rules of origin. The agreement will be signed in March 2003, and includes audit plans, audit reports, the results of advance rulings, and origin determinations and re-determinations.

18. CONTAINER TARGETING AT SEAPORTS

Through an innovative solution to ensure that containers can be examined where they first arrive, regardless of their ultimate destination in North America, Canadian and U.S. Customs agencies have created joint targeting teams at five marine ports. In the ports of Vancouver, Montreal and Halifax, U.S. officials aid Canadian customs officials in identifying which containers to examine. In the ports of Newark and Seattle-Tacoma, Canadian officials provide the same assistance to U.S. Customs agents. The work of these teams will be facilitated through the electronic transmission of advance manifest data for incoming ships and the containers they carry.

19. INFRASTRUCTURE IMPROVEMENTS

Both governments have committed funds for border infrastructure. Under Canada's new Border Infrastructure Fund, C$600 million will be provided over five years for physical and technological improvements at key border crossings. The United States Transportation Efficiency Act for the 21st Century also funds transportation projects along U.S. corridors and at border points along the Canada-United States border.

New funding will support FAST and NEXUS and facilitate the secure and efficient cross-border movement of people and goods, for example through dedicated lanes for commercial and passenger vehicles at the border between the British Columbia Lower Mainland and Washington state.

Canada and the United States are working together at key border crossings to develop computer simulations aimed at ensuring that border infrastructure investments are put

to the most effective use. The two countries will establish a binational border modeling group to analyze border congestion on an ongoing basis.

20. INTELLIGENT TRANSPORTATION SYSTEMS

Canada and the United States are piloting the Automatic Identification System (AIS) on the St. Lawrence Seaway, which uses transponder and Global Position System (GPS) technologies to allow for more effective monitoring of ships. The Cascade Gateway Advanced Traveler Information System (ATIS) will be installed at the Pacific Highway and Peace Arch crossings to enhance the mobility of people and commercial goods between Canada and the United States. We will also invest in high-energy gamma-ray systems to support joint efforts in screening marine containers arriving at marine ports in both countries.

21. CRITICAL INFRASTRUCTURE PROTECTION

Our governments have agreed on a Joint Framework for Canada-U.S. Cooperation on Critical Infrastructure Protection and have established a Binational Steering Committee to assess threats to our shared critical infrastructure and ensure an ongoing, high-level focus on the issue by both governments. The Committee has developed detailed workplans for collaboration in the areas of energy, telecommunications and transportation, and has established working groups to address horizontal issues such as research and development, interdependencies, mapping and threat information sharing. The next meeting of the Steering Committee will be held in early 2003.

22. AVIATION SECURITY

We have agreed to recognize each other's national standards for security in airports and on board flights, and to coordinate measures that are essential to protecting our citizens. With the creation of the new federal transportation security agencies and the augmentation of existing departments, the two governments have strengthened their respective capacities to set regulations, review standards, and monitor and inspect all air security services. The two governments have also assumed direct responsibility for security standards, and will work to identify best practices with a view to improving them.

23. INTEGRATED BORDER AND MARINE ENFORCEMENT TEAMS

Canada and the United States have identified 14 geographical areas for the deployment or enhancement of Integrated Border Enforcement Teams (IBETS). IBETs are currently operational in 10 of the 14 geographic areas, and will be operational in all 14 geographical areas by December 2003. IBETs will focus on criminals and terrorists that may attempt to cross the Canada-United States border.

The two countries have also begun comprehensive training programs for IBET personnel, from both Canada and the United States, to enhance their awareness and understanding of one another's laws and regulations. Two joint training sessions have

been held with additional sessions planned in the near future. These initial training sessions will form the foundation of a long-term integrated training plan.

24. JOINT ENFORCEMENT COORDINATION

The latest Canada-United States Cross-Border Crime Forum (CBCF) took place on July 21-22, 2002. The participants at the CBCF reiterated the importance of the role of Project Northstar. Since becoming formally aligned with the CBCF in early 2001, the role of Project Northstar as a mechanism for joint law enforcement coordination has been significantly enhanced. Project Northstar will have a border-wide meeting in Winnipeg in April 2003.

Project North Star will continue to:

- identify and prioritize joint obstacles for law enforcement at the border;
- bring these obstacles to policy makers at the Canada-United States Cross-Border Crime Forum for resolution; and
- work to increase and establish new, joint representation of the American and Canadian law enforcement community at the binational, regional, and local levels.

Planning is currently underway for the next Cross-Border Crime Forum, which will be hosted by the United States, in late Spring 2003.

25. INTEGRATED INTELLIGENCE

The Government of Canada has established Integrated National Security Enforcement Teams (INSETs), which will include representatives from federal enforcement and intelligence agencies, as well as international law enforcement partners such as the U.S., on a case-by-case basis. Canada has also been participating since April 9, 2002, in the U.S. Foreign Terrorist Tracking Task Force (FTTTF) in Washington, to detect, interdict, and remove foreign terrorist threats.

26. FINGERPRINTS

With the development of a Memorandum of Cooperation, the RCMP and the FBI will implement an electronic system for the exchange of criminal records information, including fingerprints, using a standard communication interface.

27. REMOVAL OF DEPORTEES

Canada and the United States are continuing cooperation in removing individuals to source countries. To date, Canada and the United States have conducted 5 joint operations resulting in 313 removals.

28. COUNTER-TERRORISM LEGISLATION

President Bush signed anti-terrorism legislation on October 26, 2001. In Canada, the *Anti-Terrorism Act* came into force on December 24, 2001.

29. FREEZING OF TERRORIST ASSETS

Canada and the United States have a working process in place to share advance information on individuals and organizations that may be designated as terrorist in order to coordinate the freezing of their assets. To date, Canada and the United States have designated or listed over 360 individuals and organizations.

30. JOINT TRAINING AND EXERCISES

Canada and the United States have been conducting a series of counter-terrorism exercises of increasing complexity that will culminate in the full-scale TOPOFF II exercise in May 2003. TOPOFF II will include a wide range of participants, from first responders to senior government leaders at the local, state/province, and federal levels and ask them to respond to multiple terrorist attacks within the United States which have cross-border implications. This exercise will provide the foundation for an ongoing program of joint training activities.

Associations

Agricultural Producers Association of Saskatchewan

- Mr. Dave Brown, Vice-President

February 21, 2003

Agriculture and Agri-Food Canada

- Mr. Rory McAlpine, Acting Director General, International Trade Policy
- Mr. Ian Thomson, Acting Director, Western Hemisphere Trade Policy Division

February 5, 2003

Alberta Canola Producers Commission

- Mr. Kenton Ziegler, Chair
- Mr. Ward W. Toma, General Manager

February 19, 2003

Asia-Pacific Foundation of Canada

- Mr. John Wiebe, President and Chief Executive Officer

March 26, 2003

British Columbia Lumber Trade Council

- Mr. John Allan, President

February 17, 2003

Canadian Agri-Food Trade Alliance

- Mr. Ted Menzies, President
- Ms. Patty Townsend, Executive Director

February 5, 2003

Canadian / American Border Trade Alliance

- Mr. Jim Phillips, President and Chief Executive Officer

March 18, 2003

Canadian Association of Petroleum Producers

- Mr. Pierre Alvarez, President

February 19, 2003

Canadian Cattlemen's Association

- Mr. Dennis Laycraft, Executive Vice President

February 19, 2003

Canadian Centre for Policy Alternatives

- Mr. Bruce Campbell, Executive Director

March 26, 2003

Canadian Chamber of Commerce

- Mr. Bob Keyes, Vice-President, International
- Mr. Alexander Lofthouse, Policy Analyst

February 12, 2003

APPENDIX V
LIST OF WITNESSES

Canadian Chemical Producers' Association

- Mr. Richard Paton, President;
- Mr. David W. Goffin, Secretary-Treasurer and Vice-President, Business and Economics

April 1, 2003

Canadian Council of Chief Executive Officers

- Mr. Thomas d'Aquino, President and Chief Executive Officer
- Mr. George Haynal, Senior Vice-President
- Mr. Sam T. Boutziouvis, Vice President, Policy and Senior Economic Advisor

February 12, 2003

Canadian Energy Research Institute

- Dr. J. Philip Prince, President
- Mr. Peter L. Miles, Senior Vice-President, Research

February 19, 2003

Canadian Federation of Agriculture

- Mr. Robert Friesen, President
- Mr. Marvin Shauf, Second Vice-President
- Ms. Jennifer Higginson, Policy Analyst

February 5, 2003

Canadian Food Inspection Agency

- Mr. Paul Haddow, Executive Director, International Affairs

February 5, 2003

Canadian Manufacturers and Exporters

- The Honourable Perrin Beatty, President and Chief Executive Officer

April 1, 2003

Canadian Trucking Alliance

- Mr. David H. Bradley, President and Chief Executive Officer
- Ms. Elly Meister, Vice President, Public Affairs

April 9, 2003

Canadian Vehicle Manufacturers' Association

- Mr. David C. Adams, Vice-President, Policy

April 1, 2003

Canadian Wheat Board

- The Honourable Ralph Goodale, P.C., M.P., Minister of Public Works and Government Services and Minister responsible for the Canadian Wheat Board

May 14, 2003

- Mr. Ian McCreary, Director
- Mr. Victor Jarjour, Vice-President
- Ms. Alexandra Lamont, Policy Advisor

February 21, 2003

Canfor Corporation

- Mr. Kenneth O. Higginbotham, Vice-President, Forestry and Environment

February 18, 2003

Centre for Trade Policy and Law

- Mr. William A. Dymond, Executive Director

February 3, 2003

Communications, Energy and Paperworkers Union of Canada

- Mr. Fred Wilson, National Representative

February 11, 2003

Department of Citizenship and Immigration

- Mr. Daniel Jean, Acting Assistant Deputy Minister, Policy and Program Development

April 9, 2003

Department of Foreign Affairs and International Trade

- The Honourable Pierre Pettigrew, P.C., M.P., Minister of International Trade

February 3, 2003

- Mr. Marc Lortie, Assistant Deputy Minister (Americas)

April 8, 2003

- Mr. Doug Waddell, Assistant Deputy Minister, Trade, Economic and Environmental Policy

March 19, 2003

- Carlos Rojas-Arbulú, Trade Commissioner, Mexico Division

April 8, 2003

- Mr. Claude Carrière, Director General, Trade Policy Bureau

February 3, 2003
March 25, 2003

Department of Foreign Affairs and International Trade

(continued)

- Ms. Elaine Feldman, Director General, Export and Import Controls Bureau

  March 19, 2003

- Ms. Suzanne Vinet, Director General, Trade Policy II, Services, Investment and Intellectual Property Bureau

  March 25, 2003

- Mr. Bruce Levy, Director, Transborder Relations with the United States

  February 3, 2003

- Mr. Claudio Vallé, Director, Technical Barriers and Regulations

  April 8, 2003

- Mr. Graeme C. Clark, Acting Director, Mexico Division

  April 8, 2003

- Mr. Matthew Kronby, Counsel, Deputy Director, Trade Law

  March 25, 2003

Doman Industries Limited

- Mr. Bob Flitton, Manager, Real Estate and Governmental Affairs

  February 17, 2003

Embassy of Mexico in Ottawa

- H.E. Maria Theresa Garcia S. de Madero, Ambassador of Mexico to Canada

  April 8, 2003 &
  May 5, 2003

- Ms. Cecilia Jaber, Deputy Head of Mission

  May 5, 2003

- Mr. Carlos Pinera, Representative of the Mexican Secretariat of the Economy in Canada

  April 8, 2003

- Mr. Fernando Espinosa, Economic Attaché

  April 8, 2003

Fisheries Council of Canada

- Mr. Ronald W. Bulmer, President

  March 18, 2003

Forest Products Association of Canada

- Mr. Avrim Lazar, President

  February 11, 2003

Fraser Institute

- Mr. Fred McMahon, Director, Centre for Globalization Studies

  February 18, 2003

Free Trade Lumber Council

- Mr. Frank Dottori, Co-President
- Mr. Carl Grenier, Senior Vice-President

February 11, 2003

Government of Mexico

- The Honourable Luis Ernesto Derbez Bautista, Secretary of Foreign Affairs
- Mr. Geronimo Gutiérrez, Undersecretary of Foreign Affairs

May 5, 2003

Independent Lumber Remanufacturers Association

- Mr. Russ Cameron, President

February 18, 2003

Industrial, Wood & Allied Workers of Canada

- Mr. Kim Pollock, National Director, Public Policy and Environment

February 17, 2003

Maritime Lumber Bureau

- Ms. Diana Blenkhorn, President and Chief Executive Officer

February 11, 2003

National Farmers Union

- Mr. Darrin Qualman, Executive Director

February 21, 2003

Nova Scotia Fish Packers

- Mr. Denny Morrow, Executive Director

March 18, 2003

United Steelworkers of America

- Mr. Dennis Deveau, Government Liaison, Legislative Department

April 1, 2003

Western Barley Growers Association

- Mr. Douglas McBain, President

February 19, 2003

Weyerhaeuser

- Mr. David A. Larsen, Vice President, Government and Public Affairs

February 17, 2003

Wild Rose Agricultural Producers

- Mr. Brent McBean, Director

February 19, 2003

Individuals

Professor Don Barry

International Relations
University of Calgary

February 20, 2003

Mr. Anthony Campbell

Consultant

March 18, 2003

Mr. Peter Clark

Partner
Grey, Clark, Shih and Associates, Ltd.

February 3, 2003

Professor Theodore Cohn

Department of Political Science
Simon Fraser University

February 18, 2003

Professor Gilbert Gagné

Department of Political Studies
Bishop University

February 3, 2003

Mr. Billy Garton

Partner
Bull, Housser & Tupper

February 17, 2003

Mr. Charles Gastle

Partner, Shibley Righton

February 11, 2003

Professor Richard Harris

Economics Department
Simon Fraser University

February 17, 2003

Professor John Helliwell

Department of Economics
University of British Columbia

February 18, 2003

Mr. Lawrence L. Herman

Counsel
Cassels, Brock & Blackwell LLP

February 4, 2003

Mr. Jon Johnson

Partner
Goodmans LLP

February 4, 2003

Professor Laura Macdonald

Associate Professor and Director, Centre for North American Politics and Society
Carleton University

April 8, 2003

APPENDIX V
LIST OF WITNESSES

The Honourable Roy MacLaren

Former Minister for International Trade

February 4, 2003

Professor George MacLean

Political Studies
University of Manitoba

February 21, 2003

Ms. Kathleen Macmillan

President, International Trade Policy Consultants

February 3, 2003

Professor Donald McRae

Business and Trade Law
University of Ottawa

February 3, 2003

Professor Armand de Mestral

Faculty of Law
McGill University

February 27, 2003

Professor Rolf Mirus

Director, Centre for Economic Research, School of Business
University of Alberta

February 20, 2003

Mr. Tim O'Neill

Executive Vice-President and Chief Economist
BMO Financial Group

March 26, 2003

Professor Richard Ouellet

Assistant Professor, Faculty of Law
Laval University

February 27, 2003

Mr. Les Reed

Forest Policy Consultant

February 17, 2003

Mr. Steven Shrybman

Lawyer
Sack Goldblatt Mitchell

February 27, 2003

Mr. David Usherwood

February 19, 2003

Fact Finding Mission
Washington, D.C., April 28 – May 1st, 2003

American Consumers for Affordable Homes

- Ms. Susan E. Petrunias
- Mr. Bruce H. Hahn, President, American Homeowners Foundation
- Mr. Kent Knutson, Vice President, Governmental Relations, Home Depot
- Mr. Jonathan Gold, Vice President, International Trade Policy, International Mass Retail Association
- Mr. Michael S. Carliner, Staff Vice President, Economics, National Association of Home Builders
- Mr. Jason M. Lynn, Legislative Director, National Association of Home Builders
- Mr. Michael Strauss, Legislative Communications Director, National Association of Home Builders
- Ms. Pamela J. Slater, Legislative Representative, Consumers for World Trade
- Mr. Donald Ferguson, Geduldig and Ferguson
- Mr. Gary Horlick, Wilmer, Cutler and Pickering

May 1st, 2003

American Enterprise Institute for Public Policy Research

- Mr. John C. Fortier, Ph.D., Research Associate

April 29, 2003

Americans for Better Borders Coalition

- Ms. Theresa Cardinal Brown, Coalition Co-Chair
- Mr. John Murphy, Vice-President, U.S. Chamber of Commerce

April 30, 2003

Canadian Embassy in the United States of America

- Ambassador Michael F. Kergin, Ambassador of Canada to the United States of America
- Mr. Bertin Côté, Minister (Economic) and Deputy Head of Mission
- Mr. Peter Boehm, Minister (Political)
- Mr. William R. Crosbie, Minister-Counsellor (Economic and Trade Policy)

April 29-30, 2003
May 1, 2003

Canadian Embassy in the United States of America

(continued)

- Mr. Ariel N. Delouya, Minister-Counsellor (Congressional and Legal Affairs)
- Mr. Terry R. Colli, Director, Public Affairs
- Mr. Alan H. Minz, Counsellor (Trade Policy)
- Mr. Christopher A. Shapardanov, Counsellor (Political Affairs)
- Ms. Birgit Matthiesen, Economic and Trade Policy Division
- Ms. Catherine Vézina, Multilateral Affairs

April 29-30, 2003

May 1, 2003

Congressional Research Service

- Mr. Ian F. Ferguson, Analyst in International Trade and Finance

April 29, 2003

Embassy of the United States of America, Ottawa

- His Excellency Paul Cellucci, Ambassador of the United States of America to Canada
- Mr. Michael Gallagher, Minister-Counsellor for Economic Affairs

Ottawa, April 28, 2003

Murphy Frazer & Selfridge

- Mr. Paul Frazer

April 29, 2003

Northern Border Caucus

- Congressman Earl Pomeroy (D-ND), Co-Chair
- Mr. Michael Morrow, Senior Staff Assistant, Trade Subcommittee, Ways and Means Committee
- Ms. Juliet A. Bender, LEGIS Fellow, Trade Subcommittee, Ways and Means Committee
- Mr. Jasper MacSlarrow, Senior Legislative Assistant, Congressman Rick Larsen
- Mr. Beau Schuyler, Senior Legislative Assistant, Congressman John Turner
- Mr. Darin T. Beffa, Legislative Assistant, Congressman George R. Nethercutt Jr.
- Ms. Lori Mrowka, Legislative Assistant, Congressman Bart Stupak
- Ms. Andrea Salinas, Legislative Assistant, Congressman Fortney H. (Pete) Stark

May 1st, 2003

Office of the United States Trade Representative

- Mr. John M. Melle, Deputy Assistant U.S. Trade Representative for North America
- Ms. Sharon Bomer Lauritsen, Deputy Assistant U.S. Trade Representative for Agricultural Affairs
- Ms. E. Sage Chandler, Director for Canadian Affairs

April 29, 2003

Permanent Mission of Canada to the Organisation of American States

- Ms. Gwyneth Kutz, Counsellor and Alternate Representative of Canada to the Organization of American States

May 1st, 2003

Senate Committee on Governmental Affairs

- Senator Susan M. Collins (R-ME), Chair
- Mr. Rob Owen, Counsel, Senator Susan M. Collins
- Ms. Jane Alonso, Legislative Assistant, Senator Susan M. Collins

April 30, 2003

Senate Subcommittee on International Trade

- Senator Craig Thomas (R-WY), Chairman
- Mr. Bryn N. Stewart, General Counsel, Senator Craig Thomas

April 29, 2003

United States Department of Commerce

- Mr. William Henry Lash III, Assistant Secretary of Commerce for Market Access and Compliance
- Mr. Andrew I. Rudman, Acting Director, Office of NAFTA and Inter-American Affairs
- Ms. Geri C. Word, NAFTA Compliance Team Leader
- Mr. Carlos Busquets, Canada Desk Officer
- Mr. Pierce Scranton, Special Assistant

May 1st, 2003

United States House of Representatives

- Congressman Amo Houghton (R- Corning)
- Mr. Bob Van Wicklin, Legislative Director, Congressman Amo Houghton

April 29, 2003

APPENDIX V
LIST OF WITNESSES

University of Maryland

- Professor Peter Morici, Professor of International Business, Robert H. Smith School of Business

April 29, 2003