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## NAFTA AND THE CANADIAN PROVINCES: TWO SHIPS PASSING IN THE NIGHT?

*James P. McIlroy\**

I am very pleased to be with you this afternoon to discuss whether the provinces of Canada are connecting with the NAFTA. And my friend Matt Schaefer is going to tackle this issue from the perspective of the American states.

As Henry mentioned, this is the second year I have had the pleasure of addressing this conference. Last year, I discussed NAFTA cross-border provision of services, and during my discussion of trade in services, I flagged the issue of the sometimes troubled relationship between the NAFTA and the Canadian provinces. This year, Henry decided to put my feet to the fire and asked me to look at how the provinces of Canada are connecting with the NAFTA.

Following on the previous discussion of Fast Track and other railroad references, you will note that, with the title of my Article, I have shifted the focus of this transportation theme from land to sea. And the title poses the following rhetorical question, are NAFTA and the provinces two ships passing in the night? You will see that I think that in many instances they are, and I think that in many cases this is going to cause problems in the future.

Let me walk you through my presentation before we begin. First, I want to look at how the provinces are connected to the NAFTA. To understand this connection, I think there are three key points to consider. First, we have to look at the interaction of the global economy and Canadian federalism. Second, it is important to appreciate that, under Canada's federal form of government, a division exists between the federal power to negotiate a treaty and the provincial power to implement the treaty in many key areas. The third point we will discuss is the mechanism that actually connects the provinces to the NAFTA, and we will see that the connection is not made by way of formal signatures by the provincial governments. Instead, the connection is made by a

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more indirect route, the so-called federal state clause.

Once we have looked at how the provinces are connected to the NAFTA, I would like to explore briefly a concrete example, which will demonstrate that the federal/provincial arrangements set up to deal with post-war international trade treaties may not be the best way to deal with the issues arising in the emerging global economy of the twenty-first century. You shall see that I believe that there are problems in the relationship between the provinces and the NAFTA, and these problems must be sorted out if the NAFTA and future treaties are to achieve their full potential in Canada.

Thirdly, I will briefly explore some of the options that should be considered to determine where we go from here. You will find that many of the options that I explore have been treated in more detail in Matt Schaefer's trail-blazing forty-page paper, which is also in your materials. I recommend you read this because I think Matt has raised a lot of the issues and has attempted to respond to them, and I commend him for this.

Let us look at what connects the NAFTA to the Canadian provinces. To understand this connection, we must step back for a moment and look at how globalism is shifting the international trade treaty agenda from federal tariff barriers to internal provincial measures. The connection between the Canadian provinces and international trade treaties, like the NAFTA, has been greatly influenced by the evolving relationship between the global trade agenda and the constitutional division of powers under Canada's federal form of government.

In the post-Second World War era, most international trade treaties focused on trade in manufactured or agricultural goods and customs tariffs imposed on these goods when they crossed national borders. In Canada the power to impose customs tariffs lay solely with the federal government, and the provincial governments had no direct authority over the implementation of Canadian tariff policy. However, after several multilateral tariff cutting rounds conducted under the auspices of the General Agreement on Tariffs and Trade, the GATT, in the 1960s and 1970s, the focus of trade liberalization treaties started to shift away from the customs tariffs imposed on manufactured and agricultural goods. And this trend resulted from the fact that the majority of economic activity in most industrialized countries was shifting from agricultural and manufacturing sectors to the services sector.

But I think it is important to reiterate the point that international trade treaties like the NAFTA now go well beyond customs tariffs and focus on topics like investment, intellectual property, government procurement, and trade in services. This is only the beginning. A new trade

agenda is now expanding to include matters that go far beyond the measures countries impose when goods cross their borders, including their internal labor practices. We just heard about environmental standards, competition policies, et cetera. And in Canada many of these more recent international trade agenda items fall squarely within provincial jurisdiction.

So to sum up my first point, I would like to emphasize that the global trade treaty agenda is focusing increasingly on areas of provincial jurisdiction. This shift in the international trade agenda is creating friction and problems at the interface between the federal power to negotiate treaties and the provincial power to implement many of the key items on the new international trade agenda.

This brings me to my second point, which is the power to negotiate versus the power to implement. There are three key points I would like to flag today. First of all, it is important to note that not one of Canada's provincial governments has actually signed the NAFTA. The sole Canadian signatory to the treaty is the federal government of Canada who signed, along with the other two so-called "Parties": the government of the United States of America and the government of the United Mexican States. Secondly, international treaties are not self-executing and do not automatically become Canadian law upon accession. Instead, as a result of the principle of parliamentary supremacy, if the implementation of a treaty requires changes to Canadian law, legislation is necessary. Thirdly, under Canada's constitution the power to legislate is divided between the federal government and the provincial governments. To make a long story short, the courts have recognized that the federal government of Canada's trade and commerce power enables Ottawa to regulate interprovincial and international trade, whereas the provincial governments have the power to regulate intraprovincial trade.

The dividing line between the federal and provincial spheres of jurisdiction has been the subject of considerable constitutional debate and litigation. The situation is unclear because, although it is clear that the federal government has the power to negotiate international treaties, Canada's constitution is silent on Ottawa's power to implement treaties. Unlike the Constitution of the United States, the Canadian Constitution was initially drafted when Canada was still a colony of the British Empire, and international treaties were negotiated by the British government. Unfortunately, in 1867, the Fathers of Confederation did not anticipate that Canada would evolve from a colonial state to a fully independent member of the international community. Section 132 of the 1867 British North American Act was, therefore, silent on the treaty implementation power of the government of Canada, and it focused solely on

the federal power to perform empire treaties.

Seventy years after Confederation, a landmark decision occurred in 1937. The so-called Labor Conventions case arose because Canada was a member of the International Labor Organization (ILO). The ILO had adopted three conventions under which members agreed to enact legislation setting a minimum wage, limiting employees' working hours, and requiring a weekly rest. When the federal Parliament enacted legislation to implement these ILO obligations, Canada's ultimate appellate court at that time, which was Britain's Judicial Committee of the Privy Council, struck down the legislation on constitutional grounds.

The learned British Lords held that Section 132 only applied to treaty obligations, which bound Canada as part of the British Empire and did not empower Ottawa to perform treaty obligations arising under treaties between an independent Canada and foreign countries. It further held that there was no such thing as a general federal power to implement international treaties. Instead, the courts looked to the substantive subject matter of the implementing legislation. If the legislation dealt with a matter allocated to the federal Parliament, then Ottawa had the power to implement the treaty; however, if the subject matter was allocated to the provincial legislatures, then Ottawa could not enact treaty-implementing legislation.

I am not a constitutional scholar, so I am not going to bore you with the last sixty years of case law and commentary that were unleashed by this 1937 Labor Conventions case. But I do think it is important that we all be aware of this constitutional context so that you can appreciate the tenuous nature of the connection between the provinces and the NAFTA.

Sovereignty is not just an issue between nations; sovereignty is also an issue within some trading partners. And in Canada the powers to negotiate and sign an international trade treaty are not always coupled with the power required to implement the treaty. However, this does not mean that the NAFTA only affects the federal government of Canada.

This brings us to my third subject, and that is the connection between the NAFTA and the provinces, the so-called federal state clause. I would like to cite Article 105 of the NAFTA, which deals with the extent of the treaty's obligations. Here is what Article 105 says. "The parties [meaning Ottawa, Washington, and Mexico City] shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments."

Article 105, as I said, is commonly referred to as a federal state clause, and federal governments in countries, including Canada, the

United States, Mexico, Australia, and others, use these clauses in international treaties to recognize that their powers are not unlimited. In Article 105 of the NAFTA, like its predecessor, Article 103 of the Canada/U.S. Free Trade Agreement (FTA), it specifies that Ottawa, Washington, and Mexico City must ensure that all necessary measures are taken.

This language appears to be a little stronger than the language used in the GATT because, in both the 1947 and 1994 GATT agreements, Article XXIV only requires that a contracting party take, "such reasonable measures as may be available to it" to ensure observance by the regional and local governments and authorities within its territories. I am not going to spend time talking about the difference between a necessary measure and a reasonable measure, but I think it is fair to say that Article 105 imposes greater obligations on the parties to the NAFTA than we see in the multilateral context.

So far the scope of Article 105 of the NAFTA has not been the subject of a dispute resolution proceeding. For example, it is not clear whether this obligation would require Ottawa to use its extraordinary powers to disallow provincial legislation that contravene a NAFTA obligation. However, it is fair to say that if Ottawa does not have the jurisdiction required to enact implementing legislation, Article 105 obliges the federal government of Canada to take all necessary measures to enforce provincial compliance or expose Canada to a claim for compensation and, ultimately, retaliation.

So to sum up our discussion regarding the connection between the NAFTA and the Canadian provinces, you should always keep in mind that this connection has been established by Article 105's federal state clause and not by the provinces becoming signatories and formal parties to the treaty. If push comes to shove, and a province refuses to give effect to a NAFTA provision that requires provincial implementing legislation, Ottawa could find itself on the hook to pay compensation or be the subject of retaliation by another NAFTA party.

Now that we understand how the provinces are connected to the NAFTA, let us look at a concrete example of how the relationship is working in practice. The example I have chosen relates to the topic I discussed here last year, the implementation of NAFTA's Chapter 12 obligations regarding cross-border trade in services. To determine how the connection is working in practice between the NAFTA and the provinces, I would like to spend a few minutes looking at what was supposed to happen, what actually happened, and then try to figure out what went wrong.

Let us look first at what was supposed to happen. As you may be

aware, NAFTA Article 1206 contains a grandfather provision that allows a state or province to reserve or exempt certain nonconforming measures from NAFTA's national treatment, most-favored nation (MFN), and local presence service obligations. To reserve these state or provincial nonconforming measures, the federal governments of Canada, the United States, and Mexico were required to list them in a document called an Annex I Schedule within two years of the date of the NAFTA's entry into force; that is, by December 31, 1995. Subsequent amendments to these grandfather nonconforming measures could not decrease the conformity of the measure.

This "list-it-or-lose-it" process was intended to create a comprehensive and transparent benchmark, which would enable anyone to determine whether a province or state was respecting the NAFTA service provisions. The onus was on the party that wished to maintain the nonconforming measure to put it down on a piece of paper. Listing it or losing it also would have created a comprehensive shopping list for future trade liberalization discussions. It was a very neat way of dealing with a difficult problem, and the fine print of Annex I required that considerable detail be provided to identify specific laws, regulations, or other measures that were not conforming. In theory, it sounded great, but let us look at what actually happened.

The first sign that things were not going all that well was when it became clear that the provinces and states would need more than two years to provide lists of their nonconforming measures to their federal governments. It was, therefore, necessary to extend the original December 31, 1995 deadline to March 31, 1996. However, the three-month extension did not solve anything because, in the end, the parties were forced to abandon the comprehensive and transparent list-it-or-lose-it format and settle for something considerably less.

On March 29, 1996, Canada's Minister for International Trade wrote to the United States Trade Representative (USTR), and attached the Canadian schedule to Annex I of the NAFTA. It was a one-page schedule. It was extremely general and it fell far short of the detail originally envisioned by the NAFTA. For example, there was no information provided under the sub-sector and industry classification headings. Although Annex I's fine print required that considerable detail be provided to identify specific laws, regulations, or other measures that were nonconforming, the measures heading only contained the following basket clause, "all existing nonconforming measures of all provinces and territories." That is what I call a basket clause. So much for transparency.

There is no document that you can now go to and look in to see what the provinces reserved. But that is not all. Canada's letter to the

USTR also stated, "For transparency, also attached are documents that list nonconforming measures maintained at the provincial and territorial level." Some of these documents did contain more detail regarding the grandfathered provincial nonconforming measures, but they were not considered to be comprehensive. So much for the comprehensive list-it-or-lose-it format.

In sum, the comprehensive and transparent NAFTA Chapter 12 list of nonconforming provincial services measures simply never materialized. So why did the provinces fail to connect with this NAFTA exercise? What went wrong? The answer is not entirely clear. But it is interesting to note that one of the bibles of international trade gossip, *Inside U.S. Trade*, carried a front-page story in its April 5, 1996 edition that stated Canada had initiated the changes to their reservations process. The story said, "[t]he Canadian federal government had been facing a rising tide of public and provincial sentiment against exempting from NAFTA disciplines only specific nonconforming measures that were to be listed individually under Annex I as the NAFTA parties had originally agreed to." The article also indicated that once one Canadian province, notably British Columbia, had decided to file only a general reservation, rather than the detailed reservations envisioned by the NAFTA, the other provinces followed suit in order to avoid a situation whereby one province's actions might be used against another province in a NAFTA challenge.

It should also be noted that this lowest common denominator was formulated by the New Democratic Party of British Columbia, in the context of a heated provincial election campaign. I do not think it is any secret that the NDP leans a little to the left, and its union allies are not particularly strong supporters of the NAFTA. In other words, you have a process whereby the people most opposed to the NAFTA define the lowest common denominator and drive the process. But please note that the Canadian provinces were not alone in their failure to connect on this occasion.

*Inside U.S. Trade* also reported, "[t]he Clinton Administration finally swung behind the idea of a general reservation, not for political reasons, but because the process of identifying state nonconforming measures over the past year had resulted in very uneven reporting from the fifty states, the District of Columbia, and the Commonwealth of Puerto Rico. A U.S. official stated that the kind of detail we were getting from some states was in many ways excessive. They were reporting many things that had nothing to do with NAFTA, while others were reporting very little." A state trade official concluded that this filing of a non-comprehensive and non-transparent general reservation would limit the amount of liberalization that NAFTA could achieve in the future.



The moral of this story is that the states and the provinces do not appear to have been equipped or inclined to meet a NAFTA requirement notwithstanding the fact that they had over two years to get their act together.

Where does that leave us today, and where do we go from here? I think it is fair to say that the 1937 Labor Conventions case has created an inconvenient precedent whereby the federal government of Canada, which creates international treaty obligations, is powerless to ensure the performance of many of these obligations. In the area of international trade treaties, Canada has been able to muddle through most of the past six decades largely because trade treaties focused primarily on areas of federal jurisdiction. However, the NAFTA, the GATT, and the World Trade Organization's future agenda have all demonstrated that international trade liberalization now affects all kinds of areas that are near and dear to the jurisdiction of the provinces.

Canada is, therefore, at a crossroads. We can either continue to try to muddle along with our existing framework of federal/provincial conferences, committees, meetings, conference calls, et cetera, or we can recognize that the status quo will not get us through the twenty-first century and start doing something about it now. I do not believe that the status quo is a secure option in the long term because Canada's foreign trading partners may become reluctant to conclude treaties with us if we cannot assure them of provincial compliance. Given Canada's economic dependency on foreign markets, Ottawa cannot afford to allow federal/provincial rivalry to diminish Canada's bargaining power in bilateral and multilateral trade negotiations.

There are several options available to change the status quo. One is to obtain provincial approval before concluding an international trade agreement. However, it must be recognized that, if elaborate federal/provincial consultations have to be held before an agreement can be concluded, Canada's ability to negotiate effectively could be diminished. Ottawa's negotiating ability will be hampered if it is unable to respond quickly to the cut and thrust of negotiations or because information is disclosed or leaked during the consultation process. If this option is to work, Canada must ensure that sufficient resources are in place in Ottawa and all of the provinces to make sure that we do not repeat the unfortunate experience of the Annex I reservation case study I just described. This may not be the best option because, as we saw in our case study, the lowest common denominator will often prevail. If one of the ten provinces is in the middle of an election campaign, it is not going to be a very good common denominator. Even if most of the provinces have the trade policy will and expertise required, it only takes one prov-

ince to create problems. Furthermore, beefing up provincial trade policy resources will also create duplication costs.

Let us look at another option. Why not clarify the constitutional authority of the government of Canada to negotiate and implement international trade treaties? Some constitutional scholars believe that the Supreme Court of Canada would not necessarily follow the 1937 Labor Conventions precedent, which, after all, was decided sixty years ago by the Judicial Committee of the Privy Council of the United Kingdom. There are different ways to set this option in motion. Ottawa could frame a series of questions and refer them to the Supreme Court of Canada, or Ottawa could simply move forward and wait for a specific piece of implementing legislation to be challenged. But others argue that a clarification may not do the trick and that a constitutional amendment may be necessary. Given Canada's recent experience with constitutional reform, this does not appear to be a viable option in the near future.

Let me conclude by again stating that I do not believe that the Canadian provinces are fully connecting with the NAFTA and other international trade treaties that have created rights and obligations that impact on areas of provincial jurisdiction. Canada is in a dilemma. On the one hand, Canada must be a credible player on the world trade stage and regulate international trade in the national interest. On the other hand, the government of Canada wishes to respect the jurisdiction of the provinces.

I do not believe that the status quo will prevail indefinitely because federal and provincial legislation will be increasingly influenced by international treaties as the global economy evolves. And this top-down approach to lawmaking will not always be compatible with the bottom-up approach that favors laws that originate in provincial legislatures. More and more, both federal and provincial legislatures will merely be involved in enacting legislation to implement obligations that have been decided as a result of international trade negotiations. Any loss of national and provincial sovereignty to international negotiators gathered in Geneva and elsewhere will, no doubt, create considerable political controversy at home. The bottom line is that Canada's nineteenth-century division of federal and provincial powers may soon collide with the emerging global economy and the international trade agenda of the twenty-first century. Something is going to have to give.

If Canada maintains the separation of the power to negotiate from the power to implement, Ottawa could find its leverage and credibility may suffer from its inability to deliver on all of its commitments. On the other hand, if Ottawa clarifies or expands its power to implement international trade treaties, provincial sovereignty will pay the price. It is

still too early to say how this dilemma is going to be worked out. In a typically Canadian fashion, we may simply attempt to muddle along with the status quo until a crisis forces a change. Come what may, I hope that my remarks this afternoon will make it easier for you to understand what is going on the next time you see a loose connection occurring between the NAFTA and the provinces.