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## **NAFTA – Canada's Approach**

### *Relations and Disputes*

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## **Prohlášení / Declaration**

Prohlašuji, že diplomovou práci na téma “NAFTA – Canada’s Approach: Relations and Disputes” jsem vypracovala samostatně. Použitou literaturu a podkladové materiály uvádím v příloženém seznamu literatury.

V Praze dne .....

I hereby declare that I wrote this diploma thesis “NAFTA – Canada’s Approach: Relations and Disputes” solely by myself. All used literature and background material is stated in the attached list of sources.

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## Introduction

In August 2005, during my stay in Canada, discussions around Canada's relationship with the United States, Canada's role within the North American Free Trade Agreement (NAFTA), and debates over NAFTA as an institution itself were taking place. Everywhere – in newspapers and magazines, on televisions, and among the people themselves – NAFTA was the hot summer topic. Many Canadians claimed that NAFTA does not guarantee Canada what was promised in the Agreement that the United States behaves according to the NAFTA obligations only when it is convenient for them and that the trilateral NAFTA partnership, as former Canadian Prime Minister Pierre Trudeau once memorably said, is like a relationship between two mice and an elephant. “When the elephant rolls over, the mouse gets squashed.”<sup>1</sup>

These angry claims and allegations rose as a reaction to the announcement of the United States that it would ignore an ultimate NAFTA Tribunal ruling that decided in favor of Canada in the matter of a softwood lumber dispute. Experiencing such a hostile tone between the two countries, seeing that even within diplomacy there were tensions, was very interesting for me, and due to this I began to study NAFTA more in detail. When deciding about my thesis topic, it was not so difficult to find an economic topic linking with my specializations that I would like to analyze further.

In my thesis I concentrated on Canada and its role within the Agreement. The main question that I will discuss in my thesis is: **What is Canada's approach toward NAFTA?** To answer this question, it is necessary to examine not only the impact of NAFTA on Canada, but also its impact on the other two economies, as well as the approaches of all three member countries toward the Agreement and their partnerships with each other. The intensity of NAFTA is shown by relations between the member countries, especially trade relations. The effectiveness of the Agreement is demonstrated by disputes and their settlements between the countries. Dispute settlements are one of the main factors that can influence public view on NAFTA, and the public view very much dictates to the country's governments the approaches toward the Agreement.

The sub-questions that will help to answer my main thesis question are: **What is NAFTA's impact on Canada? What are the relations between the NAFTA countries? What are the disputes between the NAFTA countries? How do the relations and disputes affect the public view on NAFTA?**

The main objective of my thesis is to provide sufficient and unbiased information that explains NAFTA and its influence on the member economies, its influence on NAFTA trade and

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<sup>1</sup> Pat Binns, Premier of Prince Edward Island, Canada (August 2005)

investment, and its effect on changing relations between the member countries. This objective is supported by the sub-questions, which formulate the framework of my thesis.

The thesis is divided into four main sections. The first section analyzes NAFTA, its structure, advantages and disadvantages of the Agreement's implementation, including the trade increase within the North American zone. This section also looks closely on the NAFTA's text, specifically on the Chapters that explain the dispute settlement procedure. The second section studies Canada's approach toward NAFTA – it discusses what were Canada's objectives during the NAFTA negotiations, and whether they have been fulfilled after NAFTA's implementation, and the impact of the implementation on Canada's economy, unemployment and trade disputes. The third section is the core of my thesis; it studies the relations and disputes between the three member countries. And finally, the fourth section describes the public opinions on NAFTA, showing the approaches of all citizens of each member country toward NAFTA, and then specifically the view of Canadians toward the Agreement. This last section will demonstrate how the softwood lumber dispute affected Canada's view on NAFTA, and perhaps Canada's approach toward NAFTA as well.

My thesis studies in detail three disputes. The first dispute is the never-ending and much discussed Canada-US dispute over softwood lumber that was the initial reason that made me interested in this topic. The second dispute is the first claim ever filed under NAFTA, the US-Mexico dispute *Metalclad vs. Mexico*, in which also Canada played an important role. And the third dispute is the Mexico-Canada disagreement over steel. Before these disputes are described in detail, the relations between the economies are discussed. This section therefore illustrates the intensity and the effectiveness of NAFTA within the three countries.

Most of my sources regarding these disputes are newspaper articles and the internet. I have been searching on both sides of the dispute parties, in order to avoid bias interpretations. To prevent partial or subjective information, I have been searching mostly through government and NAFTA sources. However it has not always been easy to find all sufficient information – neither the NAFTA nor the government institutions are obliged to officially inform public on the processes and results of the dispute settlements. Especially the Mexico-Canada steel dispute, in which the United States did not take a part, had a very limited number of sources.

Regarding the economic and trade figures, most of the figures come from Canada's government resources, generally from the Foreign Affairs and International Trade Canada. I have also frequently used information from the US State Departments. The Mexican sources tend to be in Spanish only, and are also not very clear and reliable so for this reason, most of my economic, trade and investment information comes from Canadian and American sources. Although most of the

information and figures corresponded to each other, there have been few indicators where Canadian and American resources differed quite notably. In such cases, for the reason of analyzing Canada's approach, I relied on Canada's resources.

The public opinion information described in the last chapter was gathered from two main sources – from the WorldPublicOpinion.org that consists of recent polls from Ipsos-Reid, CCFR, Gallup, National Opinion Research Center, NBC/Wall Street Journal, Greenberg Research, Time/CNN, EPIC-MRA, ABC/Washington Post, etc., and from Compas Inc. from August 2005 that focused on Canada's public view on NAFTA connected to US actions in the softwood lumber dispute.

NAFTA has been implemented twelve years ago and in two years it will conclude. My thesis, NAFTA – Canada's approach: Relations and Disputes, will analyze how did the Agreement intensify and affect the trilateral partnership. It will also analyze how did NAFTA intensify Canada's relations within the North American free trade zone, and how did it affect Canada itself. It will try to find out whether the elephant is rolling over the mouse, or whether it has its foot on the mouse's tail. And what happened to the other mouse.



# 1 NAFTA

In August 1992, Canada, Mexico and the United States announced the conclusion of the North American Free Trade Agreement (NAFTA). It was the first time that a trade agreement was reached between a developing country (Mexico) and two rich industrial economies (Canada, United States). The implementation of NAFTA, creating the world's largest free trade area, came into effect on January 1, 1994, following formal ratification by the legislatures of the three signatory countries. NAFTA is a further expansion of the earlier Canada-US Free Trade Agreement (CUSFTA) from 1989 that was suspended due to NAFTA. NAFTA is designed to remove barriers to trade and investment between Canada, Mexico and the United States over fourteen years; it will conclude on January 1, 2008. The Agreement is a treaty under international law.

## 1.1 NAFTA Structure

NAFTA is a complex network composed of a central institution of cabinet-level representatives, trilateral secretariats, and lower-level committees, subcommittees, advisory committees and working groups.



Source: United States General Accounting Office

NAFTA has three official languages – English, French and Spanish. In French, NAFTA is known as ALENA (Accord de libre-échange nord américain). In Spanish NAFTA is TLC (Tratado de libre comercio) or TLCAN (Tratado de libre comercio de américa del norte).<sup>[01]</sup>

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<sup>[01]</sup> Topulos, NAFTA.

### **1.1.1 Free Trade Commission**

The NAFTA's central institution and governing body is the Free Trade Commission (FTC). It is composed of cabinet-level representatives that are required to meet at least once a year, in locations rotating among the three countries. Canada's FTC representative is the Minister of Trade, the United States is represented by the US Trade Representative, and Mexico's representative is the Secretary of Trade and Industrial Development.

The FTC is in charge of fulfilling NAFTA's objectives. FTC's responsibilities include:

- supervising the implementation of NAFTA
- resolving disputes that can occur regarding NAFTA's interpretation or application
- supervising the work of the NAFTA Secretariat and NAFTA committees and working groups
- establishing additional committees and working groups as needed.

### **1.1.2 Secretariat**

The second main institutional body of NAFTA is the Secretariat. The Secretariat is an independent agency accountable to the NAFTA Free Trade Commission with its own separate responsibilities. The NAFTA Secretariat is composed of three national sections. The national sections originated already in CUSFTA to administer binational procedures for panel reviews. In NAFTA, dispute resolution provisions were extended to Mexico and a section for Mexico was added. The NAFTA Secretariat has three primary functions – to support the FTC and any working groups or committees established by it, to act as the administrative assistant for NAFTA's dispute settlement panels and related committees, and to act in a limited capacity as a depository for any investment-related disputes. More specifically, the NAFTA Secretariat administers the NAFTA dispute resolution processes under NAFTA's Chapters Fourteen, Nineteen and Twenty and has certain responsibilities related to NAFTA's Chapter Eleven dispute settlement provisions. <sup>[02]</sup>

### **1.1.3 Working Groups and Committees**

Since NAFTA's implementation, over thirty working groups, committees, subcommittees, and advisory committees have been formed to facilitate trade and investment and to ensure the effective enforcement and administration of NAFTA. Most of the working groups and committees were specified in various chapters of NAFTA, while several other were created by FTC at its first official meeting in January 1994. The purpose of these groups and committees is to provide a

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<sup>[02]</sup> Foreign Affairs and International Trade Canada

channel for discussion of issues of ongoing concerns to the NAFTA countries. The key areas in which the groups and committees work include trade in goods, rules of origin, customs, agricultural trade and subsidies, standards, government procurement, investment and services, cross-border movement of business people and alternative dispute resolution. <sup>[02]</sup> The groups are generally comprised of government experts.

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<sup>[02]</sup> Foreign Affairs and International Trade Canada

## 1.2 NAFTA Opponents and Supporters

The NAFTA promoters promised that NAFTA would create hundreds of thousands of new high-wage jobs, raise standards of living in the three economies, improve environmental conditions, and transform Mexico from a poor developing country into a booming new market. On the contrary, the NAFTA opponents argued that the treaty would launch a “race-to-the-bottom in wages”, destroy hundreds of thousands of jobs, undermine democratic control of domestic policy-making, and threaten health, environmental and food safety standards. <sup>[03]</sup>

### 1.2.1 NAFTA Opponents

The creation of NAFTA was not supported by everyone. Labor, environmental and consumer groups, among many other, saw the agreement as controversial. Canadian and American labor unions opposed NAFTA, arguing that jobs in their countries would move to Mexico because of Mexican lower labor costs. The critics also claimed that this job and industry migration to “pollution havens” in Mexico would accelerate deterioration of the Mexican environment, and force all three countries to the lowest common denominator of environmental protection. <sup>[04]</sup> Mexican opponents of NAFTA were mainly represented by local farmers, who alleged the heavy US subsidies in agriculture for American farmers, causing a great deal of downward pressure on Mexican agricultural prices, and forcing many Mexican farmers to close their business. NAFTA detractors also claimed that the agreement would benefit powerful corporations at the expense of workers, giving rise to both economic and human rights issues.

Based on these complaints, the Agreement was complemented during the NAFTA negotiations by two side agreements considering the two major problematic issues – labor and the environment. They extend into cooperative efforts to reconcile policies and procedures for dispute resolution between the member states. These side agreements complementing NAFTA are the North American Agreement on Labor Cooperation (NAALC) and the North American Agreement for Environmental Cooperation (NAAEC).

#### 1.2.1.1 NAALC and NAAEC

The NAALC supplement to NAFTA aimed to create a foundation for cooperation between Canada, Mexico and the United States, for resolving labor problems, and for promoting greater cooperation between trade unions and social organizations, in order to improve labor conditions.

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<sup>[03]</sup> Public Citizen

<sup>[04]</sup> Murray, NAFTA and the Environment.

“Though most economists agree that it is difficult to assess the direct impact of the NAALC, it is agreed that there has been a convergence of labor standards in North America. Given its limitations, however, NAALC has not produced (and in fact was not intended to achieve) convergence in employment, productivity and salary trend in North America.”<sup>[05]</sup>

The NAAEC supplement to NAFTA was a response to concerns of environmentalists regarding companies’ relocation to Mexico, or the possible reduction of US standards, if the three countries did not achieve an unanimous regulation on the environment. The NAAEC, in order to be more than a set of environmental regulations, established mechanisms for addressing trade and environmental issues, and for assisting and financing investments in reduction of pollution. By complementing NAFTA with the NAAEC, the treaty was labeled as the “greenest” trade agreement.<sup>[05]</sup>

### **1.2.2 NAFTA Supporters**

NAFTA did find many supporters as well. Multinational and transnational corporations had tendencies to support NAFTA in the belief that lower tariffs could increase their profits. NAFTA supporters also argued that trade liberalization would create substantial gains from increased trade due to comparative advantages and pointed out that the elimination of tariff and non-tariff barriers between the three economies would benefit the consumers as well as the producers. From the American and Canadian governments’ point of view, the creation of NAFTA was an opportunity to respond to the growing threat of the European Union trading block. From the Mexican government’s point of view, NAFTA was a way to secure future foreign investment.<sup>[06]</sup>

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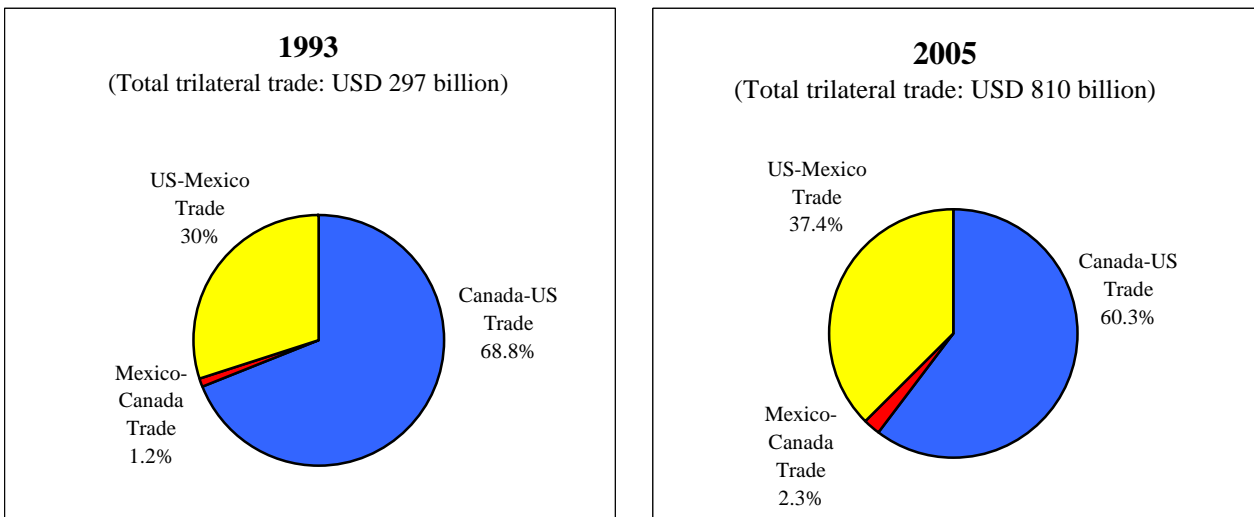
<sup>[05]</sup> Wikipedia, the free encyclopedia

<sup>[06]</sup> American Friends Service Committee

### 1.3 NAFTA's Trade

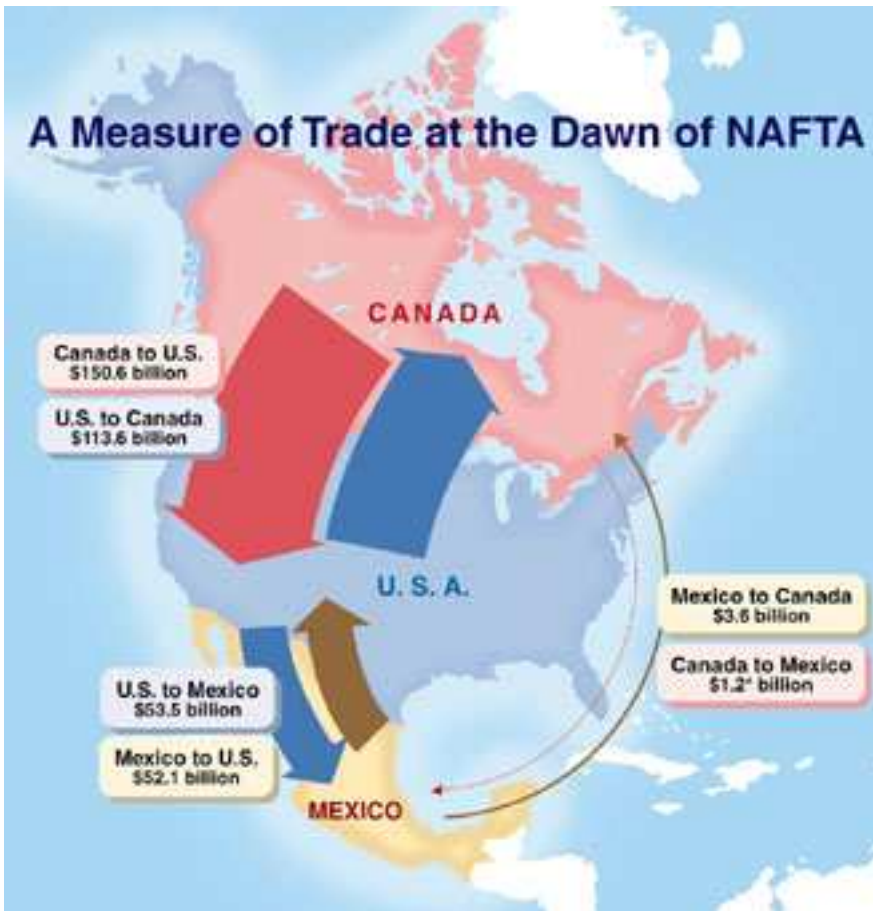
NAFTA's trade within its member countries has increased radically since the Agreement's implementation, surpassing the most optimistic predictions of free trade supporters. However, the world has changed dramatically since NAFTA was first signed, therefore not all the positive figures can be attributed to the Agreement. Nevertheless, from 1993 to 2005, trade among the NAFTA economies increased by 173%, from USD 297 billion to USD 810 billion. Each day, the three North American partners conduct about USD 2.2 billion in trilateral trade. Between 1993 and 2005, Canadian exports to NAFTA partners increased by about 144%, while United States' exports to NAFTA partners increased by 119%, and Mexican exports to the US and Canada grew by about 300%. Total direct investment by the three NAFTA countries in each other has also more than doubled in value, thus further integrating the continental economy. <sup>[07]</sup>

#### Trade between NAFTA Partners



Source: The NAFTA Office of Mexico in Canada

<sup>[07]</sup> Canadian Intergovernmental Conference Secretariat



Source: Canadian Geographic Magazine

## 1.4 NAFTA Text

The North American Free Trade Agreement and its accompanying tariff schedule consist of over 2000 pages. It is divided into eight parts. Each Part is divided into chapters.

<b>Preamble</b>	
<b>Part One: General Part</b>	
Chapter One	Objectives
Chapter Two	General Definitions
<b>Part Two: Trade in Goods</b>	
Chapter Three	National Treatment and Market Access for Goods
Chapter Four	Rules of Origin
Chapter Five	Customs Procedures
Chapter Six	Energy and Basic Petrochemicals
Chapter Seven	Agriculture and Sanitary and Phytosanitary Measures
Chapter Eight	Emergency Action: Safeguards
<b>Part Three: Technical Barriers to Trade</b>	
Chapter Nine	Standards-Related Measures
<b>Part Four: Government Procurement</b>	
Chapter Ten	Government Procurement
<b>Part Five: Investment, Services and Related Matters</b>	
Chapter Eleven	Investment
Chapter Twelve	Cross-Border Trade in Services
Chapter Thirteen	Telecommunications
Chapter Fourteen	Financial Services
Chapter Fifteen	Competition Policy, Monopolies and State Enterprises
Chapter Sixteen	Temporary Entry of Business Persons
<b>Part Six</b>	
Chapter Seventeen	Intellectual Property
<b>Part Seven: Administrative and Institutional Provisions</b>	
Chapter Eighteen	Publication, Notification and Administration of Laws
Chapter Nineteen	Review and Dispute Settlement in Anti-dumping
Chapter Twenty	Institutional Arrangements and Dispute Settlement Procedures
<b>Part Eight: Other Provisions</b>	
Chapter Twenty-One	Exceptions
Chapter Twenty-Two	Final Provisions

An even more detailed NAFTA text can be found in Appendix 2.



The Preamble records the political commitment of the three governments in entering into the Agreement. Part One establishes the objectives and the scope of the Agreement and other general provisions applicable to the Agreement as a whole. Part Two sets out the rules for trade in goods, including rules of origin, national treatment, general market access conditions and safeguards. It also includes special provisions in trade in agricultural, energy, textile, clothing and automotive products. Part Three deals with technical barriers to trade. Part Four sets out the disciplines on government procurement. Part Five addresses the conduct of business and deals with cross-border trade in services, investment, financial services, rules of competition and temporary entry. Part Six addresses intellectual property protection. Part Seven contains the institutional, dispute settlement and transparency provisions of the Agreement. And finally, Part Eight covers the final provisions dealing with annexes, entry into force, accession and duration.<sup>[08]</sup>

#### **1.4.1 NAFTA's Objectives**

The objectives of NAFTA stated in the Agreement's Chapter One are to:

- eliminate customs barriers and facilitate cross-border trade in goods and services
- promote conditions of fair competition in the free trade zone
- substantially increase investment opportunities in the member countries
- provide adequate and effective protection and enforcement of intellectual property rights in each member country
- adopt efficient implementation, joint administration and dispute settlement procedures
- improve trilateral cooperation to extend the benefits of the agreement.

#### **1.4.2 Dispute Settlement under NAFTA**

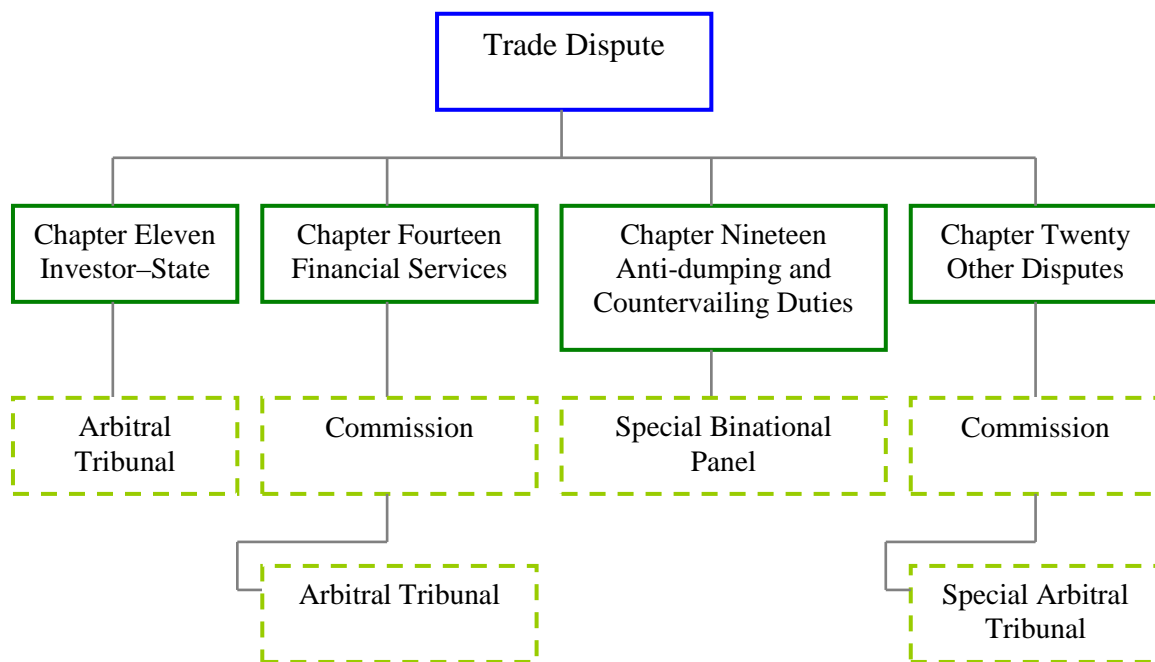
The liberalization of trade in North America in the past years naturally caused the rise of trade disputes. For this purpose, NAFTA created a trade dispute settlement mechanism. NAFTA contains formal dispute settlement provisions in six areas – in the previously mentioned NAFTA side agreements (NAAEC and NAALC), and in four chapters of the NAFTA text (Chapters Eleven, Fourteen, Nineteen and Twenty). The NAFTA side agreements handle the inter-state dispute settlement mechanisms that regard domestic environmental and labor laws. Chapter Eleven (Investment) is designed to resolve disputes between the investor and the state over property rights. Chapter Fourteen (Financial Services) creates special provisions for handling disputes in the

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<sup>[08]</sup> Government of Canada. External Affairs and International Trade. NAFTA. What's it all about?. pg.12

financial sector through Chapter Twenty dispute settlement process. Chapter Nineteen (Review and Dispute Settlement in Anti-dumping) establishes a review mechanism to determine whether final anti-dumping and countervailing duty decisions made in domestic tribunals are consistent with national laws. Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures) provides at the ministerial level government to government consultation in order to resolve high-level disputes.

### Types of Disputes and the Mechanisms



Source: North American Forum on Integration

The responsibility for the administration of the dispute settlement provision of the Agreement is given to the NAFTA Secretariat. As mentioned previously, the NAFTA Secretariat administers the NAFTA dispute resolution processes under Chapters Fourteen, Nineteen and Twenty and has also certain responsibilities related to Chapter Eleven dispute settlement provisions. Each national section of the NAFTA Secretariat maintains a court-like registry relating to panel, committee and tribunal proceedings. The national sections are located in the capital cities of each NAFTA country – Ottawa, Washington, D.C. and Mexico City. <sup>[09]</sup>

<sup>[09]</sup> Project on International Courts and Tribunals

### 1.4.2.1 Chapter Eleven

NAFTA's Chapter Eleven addresses foreign investment that deals with the protection of foreign investors from Canada, Mexico and the United States investing in one of the other NAFTA countries. As many parts of NAFTA, Chapter Eleven was carried over from CUSFTA, which had similar core liberalization disciplines on investment restrictions, national investor treatment, and investor protection from direct or indirect expropriation of their investments.<sup>[10]</sup> However the NAFTA's investment chapter covers a broader range of operations and business activities than the one in CUSFTA. The Chapter Eleven includes important provisions for resolving certain types of disputes between NAFTA governments and investors.<sup>[08]</sup>

Chapter Eleven is designed to protect the interests of foreign investors and to liberalize international investment. This chapter gives foreign investors the ability to privately enforce their investor rights. NAFTA allows private investors and corporations to sue the national government of a NAFTA country in secret arbitration tribunals if they feel that government policies or actions violate their investor rights under NAFTA. Violating the Chapter Eleven disciplines provides the foreign investors a right to claim for compensation alleging unfair or discriminatory ways treatment or government effective expropriation of investment.

Since the Agreement's enactment, corporate investors from all three NAFTA countries have used these new rights to challenge a variety of national, state and local environmental and public health policies, domestic judicial decisions or federal procurement law as NAFTA violations. Forty-two cases and claims have been brought to NAFTA tribunals under the Chapter Eleven since its implementation (eighteen against Mexico, fifteen against the United States, nine against Canada). However only five of them led to an arbitral decision; other cases were either settled, withdrawn, or remain pending. From these five cases, three won against the NAFTA governments – Metalclad vs. Mexico, Pope&Talbot vs. Canada, and S.D. Meyers vs. Canada.<sup>[11]</sup> The case Metalclad vs. Mexico will be outlined in detail later.

NAFTA's investor protections are unprecedented in a multilateral trading agreement. It is often said that NAFTA is more an investment than a trade agreement. In recent years, citizens' groups and some government officials from all three NAFTA countries have become increasingly concerned of the effects of Chapter Eleven. The main focus of their concerns relates to the ability of corporations, notably foreign corporations, to use Chapter Eleven's provisions in ways that can restrict or even negate governments' ability to protect the environment and human welfare.<sup>[12]</sup>

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<sup>[10]</sup> Kirton, Maclaren, Linking Trade, Environment, and Social Cohesion, pg.105

<sup>[08]</sup> Government of Canada. External Affairs and International Trade. NAFTA. What's it all about?. pg. 14

<sup>[11]</sup> Sinclair, NAFTA Chapter 11 Investor-State Disputes.

<sup>[12]</sup> International Institute for Sustainable Development and World Wildlife Fund

### **1.4.2.2 Chapter Fourteen**

NAFTA's Chapter Fourteen involves financial services – banks, trusts, insurance and securities. Building on financial-sector provisions established in CUSFTA, NAFTA's Chapter Fourteen develops a general framework for the treatment of banking, insurance and brokerage. It contains a provision for the resolution of conflicts in the financial services area. In this case, the resolution of disputes follows the procedures set out in NAFTA's Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures), with the requirement that the panelists are financial services experts. The tribunal decisions are not binding on administrative agencies or national courts.

Chapter Fourteen uses a negative list for specific reservations, and these allow each country to maintain distinct prudential and protective regulation of financial sectors. Since NAFTA's enactment, forty-five reservations have taken place. Canada scheduled one reservation only, the United States listed eighteen and Mexico had twenty-six reservations.<sup>[13]</sup>

### **1.4.2.3 Chapter Nineteen**

NAFTA's Chapter Nineteen, considering anti-dumping and countervailing duties, basically extended the provisions of the CUSFTA to Mexico. The NAFTA preserved the right of each member country to apply its anti-dumping and countervailing duty laws to imported goods. However, to ensure that each NAFTA member fairly applies its own national trade remedy laws, Chapter Nineteen allows parties to appeal the final administrative determinations before binational panels (instead of appealing through national courts).

Chapter Nineteen offers a binational panel to review the work of national trade arbitration tribunals, when the aggrieved party feels that the national tribunal of its partner did not interpret properly the domestic trade law. The Chapter Nineteen panel process depends on the application of the domestic law of the party whose agency's determination is challenged. The chapter is limited to establishing binational panels of five experts to review whether the anti-dumping and countervailing duty cases were decided in a reasonable manner consistent with national law. The panelists are five citizens from the two relevant NAFTA countries and are generally lawyers experienced in international trade law.

Decisions by Chapter Nineteen panels can be challenged before NAFTA Extraordinary Challenge Committee (ECC) – a safeguard procedure that protects the integrity of the panel process. If the aggrieved party alleges that a panel is biased or exceeded its authority, it can appeal

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<sup>[13]</sup> Institute for International Economics

the panel's decision before the ECC. However, the Committee does not function as an ordinary appeal. Under the NAFTA, the ECC will only cancel or remand to the panel the decision if it involves a significant and material error that threatens the integrity of the NAFTA dispute settlement system. Since its implementation, no NAFTA party has successfully challenged a Chapter Nineteen panel's decision before the ECC.<sup>[05]</sup>

In most cases, panel decisions lowered US anti-dumping and countervailing duties against Canadian and Mexican exports. Since NAFTA's enforcement, hundred-and-three panel reviews have been initiated under NAFTA's Chapter Nineteen. However in recent years, many of intra-NAFTA cases are increasingly starting to appeal, rather than to Chapter Nineteen panels, to the World Trade Organization (WTO), and this trend is increasing.

One of the most controversial trade disputes in recent years that has been litigated before Chapter Nineteen panels is the Canada-US softwood lumber dispute. Also, the four trade steel disputes that have been litigated between Canada and Mexico were all being resolved under Chapter Nineteen. These Canada-US and Canada-Mexico dispute cases will be described in detail further on in the text.

#### **1.4.2.4 Chapter Twenty**

NAFTA's Chapter Twenty establishes the overall institutional framework for implementing NAFTA. While Chapters Eleven, Fourteen and Nineteen are narrowly defined, Chapter Twenty emphasizes the resolution disputes through a variety of means – interstate consultations, referral to a panel of independent experts, or resolution of the dispute through national courts by the complainant.<sup>[13]</sup>

The Chapter Twenty process begins with government to government consultations, proceeds to a meeting of the ministerial level Free Trade Commission (FTC), and ends with the creation of a five-member arbitral panel. The FTC, under Chapter Twenty, conducts political consultations on matters resulting from either the implementation or interpretation of NAFTA obligations, or from changes in domestic or multilateral trade rules that affect NAFTA's operation. The FTC is responsible for the overall political supervision of the NAFTA.<sup>[13]</sup>

Chapter Twenty has been used less frequently than the other chapters. Since NAFTA's implementation, only eleven cases have been brought to the Chapter Twenty panel, and only three of them have progressed to the stage of panel deliberations. All Chapter Twenty disputes involved the United States – either as the defendant (seven cases) or as the complainant (four cases).

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<sup>[05]</sup> Wikipedia, the free encyclopedia

<sup>[13]</sup> Institute for International Economics

Between Canada and Mexico no cases under Chapter Twenty have taken place. Unlike other NAFTA dispute settlement procedures, Chapter Twenty “lacks any comprehensive, official record of formal consultation requests compiled by the NAFTA Secretariat or individual governments.”<sup>[13]</sup>

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<sup>[13]</sup> Institute for International Economics

## **2 Canada's approach**

Canada is one of the strongest and healthiest economies among the seven leading industrial countries of the G7, which consists of Canada, Germany, France, Italy, Japan, the United Kingdom and the United States. Canada is a free market economy with slightly more government intervention than the United States, but much less than most European countries. Canada's economy is unusual for a developed country – the primary sector is very important for the country, the two most significant industries are logging and oil. This is one of the reasons why Canada is highly dependent on international trade, especially on trade with the United States. Canada is a successful trading nation with its exports accounting for over 40% of total GDP – a higher proportion than for any other G7 country. Inevitably, Canada has been largely influenced by the process of globalization just like other world economies.

The process of globalization is linked to the creation of bilateral and multilateral trade agreements. Canada's first trade agreement was the bilateral Canada-US Free Trade Agreement (CUSFTA) from 1989. In 1993, this trade agreement was extended to Mexico and the trilateral North American Free Trade Agreement (NAFTA) was created. During the past decade, Canada entered into more trade agreements with other countries (free trade agreements with Israel in 1996 and Chile in 1997), but NAFTA remains to be the most significant and the most important for Canada.

### **2.1 Canada's objectives**

During the NAFTA negotiations Canada had three basic objectives. The first objective was to provide Canada with the access to the Mexican market. The second Canadian objective was to improve and protect the bilateral CUSFTA. And the third objective was to ensure that Canada would remain an attractive location for investors.

Canada's first objective was to gain access for its goods and services to Mexico, seeing its new partner as one of the fastest growing and most promising economies in the world. The NAFTA eliminated, immediately or over the course of the transition period, all Mexican tariffs and import-licensing requirements (except on some agricultural products). Canada, on account of the Agreement, entered previously closed Mexican sectors, such as autos and parts, financial services, trucking, energy, mining and fisheries. The first objective has been accomplished, although trade between Canada and Mexico has not boost as much as expected, and neither have the relations between the two economies. However, the relations between Canada and Mexico have made a

remarkable progress in recent years, in part because of the problematical nature of relations of both countries with the United States.

Canada's second objective was to improve and protect the Canada-US Agreement CUSFTA. Canada sought to resolve the trade problems that occurred during the past few years with the United States and wanted to ensure that NAFTA would not reduce the benefits and obligations of the CUSFTA. In the end, all of Canada's CUSFTA benefits were either protected or improved during the NAFTA negotiations. "Canadian negotiators successfully pursued this [second objective] by obtaining clearer and more predictable rules of origin, an extension of duty drawback provisions, an improved mechanism for consultation and dispute settlement, a strengthened sideswipe exemption from US safeguards and a reduced US capacity to retaliate in dispute-settlement cases."<sup>[08]</sup> Even though NAFTA improved the dispute settlement mechanism between Canada and the United States, the extension of the Agreement did not eliminate the frequent and costly trade disputes between the two countries. "Canada, in particular, complained that the United States bent the rules and spirit of NAFTA to restrict imports of some of its products and services, all the while maintaining subsidies to important American producers with political weight to throw around in Washington."<sup>[14]</sup> Furthermore, the never-ending softwood lumber dispute also caused deterioration of the NAFTA partnership between the United States and Canada.

The third basic objective that Canada had set during the NAFTA negotiations was to ensure that NAFTA would not undermine its capacity to keep and attract investment. However this objective has not been fully accomplished since NAFTA's enactment. The main reason is the more appealing United States as location for foreign companies when compared to Canada. Before NAFTA, foreign multinational enterprises would locate in Canada to avoid paying tariffs. Now that there is free trade within North America, these companies can locate in "wealthier and more productive environments in the United States" and simply export to Canada.<sup>[15]</sup> This argument is also supported by the research done by the University of Toronto:

The researchers found that Canada receives only 10% of US foreign investment whereas Europe receives more than half; this sharply contrasts to forty years ago when Canada received the same amount of US foreign investment as Europe. Canada also holds 3% of the world's GDP compared to Europe, which has more than 20%. However, the US trades about the same amount with Canada as it does with Europe. NAFTA also resulted in more trade by the US with wealthy

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<sup>[08]</sup> Government of Canada. External Affairs and International Trade. NAFTA. What's it all about?. pg.8

<sup>[14]</sup> Pickard, Trinational Elites Map North American Future in "NAFTA Plus".

<sup>[15]</sup> Toye, American multinationals no longer need to locate in Canada to access its market.



countries whereas much of the US trade with developing countries has been replaced by less expensive imports from Mexico.<sup>[15]</sup>

January 1, 2004 marked the tenth anniversary of the NAFTA's implementation. This anniversary provided the occasion to debate over NAFTA and further trade and investment negotiations that could enter a new and deeper phase. The first decade of the Agreement was seen as successful in some aspects, however many failures occurred as well.

## **2.2 NAFTA's Impact on Canada**

When the leaders of Canada, Mexico and the United States signed the North American Free Trade Agreement in 1993, proponents proclaimed it not just as an agreement to lower and eliminate barriers to trade, but as a tool that would increase economic growth, create jobs and strengthen democracy. NAFTA promised to stimulate competition and to free North America from harsh and often unfair tariffs that restricted trade between the three nations. Canada specifically expected that NAFTA would protect the country against the US protectionism, that it would attract foreign investment, and that it would create more and better jobs. Despite these great expectations of NAFTA, certain results have not been not as successful for Canada as initially planned.

### **2.2.1 Impact on Economy**

Since NAFTA has been signed, it has been difficult to analyze its macroeconomic effects due to the large number of other variables in the global economy. However, various economic studies generally indicate that rather than creating an actual increased trade, NAFTA has caused trade diversion, in which the NAFTA members now import more from each other at the expense of other countries worldwide.<sup>[16]</sup> Nevertheless, NAFTA has stimulated trade and investment between its members. In this context, the agreement is very widely seen as successful – trade and investment between member nations have approximately tripled. Canada's trade of goods and services, as well as investment flow within NAFTA, reached its maximum values.

Since 1994, Canada's merchandise trade with its NAFTA partners has increased by 122%, reaching USD 598.5 billion in 2005. Between 1994 and 2005, Canadian merchandise exports to the United States grew at a compounded annual rate of 6.5%. To Mexico, bilateral trade reached USD

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<sup>[15]</sup> Toye, American multinationals no longer need to locate in Canada to access its market.

<sup>[16]</sup> Canadian Democratic Movement

17.8 billion in 2005 – a 292% increase from pre-NAFTA levels (1993). Altogether, NAFTA partners account for 84.7% of Canada’s total merchandise exports.<sup>[18]</sup>

Trade in services has also increased under NAFTA. Canada’s trade in services with its NAFTA partners grew at an average annual compounded rate of 6% to reach USD 78.3 billion in 2003, up from USD 46 billion in 1994. Canadian trade in services with the United States reached USD 76.4 billion in 2005, up from USD 42.3 billion in 1993. Two-way trade in services between Canada and Mexico has grown at an annual compounded rate of 10.6%, to reach more than USD 1.1 billion in 2003. Approximately 59% of Canada’s services exports go to its NAFTA partners.<sup>[18]</sup>

NAFTA has also had a positive impact on Canada’s investment. Since 1994, the annual stock of foreign direct investment in Canada has averaged USD 264.2 billion. In 2004, total FDI in Canada reached USD 365.7 billion, of which more than 65% came from the United States and Mexico. FDI in Canada from the US increased to USD 238.2 billion in 2004. Canadian direct investment to its NAFTA partners also grew, reaching USD 193.9 billion in the United States and USD 2.76 billion in Mexico.<sup>[18]</sup>

The trade and investment stimulation is seen as a positive impact on Canada’s economy. However, Canada’s dependence on the United States also increased with the NAFTA implementation, and this is not perceived so positively. Canada’s exports are now equivalent to 40% of its GDP, up from 25% in 1989. This Canada-US trade expansion has been reflected by a relative decline in trade within Canada. Canada’s trade has also become more concentrated with the US and less concentrated with the rest of the world. Two-way investment flows have increased greatly as well. Both Canadian foreign direct investment and portfolio flows to the US grew much faster than did US flows to Canada.<sup>[19]</sup> Such dependence on the United States is an eyesore to many Canadians.

### **2.2.2 Impact on (Un)employment**

Many NAFTA opponents claim that Canada’s trade expansion has a negative effect on Canada’s employment causing a major net destruction of jobs. “Evidence that the trade expansion and economic integration under NAFTA have had adverse employment effects in Canada comes from the government itself.”<sup>[19]</sup> The evidence of this adverse effect is proven by the relation between the number of jobs and imports:

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<sup>[18]</sup> Foreign Affairs and International Trade Canada. Opening Doors to the World. Canada’s International Market Access Priorities 2006.

<sup>[19]</sup> Campbell, NAFTA at Seven: Its impact on workers in all three nations.

*“While business sector exports grew quickly, import growth also kept pace. At the same time, the import content per unit of exports also grew markedly, while the domestic content per unit of exports fell ... Employment (direct and indirect) in export industries rose from 19.6% of total business sector employment in 1989 to 28.3% in 1997. However, the rapid rise in imports displaced (or destroyed) even more employment. The job-displacing effect of imports rose steadily from an equivalent of 21.1% of total business employment in 1989 to 32.7% in 1997... Imports are displacing ‘relatively’ more jobs than exports are adding. Between 1989 and 1997, 870,700 export jobs were created, but during the same period 1,147,100 jobs were destroyed by imports. Thus, Canada’s trade boom resulted in a net destruction of 276,000 jobs.”*<sup>[19]</sup>

Job creation was one of the big promises of NAFTA, but unemployment in Canada averaged 8.6% between 1995 and 2001. <sup>[20]</sup> During NAFTA’s first ten years, employment in Canada grew by 19%, representing a gain of 2.7 million new jobs. But less than half of these new jobs were full-time jobs. <sup>[21]</sup> During the first thirteen years of the CUSFTA and NAFTA, Canada created less than half as many full-time jobs as during the previous thirteen years. <sup>[20]</sup>

The year 2002 was marked by an extraordinary increase of 560,000 jobs in Canada. But 40% of these jobs were again only part-time jobs and other 17% were self-employed. “Thus, while the overall employment statistics look better, the process of creating a more flexible workforce continues.” <sup>[21]</sup> During 2003 to 2005, the unemployment rate in Canada averaged at the rate of 8%.

### **2.2.3 Impact on Trade Disputes**

When Canada first began to negotiate free trade with the United States, the government claimed that the purpose was to win exemptions for Canada from US anti-dumping and countervailing duty measures. However neither with CUSFTA nor with current NAFTA has Canada achieved this goal. Instead, Canada remains subject to arbitrary US actions such as the punitive US duty on Canadian softwood lumber exports. <sup>[21]</sup>

Instead of winning this exemption from US contingency protection laws (anti-dumping and countervailing duty measures), “all that Canada won was a provision that special panels would examine whether US laws were correctly applied in the first place.” <sup>[21]</sup> In 2005, four requests were filed for Chapter Nineteen panel review of US anti-dumping and/or countervailing duty determinations affecting Canadian products, all concerning softwood lumber. During the same year, thirteen panel reviews were active on products including softwood lumber, magnesium, wheat and

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<sup>[20]</sup> Foster, NAFTA At Ten: Nothing to celebrate.

<sup>[21]</sup> Arroyo, Cruz, Rindermann, Ranney, Dillon, Foster, Hansen-Kuhn, Lessons from NAFTA: The High Cost of “Free” Trade.

steel wire rod. Also, nine panel decisions were made (three each in softwood lumber and in wheat, one in magnesium, one in steel wire rod and one in galvanized steel), and one panel was terminated.<sup>[18]</sup> From these disputes, the softwood lumber disagreement has always been the most irritant. This dispute caused a “fierce debate between the two governments, although not as public within the United States”<sup>[22]</sup>, and tested political wills, bounds, and the effectiveness of NAFTA itself.

In August 2005, Canada-US trade relations took on “a hostile tone” after the announcement of the United States that it would ignore the NAFTA ruling on softwood lumber in Canada’s favor. The ruling confirmed the outcome of an earlier NAFTA panel, which found that Canadian exports of softwood lumber did not hurt US producers, so there was no justification for applying countervailing duties on Canadian exports. The US decision to ignore these findings and to continue to collect duties outraged the Canadians. “*Prominent national commentators proclaimed NAFTA dead. Angry citizens wrote letters calling for retaliation. Some pundits even called upon Canada to abandon NAFTA and rely on defending our interests at the World Trade Organization.*”<sup>[23]</sup>

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<sup>[18]</sup> Foreign Affairs and International Trade Canada. Opening Doors to the World. Canada's International Market Access Priorities 2006.

<sup>[22]</sup> The New International Political Economy

<sup>[23]</sup> Golden, Barrett, Enough Threats, Canada.

## 3 NAFTA Relations and Disputes

### 3.1 Canada-United States

#### 3.1.1 Canada-US Relationship

The relationship between Canada and the United States can be characterized as integrated but asymmetric. Canada and the United States are natural trading partners; this partnership is given by geographic reasons, as well as linguistic and cultural similarities. The integration between the two economies was supported by the bilateral Agreement CUSFTA from 1988 and the trilateral Agreement NAFTA from 1994. NAFTA continued in the CUSFTA's moves toward reducing trade barriers and establishing trade rules. Between 1989 and 1994, the bilateral trade increased by about 52%. Since 1994, the trade between the two economies increased by 40%.<sup>[24]</sup>

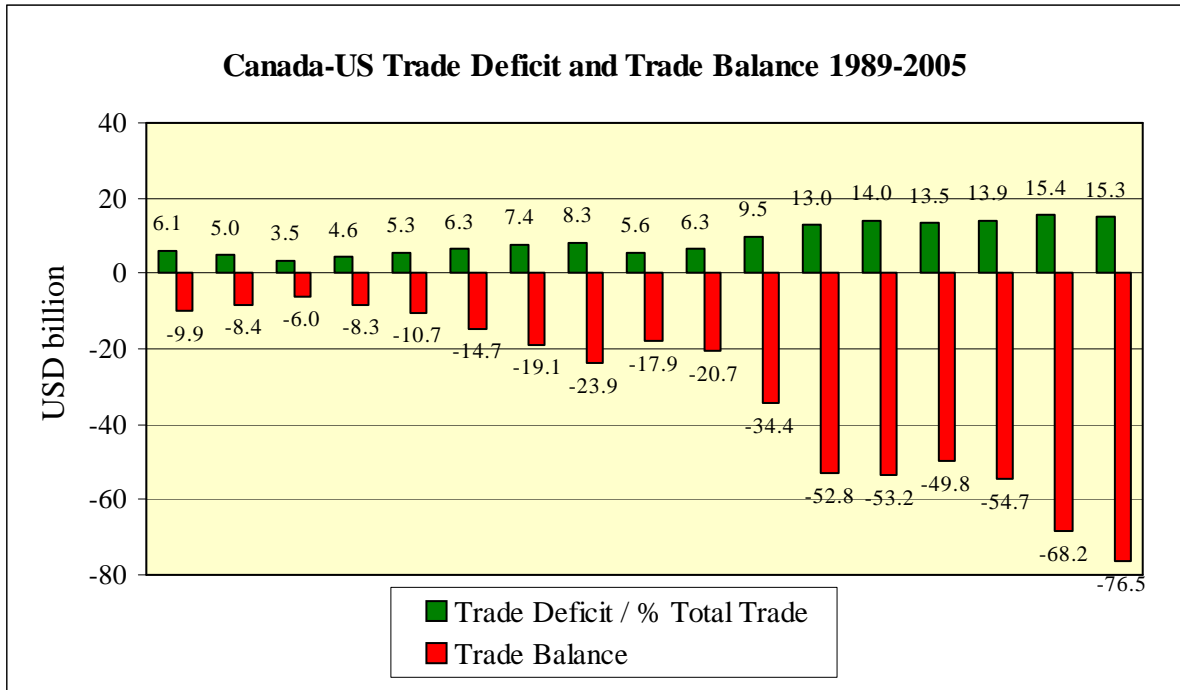
Canada and the United States are each other's most important trading partners. The countries have the largest bilateral trade relationship in the world; with total merchandise trade exceeding USD 499.3 billion in year 2005 (export USD 211.4 billion, import USD 287.9 billion).<sup>[25]</sup> While Canada is dependent on the US market, for the United States Canada is an important partner, however without being dependent on it. For the US, Canada is the largest trading partner, while for Canada, the US is the largest and the most dominant trading partner – 80% of the Canadian population lives within 200 miles (320 kilometers) from the US border and to trade with the United States is often easier and less expensive than to trade within its own country.<sup>[25]</sup> However, preserving Canadian independence against the strong pressure from the United States was and will always be a major political issue in Canada.

Under NAFTA, the growth in bilateral trade between Canada and the United States was in average almost 6% over the past decade.<sup>[25]</sup> Canada-US trade in energy is the largest US energy trading relationship in the world; Canada is the US's largest supplier of natural gas, electricity, uranium, crude oil and refined products. The US is Canada's leading agricultural market, taking nearly one-third of all food exports. Canada is the second largest US agricultural market (after Japan). Also, nearly two-thirds of Canada's forest products are exported to the United States.<sup>[24]</sup> The largest component of Canada-US trade is in the automotive sector. The US trade deficit with Canada "has continued to increase, but the rate of increase declined in 2005 perhaps partly due to the 30% rise in the Canadian dollar since 2002".<sup>[25]</sup>

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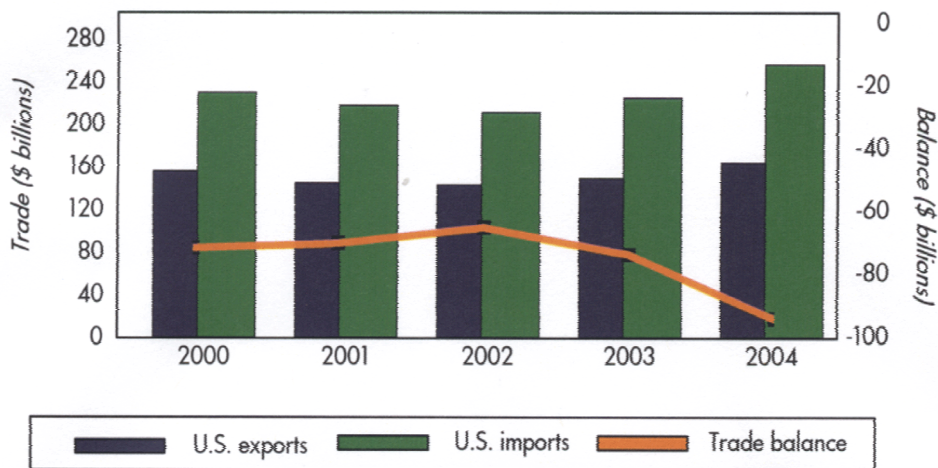
<sup>[24]</sup> Wikipedia, the free encyclopedia

<sup>[25]</sup> Fergusson, United States-Canada Trade and Economic Relationship: Prospects and Challenges.



Source: Fergusson, United States-Canada Trade and Economic Relationship: Prospects and Challenges.

### US Exports / Imports to Canada and Trade Balance



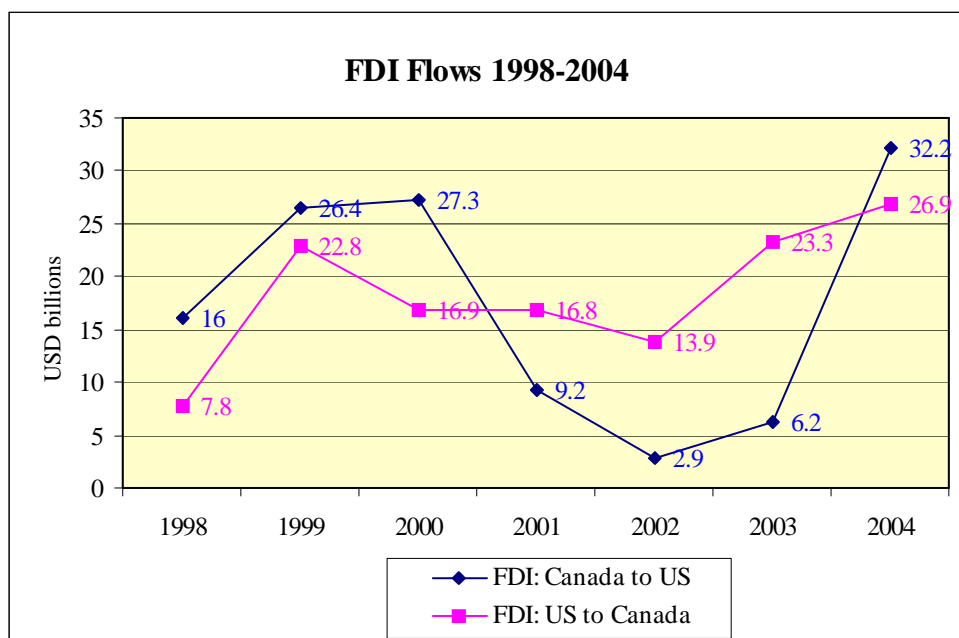
Source: United States International Trade Commission

In 2004, US exported to Canada USD 163.2 billion, while imports reached USD 255.7 billion. Leading US export categories to Canada included transportation, equipment, chemicals and

related products and electronic products. Imports exceeding exports resulted in the US trade deficit with Canada of USD 92.5 billion. <sup>[26]</sup>

Canada's trade with the United States accounts for more than half (52%) of Canada's GDP. The United States represents 81% of Canada's exports and 67% of its imports. Canada, in return, represents 23% of America's exports and 17% of its imports. <sup>[24]</sup> Canada is the leading export market for thirty-five of fifty US states, and ranks in the top three for other eight states. In fact, Canada is a larger market for the US goods than all twenty-five countries of the European Union combined, which has more than fifteen times the population of Canada. <sup>[27]</sup>

Canada and the United States have one of the world's largest investment relationships. The United States is the biggest foreign investor in Canada and the most popular destination for Canadian investment. The US investment is primarily in Canada's mining and smelting industries, petroleum, chemicals, finance, manufacture of machinery, and transportation equipment. Canadian investment in the United States is concentrated in manufacturing, wholesale trade, real estate, petroleum, finance, insurance and other services. <sup>[24]</sup> In 2004, the US direct investment in Canada was worth more than USD 228 billion, while Canadian direct investment in the United States was close to USD 165 billion. Canada is the seventh largest investor in the US, accounting for 7.6% of all Foreign Direct Investment (FDI) in the country. <sup>[27]</sup>



Source: Fergusson, United States-Canada Trade and Economic Relationship: Prospects and Challenges.



<sup>[26]</sup> United States International Trade Commission

<sup>[24]</sup> Wikipedia, the free encyclopedia

<sup>[27]</sup> Foreign Affairs and International Trade Canada

The countries differ in many economic indicators. In the indicators of gross domestic product (GDP) and purchasing power parity (PPP), Canada is acting as a smaller copy of the United States: GDP (in nominal terms) of the US is more than eleven times higher and PPP of the US is almost twelve times higher than in Canada. This large and historic disparity presents opportunities and challenges for Canada. NAFTA provides Canada with “a large market for its exports at its doorstep”, however it also leads to “increased import competition for small-scale Canadian businesses.”<sup>[25]</sup>

Other economic indicators of Canada and the United States with comparison analysis can be seen in the following table:

 <b>ECONOMIC INDICATORS</b> 			
	CANADA	UNITED STATES	ANALYSIS
GDP (2005)	USD <b>1,124</b> trillion	USD <b>12,486</b> trillion	<i>US has 11.1 times greater GDP.</i>
GDP per capita (2005) Nominal PPP	USD <b>34,880</b> USD <b>34,790</b>	USD <b>42,125</b> USD <b>42,125</b>	<i>US has 17.2% greater GDP per capita.</i>
GDP growth rate (2005)	<b>2.9%</b>	<b>3.5%</b>	<i>US GDP is growing by 1.2 times greater rate.</i>
Personal Disposable Income per capita (2005)	USD <b>20,682</b>	USD <b>30,469</b>	<i>US has a 32.1% higher disposable income.</i>
Unemployment Rate (2005)	<b>6.7%</b>	<b>5.5%</b>	<i>Canada has a 1.2 times higher unemployment rate.</i>
Trading Partners - Exports / Imports	US: <b>81.4% / 66.8%</b>  Japan: <b>2.3% / 2.9%</b>  UK: <b>2.1% / 2.4%</b>	Canada: <b>23.4% / 17.2%</b>  Mexico: <b>13.3% / 10.2%</b>  China: <b>4.6% / 14.6%</b>	<i>US is Canada's largest trading partner. Canada is US' largest trading partner.</i>
Government Surplus/ Deficit as % of GDP (2004)	<b>0.68%</b>	<b>-4.72%</b>	<i>Canada's lending is 0.68% US' borrowing is 4.72% of country's GDP.</i>
Government Debt as % of GDP (2004)	<b>72.2%</b>	<b>64.0%</b>	<i>Canada has 8.2% greater debt as expressed in % of GDP.</i>
Total Government Expenditure as % of GDP (2005)	<b>68.3%</b>	<b>37.4%</b>	<i>Canada spends 5% more money in total as expressed in % of GDP.</i>

Sources: United North America  
Fergusson, United States-Canada Trade and Economic Relationship: Prospects and Challenges.



Sectoral components relative to GDP are similar in both economies. As other first world nations, the Canadian and American economies are dominated by the service industry. Both the United States and Canada are the SIA (service-industry-agriculture) economies. The service sector represents almost three-fourths of country's GDP (US 79%, Canada 68%). Industry sector, although decreasing in both countries over time, is still remaining to be second (US 20%, Canada 29%). Agriculture sector represents the lowest percentage of GDP in both economies (US 1%, Canada 2%).<sup>[25]</sup>

Both countries were founding members of the North Atlantic Treaty Organization (NATO) and the United Nations (UN), and cooperate in other multilateral institutions such as the Organization of American States (OAS). Both countries are also members of the World Trade Organization (WTO), as well as partners with Mexico in NAFTA. Approximately 300 treaties and agreements govern the Canada-US relationship and provide a legal basis for this cooperation.<sup>[28]</sup>

Although most trade issues are done fairly and according to the rules and regulations of NAFTA and other Agreements, there have been examples of several disputes. Disputes concerning trade tariffs, multilateral military action and controversial Canadian legislation such as same-sex marriage, immigration law and legal medical marijuana raise tensions and cool relations between the two countries.<sup>[24]</sup> However, one of the most serious conflicts between the United States and Canada is the dispute over softwood lumber. "The United States-Canada softwood lumber dispute is one of the most significant and enduring trade disputes in modern history."<sup>[38]</sup> "The dispute raises serious questions about trade, sovereignty, and the real nature of Canada-US relations."<sup>[29]</sup> Usually, disputes between the countries are resolved through bilateral consultative forums or referral to WTO or NAFTA dispute resolution. However, the softwood lumber dispute resolution was more complex.

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<sup>[25]</sup> Fergusson, [United States-Canada Trade and Economic Relationship: Prospects and Challenges](#)

<sup>[28]</sup> Foreign Affairs and International Trade Canada

<sup>[38]</sup> Wikipedia, the free encyclopedia

<sup>[29]</sup> CBC archives

### **3.1.2 Canada-US Dispute**

#### **3.1.2.1 Softwood Lumber**

The trade of softwood lumber is important to both countries. Canada's export of softwood lumber to the United States is one of the largest: in 2005, 21.5 billion board feet of lumber was shipped from Canada to the US, valued USD 8.5 billion, which represents over 2% of Canada's total exports to the United States. From these exports, British Columbia accounted for over 57%, followed by Quebec (16%), Ontario (9%), the Maritimes (8%), Alberta (7%), Saskatchewan and Manitoba (each 1%).<sup>2</sup> [30]

The American softwood lumber producers are not able to meet the market requirements and therefore the Canadian producers fill up this supply gap – over one third of the US consumption of softwood lumber is supplied by Canada. Housing and other industries in the United States, which employ over seven million American workers, got accustomed to this supply. In Canada, the forestry sector employs approximately 280,000 workers, and roughly 300 communities are dependent on this sector. [31]

#### **3.1.2.2 The Softwood Lumber Dispute**

The trading disagreements of softwood lumber between the United States and Canada were perceived already more than two centuries ago, the first being dated back to the 1820s between New Brunswick (Canada) and Maine (the United States)<sup>2</sup>. The softwood lumber issue also figured during the US House of Representatives consideration of a reciprocity treaty with Canada in 1853, as well as in later disagreements throughout the late 1800s and 1900s. [31] However the dispute over softwood lumber became acute and serious in 2005, when taken to NAFTA binational panels and to WTO dispute settlement panels.

The softwood lumber dispute between the United States and Canada is actually a number of disputes that have been going on for more than twenty years. The basis of the dispute over softwood lumber is the American claim that Canada is unfairly subsidizing its lumber production. The American lumber producers argue that Canadian provinces subsidize their lumber industry by charging less than market value for lumber harvested in the form of stumpage fees (fees charged by the Canadian government to logging companies for the right to harvest lumber from public land) and other practices. US timber and environmental groups also express concerns about Canadian

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<sup>2</sup> Map of Canada can be found in Appendix 1.

[30] Foreign Affairs and International Trade Canada. News Releases.

[31] Foreign Affairs and International Trade Canada

forestry management and clear-cutting practices and declare that such practices lead to dumping. Canada insists that no such thing is happening and the Canadian government refuses these allegations and demands free trade in softwood lumber. Canada asserts that its mills are modernized and efficient, even more efficient than the US operations.<sup>[25]</sup>

The softwood lumber problem is also incited by different ways of land ownerships in each country. In the United States, the majority of the harvested softwood lumber comes from privately owned land. But in Canada most of the harvested lumber comes from land that is owned by federal or provincial government. The government system of setting the charging price for harvest corporations is quite different in each country and therefore more basis of the softwood lumber dispute is created.<sup>[33]</sup>

Another aspect that also supplements into this basis of the dispute is the difference in setting the logging rights and the stumpage fees. In the United States, logging rights are sold by using a competitive auction. In Canada, stumpage fees are set by the government. These stumpage fees, which rely on number of factors such as labor and transportation costs, tend to be significantly lower than the prices coming out of the US auctions. “The American government claims that these low prices constitute a subsidy to Canadian producers. The softwood lumber dispute stems from these prices and the actions the American government has taken in response.”<sup>[33]</sup>

### **3.1.2.3 Canada-US Softwood Lumber Trade Relations**

Since 1982, a group of American softwood lumber producers, called the Coalition for Fair Lumber Imports (CFLI), has requested trade restrictions on Canadian lumber from the US government. During the last twenty years, the CFLI has had on four occasions requesting the US government to impose duties on softwood lumber imports from Canada, accusing the Canadian forestry management of subsidizing the Canadian softwood lumber industry. These four occasions are usually referred to as Lumber I, II, III and IV.

In Lumber I (1982), the US Department of Commerce (DOC) dismissed the CFLI’s accusations. However four years later, in Lumber II (1986), a countervailing duty tax of 15% was set on Canadian import of softwood lumber, and later was replaced by a 15% export tax following Canada-United States Memorandum of Understanding (MOU), which lasted for five years from 1986 to 1991. After the expiry of MOU, in Lumber III (1991), the DOC imposed a 6.51% countervailing duty, which had to be eventually withdrawn due to Canadian legal victory. Following the refund of deposits requested in Lumber III, the parties of Canada and the United

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<sup>[25]</sup> Fergusson, United States-Canada Trade and Economic Relationship: Prospects and Challenges

<sup>[33]</sup> Moffatt, The Softwood Lumber Dispute

States agreed on a quota-based Softwood Lumber Agreement (SLA), which was signed in September 1996. <sup>[30]</sup> After the expiry of SLA in April 2001, the dispute, referred to as Lumber IV, took place.

#### **3.1.2.4 Countervailing and Anti-dumping Duties**

Under the US and international trade law, two conditions need to be proven when wanting to apply countervailing and anti-dumping duty orders. The first condition is finding of subsidization or dumping. The second condition is finding that the subsidized and/or dumped imports cause or threaten to cause material injury to the domestic industry. The CFLI repeatedly claimed that the imported softwood lumber from certain Canadian provinces into the United States is subsidized and threatens to injure the US industry, and therefore required imposing countervailing duties on Canadian softwood lumber imports. Recently, the CFLI also alleged that softwood lumber companies from Canada are dumping their products into the US market, and that the softwood lumber sold in the United States is below the production cost and at prices that are lower on the American market than in Canada. <sup>[31]</sup>

#### **3.1.2.5 The Softwood Lumber Agreement**

On May 29, 1996, the Canadian and American governments signed the Canada-US Softwood Lumber Agreement (SLA), a five-year Agreement lasting from April 1996 to April 2001. The SLA provided a guarantee to Canadian softwood lumber exporters against the US trade actions. For those five years, the situation around the softwood lumber trade calmed down a bit. However, after the expiry of the SLA, the American lumber producers began to take actions again in order to hinder imports of Canadian softwood lumber into the United States. <sup>[31]</sup>

The Softwood Lumber Agreement between Canada and the United States provided a guarantee against the US trade action toward the Canadian softwood lumber exporters. The SLA required Canada to collect an export tax once lumber exports exceeded a certain limit. Although the Canadians insisted that their softwood lumber was not being subsidized, they accepted this export tax because of the needed certainty it would bring into the industry. <sup>[33]</sup>

Under the SLA, Canada could “fee-free export” into the United States 14.7 billion board feet per year of lumber first manufactured in four Canadian provinces – British Columbia (B.C.),

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<sup>[30]</sup> Foreign Affairs and International Trade Canada. News Releases.

<sup>[31]</sup> Foreign Affairs and International Trade Canada

<sup>[33]</sup> Moffatt, The Softwood Lumber Dispute

Alberta, Ontario and Quebec. When this limit exceeded, Canada was required to collect fees using a “tiered fee system”. Softwood lumber exports to the United States that originated from the four provinces and exceeded 14.7 billion board feet per year were subjected to a “Lower Fee Base” fee for the first 650 million board feet, and an “Upper Fee Base” fee for even greater quantities. These fee amounts, which were approximately USD 50 and USD 100 per thousand board feet respectively, were adjusted every year for inflation. Softwood lumber from the other Canadian provinces and territories was exempt from the SLA and could enter the United States without permit. In return for Canadian limited exports into the United States, the United States promised to dismiss any new petitions for trade action against Canada during the lifetime of the SLA. <sup>[31]</sup> Until the SLA expiry date, March 31, 2001, the disputes over the trading of softwood lumber seemed to be resolved.

#### **3.1.2.6 Expiry of SLA**

Following the expiration of the Softwood Lumber Agreement, on April 2, 2001, the Coalition for Fair Lumber Imports (CFLI), along with the International Trade Commission (ITC) and the Department of Commerce (DOC), filed a countervailing duty petition and, for the first time in history, an anti-dumping petition against the Canadian softwood lumber. With this action, the dispute referred to as Lumber IV began.

#### **3.1.2.7 Countervailing and Anti-dumping Investigations**

Under the US trade law, a countervailing duty case is an “investigation of an alleged subsidy that provides an importer with an advantage in the US market”, and an anti-dumping case is an “investigation on whether an importer is selling goods in the [US] at prices lower than in the home market or ... at prices below cost.” <sup>[36]</sup> Unlike the countervailing duty investigations, which examine the subsidy practices of governments, the anti-dumping investigations take into concern the pricing practices of individual firms. <sup>[31]</sup> In the anti-dumping investigation, the DOC carried out a country-wide research to determine whether Canadian firms were dumping lumber into the US market. As a reaction to these allegations, the Canadian government held consultations with the United States in order to point out the deficiencies in the petitions, and to urge the United States not to initiate such investigations. Despite these consultations, the investigations did take place.

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<sup>[31]</sup> Foreign Affairs and International Trade Canada

<sup>[36]</sup> Government of British Columbia

### 3.1.2.8 Lumber IV

As part of the investigations, the DOC issued series of questionnaires to the Canadian federal and provincial governments. In its final determination, issued in March 2002, the DOC found that the Canadian federal and provincial timber programs represented a countervailing subsidy at the rate of 19.34% and thus this rate had to be applied to Canadian imports of softwood lumber products.<sup>3</sup> The DOC also argued that Canadian producers were engaged in dumping of softwood lumber and imposed a dumping margin ranging from 2.26% to 15.83%<sup>4</sup> on individual companies and a dumping margin of 9.67%<sup>5</sup> on all other Canadian companies. From these duties the DOC excluded twenty companies and four Atlantic provinces. The Atlantic provinces were exempted because timber stands in these provinces are generally privately held.<sup>[25]</sup>

At the same time, the ITC made determinations on whether the alleged subsidies cause a threat of injury to the US industry. In May 2002, the ITC voted 4 to 0 that softwood lumber industry in the United States was threatened with material injury by Canadian softwood lumber imports, found by the DOC to be subsidized and sold in the United States at less than fair value. This threat of injury determination meant that countervailing and anti-dumping duties had to be imposed and remained in effect.<sup>[31]</sup>

Throughout these investigations and determinations, the Canadian government monitored the conditions in order to ensure that the United States conducted the softwood lumber case in compliance with its obligations under international trade agreements. Canada challenged each of the US anti-dumping, countervailing duty and threat of injury determinations before dispute settlement panels at the World Trade Organization (WTO) and before North American Free Trade Agreement (NAFTA) binational panels.

### 3.1.2.9 NAFTA and WTO Decisions

The WTO and NAFTA panels dealt with separate legal obligations. The WTO panels considered whether the determinations were consistent with the WTO Agreements. The NAFTA panels determined whether the DOC and ITC determinations were consistent with the US law.

In August 2003, the binational NAFTA panel ruled that, while the Canadian lumber industry is subsidized, the tariff imposed on softwood lumber by the United States is too high. The NAFTA report stated that the United States incorrectly calculated its duties that were based on US prices,

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<sup>3</sup> in April 2002 reduced to 18.79%

<sup>4</sup> in April 2002 reduced to from 2.18% to 12.39%

<sup>5</sup> in April 2002 reduced to 8.43%

<sup>[25]</sup> Fergusson, United States-Canada Trade and Economic Relationship: Prospects and Challenges

<sup>[31]</sup> Foreign Affairs and International Trade Canada

and did not take into consideration Canadian market conditions. Although NAFTA's ruling did not change the duty straight away, in fact it took more than a year before modification; it ordered the DOC to review its position. This NAFTA decision was considered to be a partial victory for Canada.<sup>[37]</sup>

Two weeks later, another partial victory for Canada was achieved. The WTO Appellate Body concluded that the United States incorrectly applied harsh duties on the Canadian softwood lumber exports. The WTO panel also discovered that the provincial stumpage programs provided a financial benefit to the Canadian producers; however without being high enough to be a subsidy, and therefore the WTO concluded that the US duties were not justified<sup>[37]</sup> and recommended to the United States to bring its measures into consistency with its WTO obligations.

In March 2004, the WTO panel found the determination of ITC (that Canadian softwood lumber imports threaten to injure the US industry) to be inconsistent with the US WTO obligations. Later that year, in November 2004, the ITC issued a revised threat of injury determination that should comply with the panel ruling. Canada requested the establishment of another WTO panel to review this revised determination.

The NAFTA Chapter Nineteen panel reviewed the determination made by the ITC that the softwood lumber industry in the United States was under a threat of injury because of Canadian imports. The NAFTA Chapter Nineteen panel found the ITC's determination to be invalid. In addition, the panel made a controversial decision and refused to allow the ITC to reopen the administrative record and ordered the ITC to issue a negative determination after it reached another affirmative determination based on the existing record. The United States challenged this decision before the Extraordinary Challenge Committee (ECC).<sup>[38]</sup>

In August 2005, NAFTA's ECC agreed with Canada and dismissed American claims that the earlier NAFTA decision in favor of Canada violated trade rules. It unanimously affirmed the original NAFTA panel's finding that the ITC had no basis on which to find that the United States was threatened with material injury by Canadian softwood lumber imports. After this result, Canada claimed that there is no longer any legal basis for maintaining anti-dumping and countervailing duty orders and that they should be terminated, and all deposits refunded, with interests, as required by US law and NAFTA.

United States' initial response was that the ECC ruling will have no impact on the anti-dumping and countervailing duty orders given by the ITC, and that more negotiations, before the softwood lumber dispute is finished, are necessary. Canada reacted by pursuing the matter before

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<sup>[37]</sup> CBC News in Depth

<sup>[38]</sup> Wikipedia, the free encyclopedia

the US Court of International Trade (CIT), which can compel the United States to respect its NAFTA obligations, to revoke the duty orders, and to refund all duty deposits.

Meanwhile in September 2005, the CFLI initiated a challenge to the constitutionality of NAFTA's Chapter Nineteen dispute settlement mechanism, claiming that it allows "binational panels of individuals to make binding decisions about application of US law to US unfair trade findings contrary to due process and constitutional requirements." The US Administration stated that it will defend the constitutionality of NAFTA Chapter Nineteen. Canada decided to intervene and work with the United States to protect its interest with respect to the NAFTA Chapter Nineteen.<sup>[31]</sup>

In November 2005, the dispute took a sudden twist with the WTO compliance panel report, this time, and for the first time, giving a partial victory to the United States. The WTO panel, considering the ITC's November 2004 injury determination, found that the US revised threat of injury determination is consistent with the WTO obligations. Canada strongly disagreed with this decision and appealed it. Nevertheless, the WTO report does not provide any legal or other justification for the United States' failure to act in accordance with its obligations under NAFTA. United States was still obliged to obey the NAFTA ruling. Therefore, in the end of November 2005, the DOC announced that it would comply with the NAFTA ruling, even though it disagreed with it, but that it would respect it.

At the end of March 2006, at the NAFTA Leaders Summit, which took place in Cancun, Mexico, Canada's Prime Minister Harper and the US' President Bush "expressed their commitment to see a resolution to the softwood lumber dispute". Both leaders "instructed their officials to examine the options of pursuing a resolution".<sup>[30]</sup>

In April 2006, the WTO Appellate Body found in favor Canada that appealed, and reversed the November's WTO compliance panel finding. The WTO Appellate Body agreed with Canada's arguments that the WTO compliance panel failed to properly review and measure the US countervailing and anti-dumping duties on Canadian softwood lumber. However, the WTO Appellate Body did not rule on whether the US measure is consistent with the WTO obligations.

Even though the challenges and appeals seemed to never end, both sides were interested in reaching an agreement. The United States wanted Canada to agree to "a tax on Canadian softwood lumber until the Canadians institute a system of competitive bidding as the Americans have". But Canada had no interest in changing its system of selling logging rights to its producers. Alternatively, Canada proposed a system similar to the Softwood Lumber Agreement (SLA) from

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<sup>[31]</sup> Foreign Affairs and International Trade Canada

<sup>[30]</sup> Foreign Affairs and International Trade Canada. News Releases.



1996, where most softwood lumber entered the United States tariff-free, with taxing imports at progressively higher rates when a certain level was exceeded. <sup>[33]</sup>

### 3.1.2.10 Framework agreement

On April 26, 2006, Canada and the United States reached a framework agreement forming the basis for an end to this never-ending dispute. Under the framework, the United States would revoke anti-dumping and countervailing duty orders on Canadian softwood lumber imports and stop collecting deposits. However, an export tax would be imposed if exports from Canadian provinces exceeded specified levels.

This framework agreement requires the United States to return about 80% of the USD 5 billion in duties that the US Customs have collected in the previous four years. From the remaining 20%, which makes about one billion USD, half would go to the US lumber industry, while the other half would go toward joint initiatives. <sup>[38]</sup> Canada, on the other hand, has to remain at, and not exceed, the 34% share of the US softwood lumber market. Furthermore, when the prices of softwood lumber exceed USD 355 per thousand board feet, no border measures for Canada's softwood lumber will be imposed. The next day, on April 27, 2006, it has been officially set that Canada and the United States had agreed on a seven year deal to end the softwood lumber dispute.

However, before a final agreement is reached, lumber companies and associations in both countries must drop their legal complaints, and the Canadian government must pass the new export tax legislation. The CFLI, declared its support to this framework, adding that it would work closely with the US trade officials "to ensure that an agreement is administered and enforced effectively to establish a fair competitive playing field for US sawmills, mill workers and family timberland owners across the United States". <sup>[39]</sup>

*"The draft softwood lumber agreement reached with the United States ... makes the best of a bad situation and buys lumber producers an interlude of much-needed peace free from the punishing effects of US trade actions. The tough decisions for Canadian policy makers will not end when negotiations with the Americans conclude, however. Assuming a final agreement can be reached, Canadian governments will need to administer it in a way that balances the objectives of fairness and industry competitiveness against the desire of producers to be compensated for losses they incurred in the latest lumber battle. An essential issue will be to decide on measures to limit exports to the United States. Based on experience with similar trade situations, ... Canada might*

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<sup>[33]</sup> Moffatt, [The Softwood Lumber Dispute](#)

<sup>[38]</sup> Wikipedia, the free encyclopedia

<sup>[39]</sup> Embassy of the United States of America, Ottawa

*have only one opportunity to get this right. This argues for careful planning and some political backbone in the early stages to avoid problems later on.”* <sup>[40]</sup>

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<sup>[40]</sup> Macmillan, Administering the Softwood Lumber Agreement: The Case for Tax-Only Export Measures. pg.1

## 3.2 United States-Mexico

### 3.2.1 US-Mexico Relationship

The relationship between the United States and Mexico can be characterized as unique and asymmetric. The economic relationship between these two countries is unique because of Mexico's proximity to the United States, but also because of the large differences in economic development between the two asymmetrical economies – one highly advanced, the other still developing. Mexico is the first developing country with which the United States entered into a free trade agreement – NAFTA.

For decades, the two economies were taking actions toward a greater integration. The bilateral relationship between Mexico and the United States changed significantly when NAFTA was signed in 1994. The economic liberalization of the Mexican economy since the 1980s already led to a high integration of the countries' markets, but signing NAFTA "meant that the governments were willing to establish a formal and extensive commercial and financial cooperation agreement".<sup>[41]</sup>

*"In the past, the asymmetry of economic and political power between both countries had determined the fact that the [United States] could achieve its goals in every area without assuming the costs of establishing formal compromises with Mexico. In turn, Mexico [did not] have enough bargaining power to influence [the US] policies according to its own interests. Nevertheless, in the case of NAFTA both countries agreed that the best way to protect their interests in light of changes and new trends in the international environment was through economic cooperation."*<sup>[41]</sup>

It is quite clear why the US-Mexico relationship is important to Mexico, however to the United States the bilateral relationship is also, for many reasons, important. For the US, the bilateral economic relationship is significant because of Mexico's proximity and because of the large amount of trade and investment interactions. Both countries are also closely tied in areas that are not directly related to trade and investment, and have common interests. They share a 2,000 mile (3,200 kilometers) border and have broad interconnections through the Gulf of Mexico. For the United States that is considering free trade initiatives with Latin American countries, the effects of the US-Mexico relation can provide indications. Another important reason is related to the problem of Mexican migrant workers into the United States, which has been a major political and social issue between the two countries.<sup>[42]</sup>

Since the establishment of NAFTA, Mexico became the United States' second largest trading partner, replacing Japan that was there during the 1990s. However, this position is now

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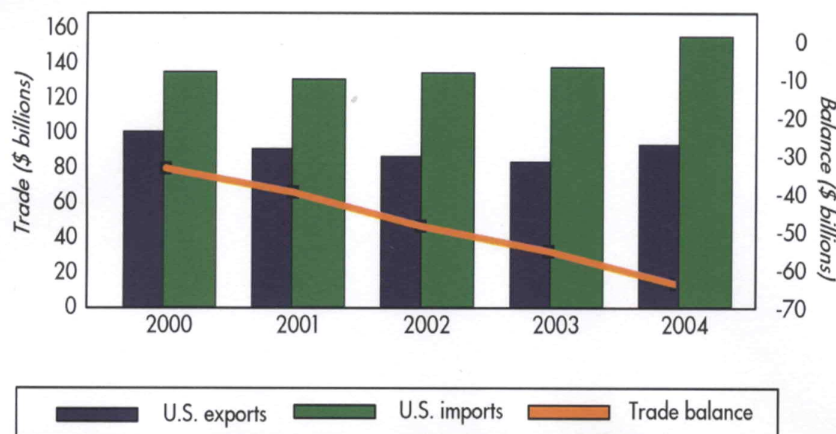
<sup>[41]</sup> Délano, Mexico-U.S. Migration After NAFTA: The Boundaries for Cooperation

<sup>[42]</sup> Villarreal, U.S.-Mexico Economic Relations: Trends, Issues, and Implications

threatened by the growth of the US trade with China. In the US exports, Mexico still ranks second (after Canada), but in the imports, Mexico currently ranks third among US trading partners (after Canada and China that moved to the second place).

US-Mexico trade has grown exponentially since the signing of NAFTA, growing from USD 89.5 billion in 1993 to USD 275.3 billion in 2004 – a three times increase over eleven years.<sup>[43]</sup> In 2004, US exported to Mexico USD 93 billions, while imports reached USD 155 billion. Imports exceeding exports result in the US trade deficit with Mexico of USD 61.9 billion.<sup>[44]</sup> The largest elements in this deficit with Mexico were imports of maquila produced goods, oil, machinery and transport equipment.<sup>[45]</sup>

### US Exports / Imports to Mexico and Trade Balance



Source: United States International Trade Commission

Obviously, Mexican economic dependence on the United States is greater than the US' dependence on the Mexican market. The trend of the past years is characterized by having more than four-fifths of Mexican exports go into the United States, which makes the Mexican economic cycles very dependent on the American economic behavior. Mexico exports about 88% to the US, and imports 56% from the US sources. Exports represent 30% of Mexico's GDP. On the other hand, the United States exports to Mexico 14%, and imports 11% from Mexico.<sup>[43]</sup>

Mexico is one of the world's most trade dependent countries and its trade policy is among the most open in the world. It has twelve free trade agreements with over forty countries – more than 90% of trade is under free trade agreements.<sup>[46]</sup> Since the 1994 devaluation of the peso,

<sup>[43]</sup> Cañas, Coronado, Gilmer, U.S., Mexico Deepen Economic Ties



<sup>[44]</sup> United States International Trade Commission

<sup>[45]</sup> Institute of Public and International Affairs

<sup>[46]</sup> The North American Institute

Mexican government improved the country's macroeconomic indicators. Inflation and public sector deficits are currently both under control. <sup>[47]</sup>

Mexico's economy is relatively small compared to the US economy. Mexico's GDP in 2005 was USD 1.066 billion, about 8% of the GDP of the United States. Because of Mexican dependence on the US, the Mexican economy is strongly linked to the US business cycle. As the US economy emerged from its downturn in 2001, so did the Mexican economy, growing at a 4.4% rate in 2004, and 3% in 2005. <sup>[47]</sup> Other economic indicators of both countries are shown in the following table:

 <b>ECONOMIC INDICATORS</b> 			
	<b>UNITED STATES</b>	<b>MEXICO</b>	<b>ANALYSIS</b>
GDP (2005)	USD <b>12.766</b> trillion	USD <b>1.066</b> trillion	<i>US has 12 times greater GDP.</i>
GDP per capita (2005)	USD <b>42,775</b>	USD <b>10,000</b>	<i>US has more than 4 times greater GDP per capita.</i>
GDP growth rate (2005)	<b>3.5%</b>	<b>3%</b>	<i>US GDP growth rate is higher than the Mexican.</i>
Personal Disposable Income per capita	USD <b>30,469</b> (2005)	USD <b>6,770</b> (2004)	<i>US has a 4.5 times higher disposable income.</i>
Unemployment Rate (2005)	<b>5.5%</b>	<b>3,6%</b> <sup>6</sup>	<i>Mexico has a higher unemployment rate.</i>
Trading Partners - Exports / Imports	Canada: <b>23.4% / 17.2%</b>  Mexico: <b>13.3% / 10.2%</b>  China: <b>4.6% / 14.6%</b>	US: <b>87.6% / 55.1%</b>  Canada / China: <b>1.8% / 7.1%</b>  Spain / Japan: <b>1.1% / 5.3%</b>	<i>US is Mexico's largest trading partner. Mexico is US' second largest export partner, third largest import partner.</i>
Government Surplus/Deficit as % of GDP	<b>-4.72%</b> (2004)	<b>-3.1%</b> (2003)	<i>Mexico's borrowing represents 3.1% of its GDP. US' borrowing represents 4.72% of its GDP.</i>
Government Debt as % of GDP (2004)	<b>64%</b>	<b>23%</b>	<i>US has 2.8 times greater marketable debt as expressed in % of GDP.</i>
Total Government Expenditure as % of GDP	<b>36.5%</b> (2004)	<b>26.1%</b> (2003)	<i>US spends 10.4% more money in total as expressed in % of GDP.</i>

Sources: Wikipedia, the free encyclopedia  
United North America

<sup>[47]</sup> U.S. Department of State

<sup>6</sup> plus underemployment of perhaps 25%

The United States is the largest source of foreign direct investment (FDI) in Mexico. Since 1994, the United States accounted for 62% of all foreign direct investment in Mexico.<sup>[43]</sup> US FDI in Mexico increased from USD 17 billion in 1994 to USD 61.5 billion in 2003 – an increase of 263%. In 1995, the level of the US FDI in Mexico decreased somewhat because of the Mexican currency crisis, but after 1996, the FDI inflow continued.<sup>[42]</sup> The significant increase of the American investment in Mexico over the last ten years is largely based on the process of the foreign investment liberalization in Mexico, which happened during the late 1980s and the early 1990s, and continued within NAFTA. US capital flows to Mexico are much smaller, in 2003 they accounted for USD 5.7 billion.<sup>[42]</sup>

Mexican FDI in the United States is much lower than the US investment in Mexico. In 2003, Mexican FDI in the US accounted for USD 6.7 billion – an increase of USD 4.6 billion since 1994. Mexican FDI represented 5% of total FDI in the United States in 2003. However, this figure increased only by 1% since 1994.<sup>[42]</sup>

Almost one-half of the total FDI investment in Mexico regards the manufacturing industry, of which the maquiladora industry forms a major part. Maquiladora is an “assembly plant in Mexico, especially one along the border between the United States and Mexico, to which foreign materials and parts are shipped and from which the finished product is returned to the original market.”<sup>[47]</sup> The Mexican maquiladora industry is essential to the US-Mexico economic relation in many ways. It helps to attract investment in Mexico from countries like the United States that have a relatively large amount of capital. The maquiladora industry is closely linked to US-Mexico trade in various labor-intensive industries such as textiles and apparel, auto parts, and electronic goods. Maquiladoras account for approximately 35% of Mexico’s total imports and nearly 50% of total exports.<sup>[42]</sup>

The two economies are also linked by the flow of Mexican immigrants into the United States and the remittances they send back to their home country. Remittances are contributions made by Mexicans living abroad, both legally and illegally, to their families in Mexico. They play a strong role in the Mexican economy and form an important aspect of the US-Mexico economic relation. In 2005, about ten million Mexicans residing in the United States, sent back USD 18 billion – an amount equivalent to 3% of Mexico’s GDP.<sup>[48]</sup> “Workers’ remittances now occupy second place as a source of foreign exchange in Mexico, behind maquiladoras and ahead of tourism and foreign direct investment.” The remittances increased from USD 84 million in 1960 (USD 531

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<sup>[43]</sup> Cañas, Coronado, Gilmer, U.S., Mexico Deepen Economic Ties

<sup>[42]</sup> Villarreal, U.S.-Mexico Economic Relations: Trends, Issues, and Implications

<sup>[47]</sup> U.S. Department of State

<sup>[48]</sup> Wikipedia, the free encyclopedia

million in 2005 dollars) to USD 18 billion in 2005. Remittances have two major advantages – they are stable and countercyclical. <sup>[43]</sup>

As with Canada, the trade disputes between the United States and Mexico are generally settled in WTO and NAFTA panels or through negotiations between the two countries. The main disagreements between the United States and Mexico involve agricultural products such as sugar, high fructose corn syrup, apples and rice. <sup>[47]</sup> However, the first claim ever filed under NAFTA was the dispute between Metalclad, a US company from California, and the Mexican government on the issue of a hazardous waste landfill. Although it was a dispute between the United States and Mexico, Canada also played an important role in it.

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<sup>[43]</sup> Cañas, Coronado, Gilmer, U.S., Mexico Deepen Economic Ties

<sup>[47]</sup> U.S. Department of State

## 3.2.2 US-Mexico Dispute

### 3.2.2.1 Hazardous Waste

Hazardous waste can be characterized as waste that is corrosive, reactive, ignitable or toxic. It represents dangers to public health and to the environment, especially if improperly managed. Hazardous waste can be generated at each stage of the production process, as well as in the use and disposal of manufactured products.<sup>[50]</sup>

Hazardous waste is regulated in Mexico through laws, rules and standards. The laws set out obligations and rights for generators and facilities that manage hazardous wastes. However, only in the last decade, the Mexican environmental laws had been adequate, and only since 1993, have these laws been supported by appropriate implementing regulations, standards and institutional infrastructure to make them effective.

Concerns of opponents toward signing NAFTA, regarding the environmental issues, illustrated that the increased trade will lead to further environmental degradation in Mexico, as companies will move their operations to Mexico to avoid strict environmental enforcement in the United States. Since NAFTA, Mexico began a serious effort to enforce its environmental laws for new companies, diminishing any incentive for firms to relocate to Mexico to avoid environmental enforcement.<sup>[51]</sup> Mexico has few adequate hazardous waste management facilities, resulting in an increasing threat to environmental integrity, water quality and human health.

### 3.2.2.2 Coterin

In 1990, the federal government of Mexico gave a permit to a Mexican company, Coterin, which allowed it to operate a hazardous waste transfer facility in a sparsely populated valley La Pedrera in Guadalupe, in the State of San Luis Potosi<sup>7</sup> (SLP). However, Coterin did not operate as authorized – instead of transferring the waste, the company dumped 20,000 tons of hazardous waste on the ground without any treatment. This action was strongly opposed by the local residents and municipal politicians. Based on this violation, the Mexican government decided to shut down the hazardous waste station from September 1991 to February 1996.

Despite this action, Coterin decided to expand its transfer station into a toxic waste processing plant and landfill. In 1991, the company applied to the municipality for a permit to construct this landfill – always at the same location. The municipality refused to give Coterin this

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<sup>[50]</sup> Clapp, Piles of Poisons in Mexico

<sup>[51]</sup> United States-Mexico Chamber of Commerce

<sup>7</sup> The State can be found on the Mexican map in Appendix 1.



permit and the refusal was reconfirmed by a newly elected municipal government in 1992. However in 1993, Coterin did receive three permits in respect of the hazardous waste landfill. Two of the permits were environmental impact authorizations that allowed the construction and operation of the landfill. The third permit was a land use permit.<sup>[52]</sup> The municipal permit, however, was still missing.

### 3.2.2.3 Metalclad

In April 1993, an American corporation Metalclad, interested in this project, entered into an option agreement to acquire Coterin. Under the option agreement, Metalclad required the condition that either a municipal permit was issued to Coterin, or that Coterin received a definitive judgment from the Mexican courts that a municipal permit was not necessary for the construction of the landfill. After the Mexican federal officials assured Metalclad that Coterin had all the authorities required to undertake the landfill project, Metalclad in September 1993 purchased Coterin.<sup>[52]</sup>

Metalclad continued in Coterin's efforts to expand the transfer station into a toxic waste processing plant and landfill. Metalclad secured the required federal permits, but failed to secure a local municipal construction permit. In 1994, the local municipality of Guadalcazar ordered the corporation to cease construction of this new toxic waste facility because of the absence of a municipal construction permit. Metalclad applied for this permit but, despite the local opposition, continued in the construction, while the permitting process was pending. By March 1995, the landfill was completed – under the federal permit, but without the proper municipal permit. Metalclad was prevented from opening and operating the site because of continued local opposition and active public demonstrations.

In 1995, federal authorities audited the completed facility and negotiated an agreement with Metalclad, under which the corporation was allowed to operate the landfill. Metalclad had to undertake “certain remediation actions to clean up waste remaining on the site from its earlier use by Coterin”. The corporation was also instructed to establish an “environmental buffer zone” around the facility and to undertake some “community-related activities”.<sup>[10]</sup>

In December 1995, the municipal government of Guadalcazar denied Metalclad's request for a permit, and reprimanded the corporation for going on without proper authorization. Metalclad strongly disagreed with such decision stating that it had been reassured by the Mexican federal officials that all the authorities required for the construction and operation of the landfill had been

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<sup>[52]</sup> Defence of Canadian Liberty Committee

<sup>[10]</sup> Kirton, Maclaren, Linking Trade, Environment, and Social Cohesion. pg.111

given. In October 1996, Metalclad informed the Mexican government of its intentions to sue Mexico under NAFTA's Chapter Eleven.<sup>[53]</sup>

#### **3.2.2.4 NAFTA Dispute**

On January 2, 1997, Metalclad sued the Mexican government under NAFTA's investment provisions for USD 90 million – a sum representing its investment along with foregone profits. The corporation filed a Notice of Claim with the International Center for the Settlement of Investor Disputes (ICSID), a member of the World Bank Group. In the complaint, Metalclad accused the Mexican government for violating a variety of its NAFTA's obligations described in the NAFTA Text, all under Chapter Eleven, such as “non-discriminatory treatment of foreign investment” (Article 1102), “most-favored-nation treatment” (Article 1103), and treating foreign investor according to “fair and equitable treatment” in accordance with international law (Article 1105). Metalclad also accused the Mexican government for expropriating its investment (Article 1110).<sup>[54]</sup>

Metalclad dealt with the central authorities that assured the corporation of its full power to authorize the construction and operation of the landfill. Metalclad therefore believed that the responsibility for obtaining project support in the state and local community depended on the federal government. On the contrary, Mexico denied that any federal officials represented that a municipal permit was not required, and affirmatively stated that a permit was required, and that Metalclad knew, or should had known, that the permit was required.<sup>[55]</sup>

In September 1997, the governor of SLP, just before the expiry of his term, declared the site to be part of a special ecological zone for the preservation of the area's “unique biological diversity” and “several species of rare cacti”.<sup>[53]</sup> With this declaration, the operation of a toxic waste processing plant and landfill was buried.

#### **3.2.2.5 Tribunal's Outcome**

In August 2000, the NAFTA Chapter Eleven tribunal released its decision, where it accused Mexico of violating its obligations. It held that Mexico's actions amounted to expropriation, contrary to NAFTA Article 1110. The tribunal also declared that the minimum standard of

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<sup>[53]</sup> Public Citizen. Friends of the Earth.

<sup>[54]</sup> Cronin, Jenkins, Metalclad in Mexico

<sup>[55]</sup> International Centre for Settlement of Investment Disputes

treatment obligations, described in NAFTA Article 1105 (fair and equitable treatment), had not been met.<sup>[56]</sup>

The tribunal ruled that the local community had no right to deny the corporation a permit only for environmental and public health concerns, or because the corporation built the landfill first and asked for the permit second. The tribunal also decided that to license hazardous waste plants was the duty of the federal government, not the local municipalities. Therefore the tribunal concluded that Mexico expropriated the corporation's investment in building a landfill that was never opened.<sup>[57]</sup>

Specifically, the tribunal decided that three actions by the Mexican subnational governments were incorrect and violated Metalclad's NAFTA rights. Firstly, in December 1995, the Mexican municipality denied Metalclad a construction permit for a landfill. Secondly, in February 1996, the Mexican municipality obtained an injunction preventing Metalclad from operating the landfill. And thirdly, in September 1997, the Governor of SLP issued an ecological decree that an area including the landfill would be preserved as an ecological reserve.<sup>[52]</sup> According to the tribunal's decision, these three actions damaged Metalclad and Mexico was ordered to pay the corporation compensatory damages in the amount of USD 16.7 million.

Metalclad called this ruling a "hollow victory", as it sought USD 90 million in damages that included lost potential business costs, but received only the compensation for the actual cost of the original investment. Regarding Mexico, the country strongly disagreed with the tribunal's decision, but stated that it did not force Mexico to change its mind on supporting NAFTA's investment rules.<sup>[59]</sup> The environmentalists were also strongly against the result of the dispute, claiming that a precedent can be set whereby a foreign corporation can sue a government if not liking the local environmental rules.<sup>[50]</sup> Mexico stated that it will appeal this tribunal's decision.

This was the first time that a legal victory was upheld by an American company that claimed the Mexican government of violating protecting investor rules in NAFTA. Alleging arbitral error, Mexico challenged the NAFTA tribunal's decision with the support of Canada.<sup>[60]</sup> In October 2000, the government of Mexico appealed the tribunal's decision in Canada. Canada was chosen because the tribunal designated Canada's province British Columbia (B.C.) as a neutral ground. Mexico was supported by Canada, having the Canadian government also intervene in the appeal.

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<sup>[56]</sup> Foreign Affairs and International Trade Canada. News Releases.

<sup>[57]</sup> Shrybman, Mitchell, Mexico v. Metalclad - Reasons for Judgement

<sup>[52]</sup> Defence of Canadian Liberty Committee

<sup>[59]</sup> International Centre for Trade and Sustainable Development

<sup>[50]</sup> Clapp, Piles of Poisons in Mexico

<sup>[60]</sup> DePalma, Judge Issue Split Decision in Nafta Rules Case, pg.1

The Mexican appeal to the British Columbia Supreme Court was not a challenge to the legitimacy of NAFTA. It was a claim that the NAFTA tribunal did not apply the rules of NAFTA properly.<sup>[52]</sup> Canada agreed and supported Mexico with this decision.

### 3.2.2.6 Canada's Role

This was the first occasion for a Canadian (or any other) court to consider an application for statutory review of a decision by a NAFTA Chapter Eleven tribunal. “The case represented a critical test of how Canadian courts would deal with NAFTA based arbitral awards.”<sup>[57]</sup> Recognizing that the decision with Metalclad can have a persuasive impact on future disputes, Canada decided to intervene in this dispute. Canada, the Canadian Union of Public Employees (CUPE), and the Province Of Quebec filed to the B.C. Supreme Court an application seeking for the right to intervene. The purpose of this intervention was to ensure that Canadian interests were represented, and to assist the B.C. Supreme Court in the establishment of important principles governing the interpretation of NAFTA's Chapter Eleven investment provision. In January 2001, Canada and Quebec were granted the right to intervene, however the application of CUPE was denied by the court.

Canada filed a submission to the B.C. Supreme Court that intervened on the issues of “the appropriate categorization” of NAFTA Chapter Eleven arbitrations, “the appropriate standard of review”, “errors by the tribunal, including misinterpretation of provisions on minimum standard of treatment and expropriation”, and “misinterpretation and application of domestic law”. Canada argued that the interpretation of NAFTA must promote NAFTA's objectives as a whole, and “ensure the governments possess flexibility to safeguard public interests”.<sup>[56]</sup> Canada also argued that the NAFTA tribunal “incorrectly read into the Agreement obligations that federal governments are obligated to remove all doubt and uncertainty about all relevant legal requirements applicable to NAFTA investors”.<sup>[61]</sup> These expansive obligations were greater than the ones contemplated by NAFTA. In Canada's point of view, the tribunal did not have the authority to expand these obligations in such manner.<sup>[56]</sup>

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<sup>[52]</sup> Defence of Canadian Liberty Committee

<sup>[57]</sup> Shrybman, Mitchell, Mexico v. Metalclad - Reasons for Judgement

<sup>[56]</sup> Foreign Affairs and International Trade Canada. News Releases.

<sup>[61]</sup> Foreign Affairs and International Trade Canada

### 3.2.2.7 B.C. Supreme Court's Outcome

In May 2001, Justice David Tysoe of the B.C. Supreme Court released his decision in the Metalclad vs. Mexico dispute. Justice Tysoe found no evidence that transparency was a requirement for compliance with Article 1105 (fair and equitable treatment), and therefore no evidence of a violation of Article 1110 (expropriation) on account of events preceding the ecological decree that the Governor of SLP issued in September 1997. Justice Tysoe also rejected the tribunal's finding that the series of contradicting declarations made to Metalclad by Mexican federal, state and local governments violated NAFTA's guarantee of clear and transparent rules to protect investor's rights. He ruled that in NAFTA's Chapter Eleven were no transparency obligations.

However, Justice Tysoe kept in place the arbitration tribunal's decision that actions taken by the Mexican government to prevent Metalclad from opening the landfill amounted to the expropriation of the corporation's investment. He also found, as the tribunal, that the SLP governor's action, to designate the site of the landfill as an ecological reserve, was really a ploy to block the landfill without having to compensate Metalclad. However, because Metalclad continued in the construction after the site was declared an ecological reserve, the B.C. Supreme Court lowered the award to USD 15.6 million.

After this ruling, both Metalclad and the Mexican government expressed discontent and each declared to appeal. Yet both sides were interested in ending this dispute. After subsequent discussions, the Mexican government agreed to pay the reduced award. Mexico decided to settle "because NAFTA as an institution [was] much more important for the Mexican government than just this specific case".<sup>[62]</sup> Mexico's willingness to settle also helped to re-boost investor confidence in the country. In late October 2001 the Mexican government paid Metalclad the decided amount to end the five-year dispute and to "honor its international obligations"<sup>[63]</sup> and the dispute ended.

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<sup>[62]</sup> Hechler, U.S firm gets \$ 16M settlement, pg.A17

<sup>[63]</sup> Los Angeles Times, Metalclad to Receive \$16 Million, pg.8

## 3.3 Mexico-Canada

### 3.3.1 Mexico-Canada Relationship

Canada and Mexico share the world's largest economy as their neighbor, and for both countries the United States is the largest and the most important trade partner. NAFTA is often seen as two bilateral relationships with the United States. The relationship between Canada and Mexico is the often forgotten within NAFTA. Sixty years have passed since the countries' first establishment of diplomatic relations <sup>[64]</sup>, yet only 2.3% of intra-NAFTA trade, about USD 18.6 billion in 2005, takes place between them. <sup>[65]</sup>

Despite Mexico-Canada trade being a very small part of the total NAFTA trade, the economic relations between the two countries grew significantly since the NAFTA's implementation. Both imports and exports between the economies reached record values in 2004, and the total bilateral trade was USD 15.7 billion – almost a quadruple of the 1993 value.

Canada is Mexico's second largest trading partner, after the United States. In 2004, Mexico's trade balance with Canada represented USD 2.8 billion in exports, and USD 5.4 billion in imports. Canadian exports to Mexico increased by 361% since 1993. <sup>[65]</sup> Almost half of Canada's exports to Mexico take place in resource-based industries such as agriculture (which represents 20% of the total of the export commodities to Mexico), forestry and fishing, food, beverage and tobacco and primary and non-metallic. <sup>[66]</sup> Canadian products account for 2.7% of Mexico's total imports

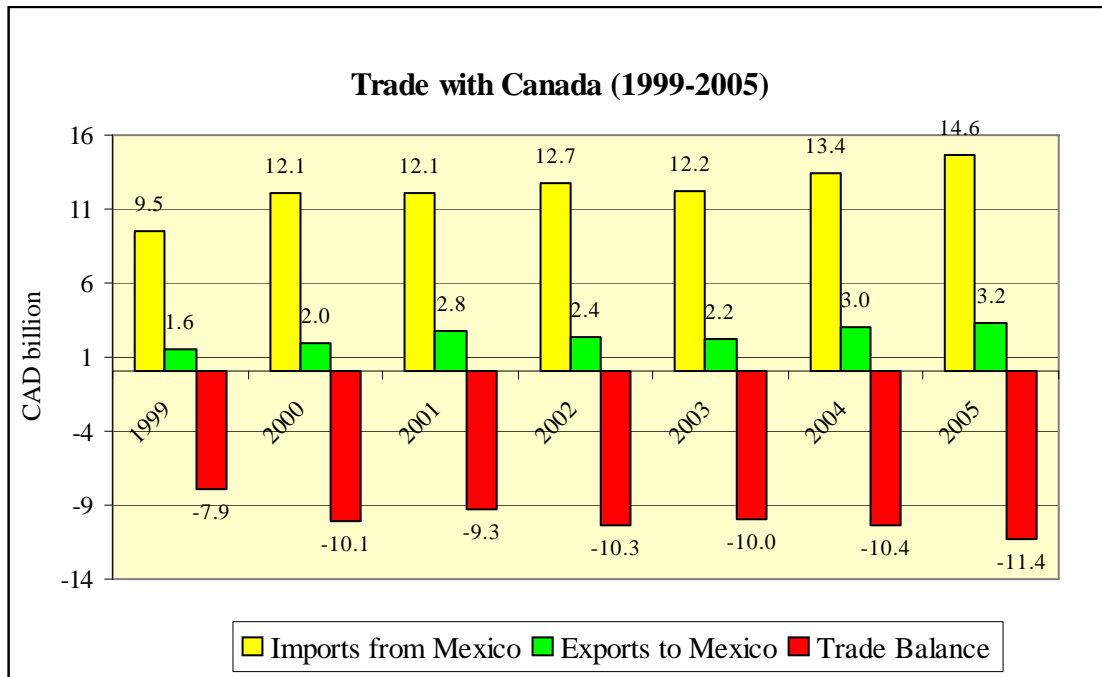
Mexico is Canada's fifth largest trading partner, after the United States, China, Japan and the United Kingdom. In 2004, Canada's trade balance with Mexico represented USD 6.3 billion in exports, and USD 14.7 billion in imports. Mexico is on the plus side of the trade balance, with Mexican exports accounting for almost seven of every ten dollars in bilateral trade. "With respect to the regional distribution of trade, more than four fifths of bilateral trade in 2004 was concentrated in just three of the ten of the ten Canadian provinces: Ontario captured 74.4% of total bilateral trade, followed by Alberta (7.3%), which displaced Quebec (7.2%) as Mexico's second largest provincial trading partner." Mexico substantially diversified its exports to Canada from less than 1,000 products in 1993 to almost 4,000 products in 2004. Mexico is Canada's third most important supplier, after the United States and China. <sup>[65]</sup>

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<sup>[64]</sup> Report of the Standing Senate Committee on Foreign Affairs

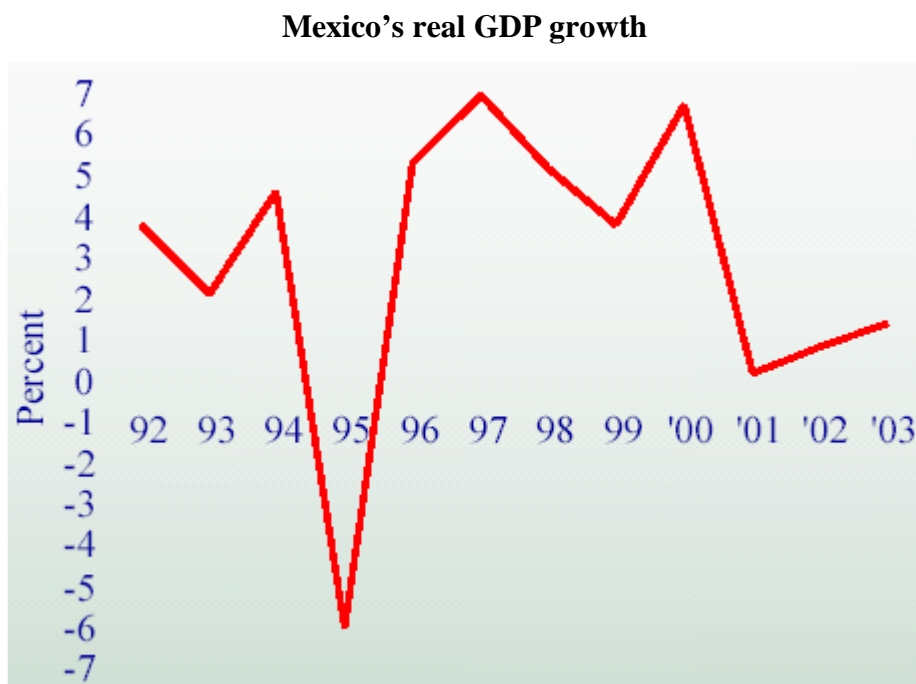
<sup>[65]</sup> The NAFTA Office of Mexico in Canada

<sup>[66]</sup> Canada's Business and Consumer Site



Source: Foreign Affairs and International Trade Canada

Mexico's weak economic performance contributed to Canada's weak export growth to Mexico since 2000. Mexico, like Canada, is highly dependent on its exports to the United States, which account for almost one-quarter of its GDP. Recent economic slowdown in Mexico lowered the Mexican demand for imports from all countries, including Canada. <sup>[66]</sup>





Source: Canada's Business and Consumer Site

<sup>[66]</sup> Canada's Business and Consumer Site

Mexico is a SIA (service-industry-agriculture) economy as Canada. In 2005, the service sector represented more than 70% of Mexico's GDP, the industry sector accounted for almost 26% of the country's GDP, and agriculture represented almost 4% of GDP. Although the agriculture sector represents the lowest percentage of GDP in Mexico, it is higher than Canada's (2%).

The comparison of the countries' main economic indicators is given in the following table:

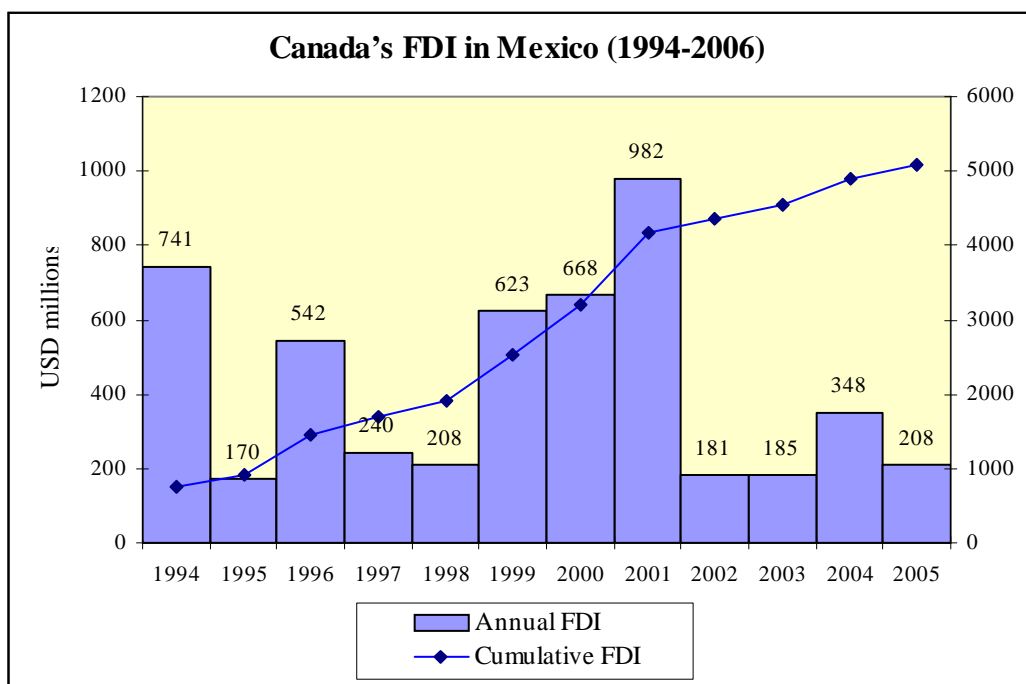
  <b><u>ECONOMIC INDICATORS</u></b>			
	<b>MEXICO</b>	<b>CANADA</b>	<b>ANALYSIS</b>
GDP (2005)	USD <b>1,066</b> trillion	USD <b>1,124</b> trillion	<i>Canada has a higher GDP.</i>
GDP per capita (2005)	USD <b>10,000</b>	USD <b>34,880</b>	<i>Canada has more than 3 times greater GDP per capita.</i>
GDP growth rate (2005)	<b>3%</b>	<b>2.9%</b>	<i>GDP growth rate is slightly higher in Mexico.</i>
Personal Disposable Income per capita	USD <b>6,770</b> (2004)	USD <b>20,682</b> (2005)	<i>Canada has a 3 times higher disposable income.</i>
Unemployment Rate (2005)	<b>3.6%</b> <sup>8</sup>	<b>6.7%</b>	<i>Canada has a 1.8 times higher unemployment rate.</i>
Trading Partners - Exports / Imports	US: <b>87.6% / 55.1%</b>  Canada / China: <b>1.8% / 7.1%</b>  Spain / Japan: <b>1.1% / 5.3%</b>	US: <b>81.4% / 66.8%</b>  Japan: <b>2.3% / 2.9%</b>  UK: <b>2.1% / 2.4%</b>	<i>Both countries have US as the largest trading partner. Other vary.</i>
Government Surplus/Deficit as % of GDP	<b>-3.1%</b> (2003)	<b>0.68%</b> (2004)	<i>Mexico's borrowing represents 3.1% of its GDP. Canada's lending represents 0.68% of its GDP.</i>
Government Debt as % of GDP (2004)	<b>23%</b>	<b>72.2%</b>	<i>Canada has more than 3 times greater marketable debt as expressed in % of GDP.</i>
Total Government Expenditure as % of GDP	<b>26.1%</b> (2003)	<b>68.3%</b> (2005)	<i>Canada spends 42.2% more money in total as expressed in % of GDP.</i>

Sources: Wikipedia, the free encyclopedia  
United North America

<sup>8</sup> plus underemployment of perhaps 25%



Canada's investment in Mexico increased steadily over the 1990s, but declined from 2001 onwards. Canada's cumulative investment in Mexico between January 1994 and June 2005 amounted USD 5.1 billion, making Canada the fifth largest foreign investor in Mexico after the United States, Spain, the Netherlands and the United Kingdom. In June 2005, 1,651 Mexican companies were registered with Canadian capital. These firms concentrated in services (45.2%), manufacturing (18.6%), retail and wholesale (17.4%), and mining and extraction (14.4%) sectors.<sup>[65]</sup>



Source: The NAFTA Office of Mexico in Canada

Mexico's investment, on the other hand, accounts for a very small portion of Canada's total inward FDI. In 1994, it accounted for 0.1% of Canada's total FDI, ten years later it was even a smaller portion – only 0.03%.<sup>[66]</sup> There are over 1,300 Canadian firms based in Mexico.<sup>[64]</sup> In 2004, the Mexican FDI in Canada was USD 427 million (In the same year, Canadian FDI in Mexico was almost USD 3 billion).<sup>[67]</sup>

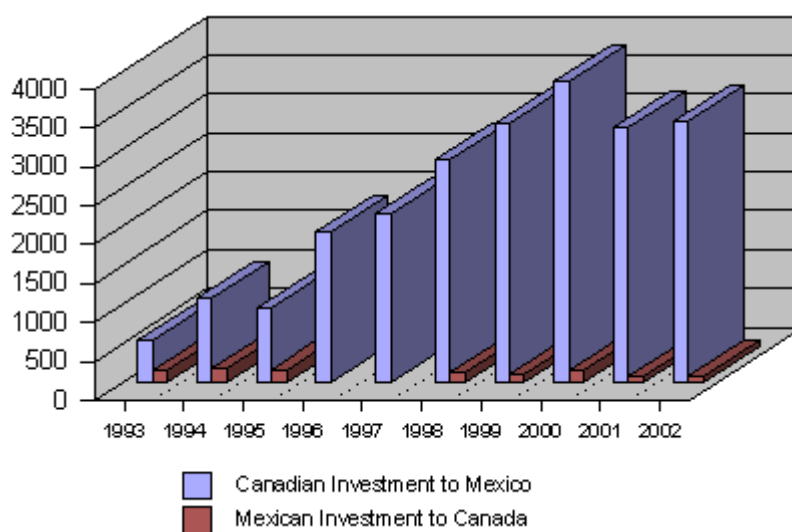
<sup>[65]</sup> The NAFTA Office of Mexico in Canada

<sup>[66]</sup> Canada's Business and Consumer Site

<sup>[64]</sup> Report of the Standing Senate Committee on Foreign Affairs

<sup>[67]</sup> CanadExport

### Mexico-Canada FDI Relation



Source: Foreign Affairs and International Trade Canada

The relationship between Canada and Mexico is weak. The countries have to some degree disappointed each other. Canada has not actively helped Mexico with its economic development, and Mexico has stumbled in dealing with Chinese competition, growing less robustly than expected.<sup>[68]</sup> There are several problems that continue to stand in the way of a stronger bilateral economic bond between the two economies. These problems, among others, are: “the less-than-vibrant Mexican economy”, “the lack of progress on structural reforms within Mexico that would lead to greater Canadian investment and subsequent trade”, “the continued fixation of Canadian business on the [American] market”, and a “number of trade concerns in the farm sector”.<sup>[64]</sup>

The weak bilateral relationship between Canada and Mexico reflects in the number of disputes between the two countries – the low amount is incomparable with the high number of disputes that each country has with the United States. Since the implementation of NAFTA, there have been only four dispute cases between Canada and Mexico – all concerning anti-dumping complaints on steel. The most serious one was the dispute regarding rolled plate steel imports to Mexico.

<sup>[68]</sup> Goldfarb, The Canada-Mexico Conundrum: Finding Common Ground

<sup>[64]</sup> Report of the Standing Senate Committee on Foreign Affairs

### 3.3.2 Mexico-Canada Dispute

#### 3.3.2.1 Steel Industry

Steel is the most prevalent industrial material. It is generally a hard, strong, durable, malleable alloy of iron and carbon, usually containing between 0.2 and 1.5% of carbon, often with other constituents. <sup>[69]</sup> The differences of the amount of carbon and its distribution in the alloy control qualities of the resulting steel. Steel is an integral part of containers, machines, automobiles, appliances, structures and thousands of other industrial and consumer products. This is due to the low cost of steel that attributes to manufacturers, builders and designers demand. <sup>[70]</sup>

The steel industry in North America endured an enormous employment reduction during the 1980s and a wave of bankruptcies during the late 1990s and early 2000s. Steel is a “pro-cyclical business”, with prices decreasing during recessions and increasing during economic recoveries. Between 1998 and 2001, the North American steel industry faced an onslaught of steel imports that led to a steady reduction in steel prices. During 2004, world steel prices increased sharply, on average between 30 – 40 %, depending on the product, due to recovering world economy and rapid economic development, in China and other Asian countries such as India, Thailand and Korea. <sup>[70]</sup>

The North American steel industry has undergone significant restructuring in the last years. As a result, the current steel industry has fewer, but financially stronger, companies. North American steelmakers have the highest labor productivity rates in the world steel industry. <sup>[70]</sup>

In 2004, the largest steel exporting countries were Japan (34.8 million tonnes), the EU15 (31.8), Russia (30.4), Ukraine (28.2) and China (20.0). The largest steel importing countries in were China (33.2 million tonnes), USA (32.8), the EU15 (30.4) and South Korea (17.7). <sup>[71]</sup>

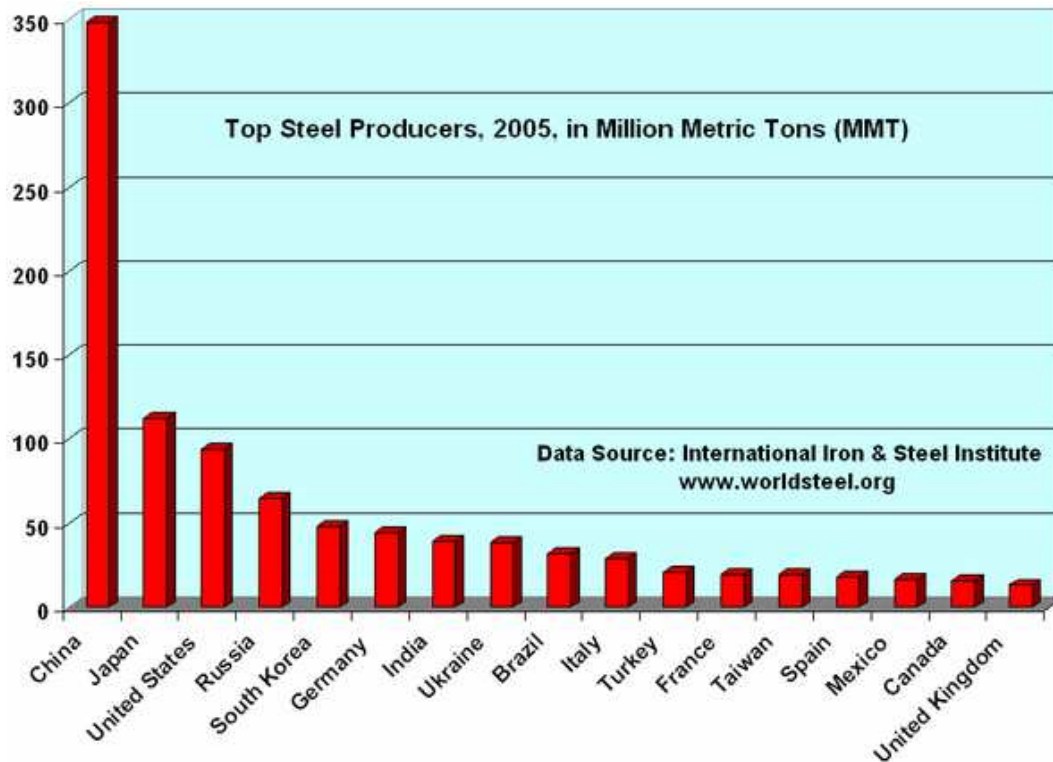
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<sup>[69]</sup> Encyclopediclopedia

<sup>[70]</sup> Considine, The Transformation of the North American Steel Industry: Drivers, Prospects, and Vulnerabilities

<sup>[71]</sup> Iron and Steel Statistics Bureau

The top steel producers are seen in the following graph:



Source: Wikipedia, the free encyclopedia

Canada and Mexico have a similar steel production. In 2005, Mexico produced 16.2 MMT (1.43% of total production) and Canada 15.3 MMT (1.35% of total production).<sup>[72]</sup>

### 3.3.2.2 The Steel Dispute

#### 3.3.2.2.1 Mexican Allegation

The Mexico-Canada steel dispute began before the countries became NAFTA partners. In August 1993, Mexican steel companies AHMSA (Mexico's largest steelmaker) and HYLSA appeared before Mexico's Ministry of Trade and Industrial Development (SECOFI) to request the application of a compensatory quota regime and the beginning of an anti-dumping and countervailing duties investigation on imports of rolled steel plate from Brazil, Canada, Korea, South Africa, Venezuela and the United States. In Mexico, the anti-dumping and countervailing investigations are conducted by SECOFI. The year 1992 was chosen to be the period under investigation.

In November 1993, an American steel company with Canada operations, Titan, and Canadian steel companies, Algoma, Dofasco and Stelco, were notified by SECOFI of the initiation

<sup>[72]</sup> Wikipedia, the free encyclopedia

of the investigation, and were asked to submit specific information, as well as to complete the anti-dumping questionnaire.

The investigation by SECOFI of injury, attributed to imports of rolled steel plate from Canada, was based on the assumption that all the imports were selling in Mexico at unfairly low prices and, when accumulated with imports from other sources, were determined to be injurious to domestic producers in Mexico. <sup>[73]</sup>

In April 1995, SECOFI decided to continue with the administrative investigation without imposing the requested compensatory quotas on rolled steel plate originating in or imported from Canada. However in December 1995, SECOFI accused Canadian steel producers of dumping in Mexico and ruled in its final determination to impose definitive anti-dumping duties on rolled steel plate imports originating in or imported from Canada. The duties were set for any exporting Canadian company in the amount of 31.08%. NAFTA had been implemented already almost for two years when this decision was ruled.

#### **3.3.2.2.2 Canadian Allegation**

From 1995 to 1997, steel exports to Mexico fell suddenly due to the Mexican currency devaluation and the lack of economic activity in 1995. SECOFI's decision was seen from the Canadian point of view as "controversial, particularly since it came at a time when the Mexican economy was in a downward spiral, a year after a botched currency devaluation left the peso with less than half of its value against the dollar. Mexico intended to export its way back to economic growth, and trade cases were brought against numerous products" <sup>[74]</sup>

Canada's steel industry appealed the penalties imposed on plate steel under NAFTA Chapter Nineteen dispute resolution provisions. In January 1996, Dofasco, Stelco, Algoma and Titan requested the review of the December's final determination of the anti-dumping and countervailing duties investigations on rolled steel plate imports originating in Canada, based on Article 1904 of NAFTA's Chapter Nineteen. In February 1996, the companies submitted their complaints also before the Mexican section of the Secretariat of NAFTA.

In May 1997, the binational panel decided in favor of the Canadian steelmakers and ordered that the country-wide price discrimination margins against Canadian producers must be reassessed. In December 1997, the panel's decision was modified. The binational panel ordered SECOFI to repeat several technical procedures in the original investigation with the stipulation that it considers only the steelmaker Titan, and not the other steel producers. The panel agreed that no other

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<sup>[73]</sup> Foreign Trade Decision System. Decision of the Panel.

<sup>[74]</sup> Hall, Nafta panel favors Canadian steel industry, pg.4A

company than Titan exported the same steel product to Mexico in 1992 (the period under investigation), and therefore cannot be considered in the investigation.

In February 1998, SECOFI announced that upon reinvestigating the original anti-dumping duty trade case against imports of rolled steel plate from Titan, it had adjusted the dumping margin upwards from 31.08% to 108%. Although the binational panel ruled in December that Titan was the only company that exported rolled steel plate to Mexico during the period of investigation, SECOFI's remand determination found that not only Titan, but the other three companies (Dofasco, Stelco, Algoma) as well, dumped rolled steel plate in Mexico in significant volumes, and that those imports continued to injure Mexican steel companies. Based on this allegation, the Canadian steelmakers were also hit with the extensive 108% duty on imports of rolled steel plate into Mexico. This result was viewed as "ludicrous"<sup>[75]</sup> by the Canadian steelmakers and they appealed it.

In August 1998, the NAFTA panel directed SECOFI to once again evaluate Canadian plate steel exports to Mexico in 1992, finding the 108% margin illegal. The panel ordered to lower the dumping tariff for the three Canadian mills, and stated that it must be below the firstly given margin of 31.08%. Considering Titan, the panel ordered to modify the decision and to recalculate a new margin for the steel company. By 1999, the margin was subsequently changed to 25.45% for the three Canadian steelmakers and 133.79% for Titan – this time by the NAFTA panel.

### **3.3.2.3 New Resolution?**

Between 1998 and 2001, the North American steel industry faced an onslaught of steel imports that led to a steady reduction in steel prices. It was necessary for the NAFTA countries to find a common strategy that would operate against government support and distorted markets, which lead to "cycles of oversupply", "depressed prices and profits", disputes, "injured producers and the inevitable increase in trade actions".<sup>[76]</sup> To demonstrate shared interests in addressing market distortions in the steel sector, and furthering the integration of their steel industries in the context of greater North American economic integration, the NAFTA governments pledged a joint statement to identify areas in which Canada, Mexico and the United States can work together to promote more openness in the North American steel market and cooperation on steel trade and industry policies.<sup>[77]</sup>

The NAFTA governments agreed to establish a NAFTA Steel Trade Committee in recognition of the importance of maintaining an open steel market within North America. This

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<sup>[75]</sup> Haflich, Canadians eye re-evaluation.

<sup>[76]</sup> International Trade Administration. U.S. Department of Commerce.

<sup>[77]</sup> Foreign Affairs and International Trade Canada

Committee was planned to be a consultative mechanism for providing a forum for regular exchanges of information and views, for reviewing progress, and for developing possible approaches to current and potential problems.<sup>[76]</sup>

#### **3.3.2.4 North American Steel Trade Committee**

In December 2002, the governments of Canada, Mexico and the United States announced the formation of the North American Steel Trade Committee (NASTC) that would meet for the first time in November 2003 in Mexico City. The objectives of NASTC were: to promote continued cooperation among the three governments on international steel policy matters, to serve as a consultative mechanism for regular exchanges of information and review of progress on matters of mutual interest or concern, and to reduce the remaining distortions in the North American steel market.<sup>[78]</sup> Since then, the NASTC emerged as an “important forum for industry/government collaboration on a wide range of activities including cooperation in multilateral negotiations, regular information and analytical exchanges and joint efforts to address government interference in the global steel market”.<sup>[79]</sup>

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<sup>[76]</sup> International Trade Administration. U.S. Department of Commerce.

<sup>[78]</sup> Foreign Affairs and International Trade Canada

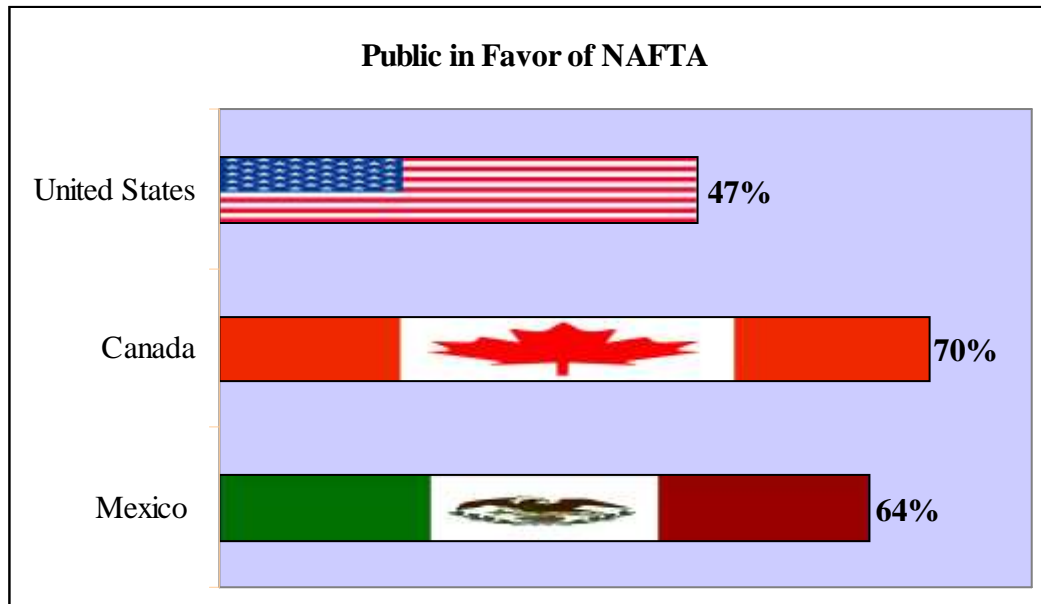
<sup>[79]</sup> Security and Prosperity Partnership Of North America

## 4 Public Opinion on NAFTA <sup>[80]</sup>

The disputes and their settlements are one of the main factors that can influence public view on NAFTA. The public opinion can become a very powerful tool forcing the government to act accordingly. There are many polls that deal with the Canadian, American and Mexican people's opinion on NAFTA.

### 4.1 Opinions on NAFTA

Recent polling suggests that there is no clear positive or negative public attitude towards NAFTA. The people are divided as to whether NAFTA has been good or bad. Public opinions in Mexico, Canada and the United States tend to be positive to NAFTA. A survey conducted in July 2004 by CIDE and COMEXI in Mexico found that 64% of the Mexican public favored NAFTA. Canadian opinion, reported in a June 2003 Ipsos Reid survey, found that 70% of Canadians supported NAFTA. The Program on International Policy Attitudes reported in a January 2004 poll that 47% of Americans felt that NAFTA has been good for their country, while 39% felt that it had been bad.



The view of reducing trade within NAFTA is rejected by majorities across North America. A poll on NAFTA conducted in all three countries by Ipsos Reid in 2002 explored public preferences for "making trade closer" between the three countries, keeping "trade between the

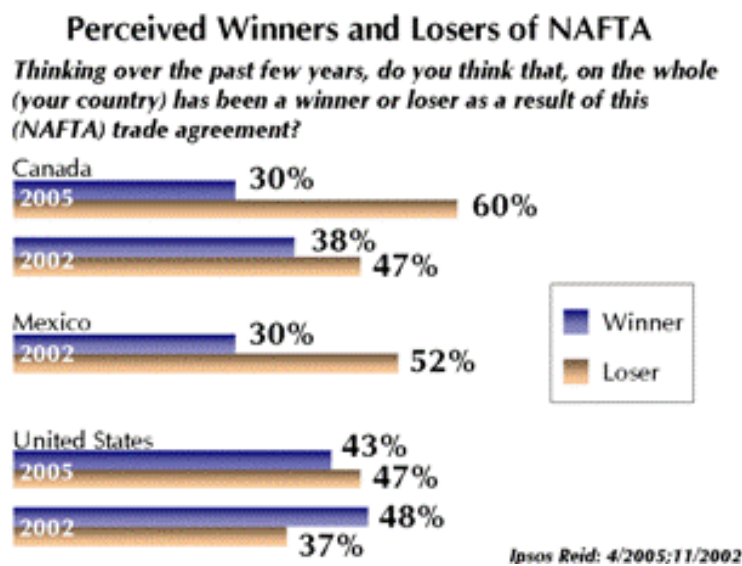
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<sup>[80]</sup> Weber, In Mexico, US and Canada, Public Support for NAFTA Surprisingly Strong, Given each Country Sees Grass as Greener on the Other Side



countries and their economies the way they are today” or “reduce trade.” The public in all three countries favored increasing trade or keeping it the same (75% in Canada, 73% in the US and 58% in Mexico wanted to increase trade or keep it the same). Mexico appeared to be mostly divided on this issue, with 33% supporting reducing trade, In Canada and the US only 19% each desired reducing trade.

Despite the majority support for NAFTA, people in Canada and Mexico have tended to see their own country as the loser in NAFTA, and view the United States as the winner. The US public on the other hand, has viewed Mexico as the winner and has been narrowly divided about whether the US is a winner or a loser in NAFTA.



## 4.2 Canadians’ Opinion on NAFTA

The feeling among Canadians that they were the loser under NAFTA increased over time. In 2002, 47% of Canadians thought their country was losing in NAFTA, and 38% thought it was winning. By April 2005, 60% of Canadians felt that their country was losing, and only 30% felt that Canada was winning in NAFTA. One of the reasons why there was such a major increase in the negative perception is given to the mentioned trade dispute problem, which unquestionably negatively influenced Canadians’ view of US-Canada relationship, as well as their view on NAFTA as a whole.

The Canadian CEO and business leader panel attributes the US government’s refusal to remit softwood duties as decided by the NAFTA tribunal process to deterioration of Canada-US relations. The United States governments are viewed as historically unreasonable on trade issues.

The panel is concerned about the US refusal to carry out the NAFTA tribunal decision. “This refusal truly signifies NAFTA’s problems in the opinion of CEOs and opinion leaders.”<sup>[81]</sup>

*Table 1: To What Degree Does Softwood Disagreement Signify NAFTA Not Working<sup>1</sup>*

	MEAN	7	6	5	4	3	2	1	DNK
August 2005	4.8	18	20	22	16	10	8	4	2
September 2004	4.9	28	18	17	11	8	8	8	1

<sup>1</sup> (Q1) As you know, the U.S. has applied special duties on Canadian softwood because of a U.S. belief that the level of timber-cutting (“stumpage”) fees amount to a government subsidy. To what extent does this dispute demonstrate that free trade does not work? Please use a 7 point scale where 7 means demonstrates strongly it does not work and 1 the opposite.

*Table 2: Canada-U.S. Relations—Better or Worse than Historically?<sup>2</sup>*

	AUGUST 2005	MARCH 2005
The very worst we’ve had	1	6
Among the worst	24	31
Worse than average	58	54
Better than average	14	6
Among the best	2	1
The very best	0	0
Don’t know/Refused	2	2

<sup>2</sup> (Q3) Thinking back over more than a century of Canada-U.S. relations, would you say that Can-Am relations this season were...[ROTATE POLES].

*Table 3: To What Degree Does U.S. Government’s Rejection of NAFTA Tribunal Decision Signify NAFTA Not Working<sup>3</sup>*

MEAN	7	6	5	4	3	2	1	DNK
5.5	37	21	17	10	9	4	2	1

<sup>3</sup> (Q2) The NAFTA tribunal mechanism took the side of Canadian lumber companies, deciding that the U.S. government owes them mammoth compensation for tariffs that were wrongly imposed. The U.S. government refuses to pay or change its position on the special duties. To what extent does this situation demonstrate that free trade does not work? Please use a 7 point scale where 7 means demonstrates strongly it does not work and 1 the opposite.

<sup>[81]</sup> COMPAS in the Financial Post

In spite of these negative results, the Canadians feel that there is “no alternative for Canada but to play the Washington game better and address the vagaries of US protectionist leanings by leveraging US interests in support of Canadian free trade objectives.” “Even with recent disputes ... Canada is better off with NAFTA than without it.”<sup>[81]</sup>

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<sup>[81]</sup> COMPAS in the Financial Post

## Conclusion

My thesis, NAFTA – Canada’s approach: Relations and Disputes, focused on Canada and its role within the North American Free Trade Agreement. The main question I analyzed was: **What is Canada’s approach toward NAFTA?** In order to answer this question, it was necessary to study not only Canada’s approach, but also the approaches of the United States and Mexico toward the Agreement. To understand these approaches, it was essential to find out NAFTA’s impacts on the economies of the member countries and the relations between them. These relations, especially trade relations, show how intense NAFTA is. To show whether the Agreement is also effective, I studied in detail disputes and their settlements between the countries. The dispute settlement is one of the main factors that can influence public view on NAFTA, and the public view very much dictates to the country’s governments the approaches toward the North American Free Trade Agreement.

My sub-questions helping me to answer my main thesis question were: What is NAFTA’s impact on Canada? What are the relations between the NAFTA countries? What are the disputes between the NAFTA countries? How do the relations and disputes affect the public view on NAFTA? My thesis provided these answers:

### What is NAFTA’s impact on Canada?

NAFTA’s impact on Canada was analyzed by three major indicators: impact on economy, impact on unemployment, and impact on trade disputes. It has been difficult to analyze NAFTA’s effects on economy due to the large number of other variables in the global economy. However NAFTA’s implementation proved to have stimulated Canada’s trade and investment, and this stimulation is largely seen as a positive impact on the country’s economy. On the other hand, NAFTA’s trade expansion had a negative effect on Canada’s employment causing a major net destruction of jobs. The rise in unemployment was not saved by the NAFTA creation of part-time jobs; NAFTA took more jobs than it created. The effects of trade disputes taking place mainly between Canada and the United States have had rather a negative than a positive impact on Canada and the public view on NAFTA. The Agreement did not provide exemptions for Canada from the US anti-dumping and countervailing duty measures. Canada has remained subject to arbitrary US actions such as the punitive US duty on Canadian softwood lumber exports. NAFTA had provided Canada a provision that special panels examine whether the US laws were correctly applied in the first place. However from the softwood lumber dispute, we can see that the United States do not

consider such panel decisions as obligatory. Overall, NAFTA had more of a positive than a negative impact on Canada; however some of the negatives are quite serious.

#### What are the relations between the NAFTA countries?

NAFTA is more seen as two bilateral agreements, rather than one trilateral one. United States plays a dominant role within the Agreement. Canada-US relationship can be characterized as integrated but asymmetric. Canada is dependent on the US market; the United States is Canada's largest and most dominant trading partner. The economies have the largest bilateral trade relationship in the world and share one of the world's largest investment relationships. However (or for this reason) disputes between the two countries regarding mainly trade issues raise tensions and cool relations between the two countries. A similar asymmetry can be seen within the US-Mexico relationship. Mexico is the first developing country with which the United States has entered into a free trade agreement. US-Mexico trade has grown significantly since NAFTA's implementation, and the US is the largest source of foreign direct investment in Mexico. Mexico became the United States' second largest trading partner. The Mexican economic dependence on the United States is so high that the Mexican economic cycles rely on the American economic behavior. Mexico is more reconciled with the US dominant role and the country's dependence on the world's greatest economy than is Canada; preserving Canadian independence against the strong pressure from the United States was and will always be a major political issue in Canada. Although Mexico and Canada share the United States as their neighbor and experience a similar relationship with the dominant NAFTA partner, they have not seem to find a way to each other yet. Despite the Mexico-Canada economic relations growing significantly since the NAFTA's implementation, trade between the two economies represents a very small part of the total NAFTA trade; this relates to the low number of disputes between the two countries. To sum up, the relations between the NAFTA countries are good, but could be better.

#### What are the disputes between the NAFTA countries?

Most of the NAFTA disputes involve the United States. There have been only a few disputes between Canada and Mexico. My thesis studied in detail three main disputes.

The first dispute was the never-ending acute softwood lumber dispute, which showed how the United States tend to behave according to the NAFTA obligations only when it is convenient for them. The softwood lumber dispute concerned anti-dumping and countervailing duties that the Americans set on Canadian softwood lumber due to allegations of dumping and material injury of US industry. Although in August 2005 the ultimate NAFTA Tribunal ruling decided in favor of

Canada, and Canada claimed that there is no longer any legal basis for maintaining anti-dumping and countervailing duty orders on its softwood lumber exports, the US decided to ignore this panel ruling. This action deteriorated the Canada-US relationship. During this dispute, Mexico supported Canada; similarly Canada supported Mexico in my second discussed dispute.

The second dispute was the first claim ever filed under NAFTA and took place between a US corporation Metalclad and the Mexican government, on the issue of a hazardous waste landfill. The local Mexican government prevented the Metalclad corporation to build a hazardous waste plant on its territory by not giving the corporation a municipal permit. Still the plant was built because the corporation was assured by other Mexican legislators that the municipal permit is not required. Later on, the local Mexican government proclaimed the site to be part of a special ecological zone for the preservation, and the corporation had to respect that the plant cannot operate in that area. The corporation sued the Mexican government and after the NAFTA Tribunal ruling favored Metalclad, Mexico appealed this decision, and Canada strongly supported its NAFTA partner. The appellate procedure took place at a Canadian Supreme Court. This US-Mexico dispute represented a critical test for Canadian courts and their handling of NAFTA based arbitral awards.

The last dispute was the Mexico-Canada disagreement over rolled steel plate. It consisted of Mexican and Canadian allegations on imports of rolled steel plate to Mexico. The dispute began before the NAFTA implementation, however took place even after NAFTA realization. The Mexico-Canada dispute was not as acute as the previous two with the United States. For this reason, it was not very easy to find all sufficient information.

How do the relations and disputes affect the public view on NAFTA?

Despite the negative views of Canada's dependence on the United States, and the negative impacts of the softwood lumber dispute on the Canada-US relations, the public view of Canadians on NAFTA remains positive. It is actually the most positive view from all three member countries. Surprisingly, it is the United States' public that is most sceptical toward NAFTA, however the Americans were the only ones perceiving themselves as the winners of NAFTA. The polls focusing on Canada-US relations only support that the softwood lumber dispute harmed the public view on NAFTA. Nevertheless, the Canadians continue to believe that they will always be better off with NAFTA than without it.

After answering all the sub-questions, on which my thesis concentrated, my main thesis question, **What is Canada's approach toward NAFTA?**, can be answered.

Canada has always been dependent on the United States. Due to this one-way dependence, it was important for Canada to create an agreement with the United States that would regulate restrictions and obligations of the Canada-US relation. In 1989 it was CUSFTA, in 1994 extended NAFTA. The extension of NAFTA, besides promising a more desirable Canada-US relation, also created a higher bond between Canada and Mexico, an economy that was a potential promising market for Canada. After twelve years of NAFTA's implementation, the Mexico-Canada relation appears to be more of a disappointment for both economies. However, rather than with Mexico, the relation with the US is more important to Canada. One of the main reasons for Canada's support of NAFTA was to be protected from American anti-dumping and countervailing duty measures. The softwood lumber dispute demonstrated that this Canadian objective has not been achieved – NAFTA does not protect Canada from American anti-dumping and countervailing duty measures. The trade dispute results proving that NAFTA is not as effective as promised, together with the negative NAFTA impacts on Canada's employment and higher trade dependence with the United States, result in criticism of the Agreement. Nevertheless, Canada's approach toward the North American Free Trade Agreement remains to be positive. The Canadians know that they are playing with the elephant that can roll over any time; and unfortunately elephants are not scared of mice.

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