

# NOTES

## THE UNITED STATES-CANADIAN AUTOMOTIVE TRADING RELATIONSHIP AND THE LEGALITY OF THE CANADIAN DUTY REMISSION PROGRAM

### I. INTRODUCTION

The automotive industry influences the entire U.S. economy. This huge industrial structure directly affects over four million jobs in the United States.<sup>1</sup> In terms of foreign trade in 1985, the United States exported approximately \$6 billion worth of new passenger cars to foreign nations; 96 percent of those automobiles went to Canada.<sup>2</sup> This is an illustration of the U.S. automotive industry's direct interest in the U.S.-Canadian trading relationship, and the desire to obtain the potential benefits of a "broadened trading relationship" between the two countries.<sup>3</sup>

Presently, the United States and Canada have a unique duty-free automotive trading arrangement which is distinguishable from those of other automotive trading nations. The agreement was established by the United States-Canadian Agreement Concerning Automotive Products of 1965 (Auto Pact).<sup>4</sup> The fundamental principle of free trade mandates the removal of trade barriers, such as import duties.<sup>5</sup> Free trade between two trading countries enhances the general welfare of a nation's economy by allowing greater exchange and production gains within the respective countries.<sup>6</sup>

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1. Roy & Rassuli, *International Trade Barriers and the United States Automotive Industry*, 14 U. Tol. L. Rev. 263 (1982-83).

2. *U.S.-Canada Automotive Trade: Hearing Before the Subcomm. on Economic Stabilization of the House Comm. on Banking, Finance, and Urban Affairs*, 99th Cong., 2d Sess. (Sept. 23, 1986) [hereinafter *Hearing*] (testimony of Thomas Hanna, President and Chief Executive for the Motor Vehicle Manufacturers Association of the United States, Inc. (MVMA), concerning the United States-Canada Auto Pact: particularly in connection with the negotiations currently underway between these two governments concerning the possibility of establishing a border free trade arrangement).

3. *Id.* In the past, Canada has been among the leading trading partners of the United States. *Id.*

4. Agreement Concerning Automotive Products, Jan. 16, 1965, United States-Canada, 17 U.S.T. 1372, T.I.A.S. No. 6093 [hereinafter *Auto Pact*].

5. Roy & Rassuli, *supra* note 1, at 268.

6. *Id.* The benefits of free trade accrue from "market rationalization and efficiencies" that in the past have been illustrated as a compliment to the reduction of trade barriers between two countries. Moreover, free trade increases income. *Id.*

The purpose of this Note will be to examine the importance of the well established U.S.-Canadian automotive trading relationship. The main focus will be placed on the implementation of the Canadian Duty Remission Program and its impact on U.S. trading forces in relation to international agreements. In Part II, the Auto Pact's objectives, background, provisions and operations will be shown to express the vitality of such an agreement in an international trading relationship between two trading allies. In Part III, the Canadian Duty Remission Program will be explored through an analysis of how the program is used by the Canadian Government to create various investment incentives. A discussion will then follow to illustrate the origins and establishment of the program and how it has progressed and operated for the benefit of the Canadian Government and its economy. Next, the Remission Program's legality and its alleged violation of several international agreements with manifest adverse effects on the United States will be examined. Part IV will analyze the various options available to the United States with regards to the most appropriate course of action that the United States should undertake in considering the Canadian Duty Remission Program as a factor of international trade. Part V will conclude with final suggestions for approaching a healthy U.S.-Canadian automotive trading relationship.

## II. THE AUTO PACT: OBJECTIVES, BACKGROUND, PROVISIONS AND OPERATION

The Auto Pact of 1965 was an important and successful step taken by the United States and Canada to create a globally competitive North American automotive industry.<sup>7</sup> The effect of the U.S. and Canadian free-trade policy on automobiles and most automotive products has effectively integrated each country's automotive market, and has entitled the producers to gain the benefits of increased efficiencies through the economies of scale.<sup>8</sup>

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7. *Hearing, supra* note 2 (testimony of Thomas Hanna). Governing the largest single automotive market in the world requires departures from each country's ordinary trade and investment practices. The Auto Pact has been a dominant factor in the expansion of bilateral trading arrangements. *Id.*

8. *Id.* As the Auto Pact has encouraged the integration and rationalization of U.S. and Canadian automotive operations, it has improved productivity and has resulted in the production of optimum levels of components and vehicles. This increased productivity is of equal importance to both the U.S. and Canadian economies. Furthermore, consumers have benefitted from improved access to the other country's markets for automotive products. *Id.*

When the Canadian Value Added content level is at least 50 percent, consumers are permitted to purchase automobiles in Canada and bring them across the U.S. border with-

The original function of the Auto Pact was to eliminate the various imposed duties placed upon vehicles and original equipment parts shipped between the United States and Canada.<sup>9</sup> The intention was to create a single North American market.<sup>10</sup> The Auto Pact was created to establish a free-trade agreement between the United States and Canada in response to the sudden overwhelming bilateral trading problems of the automotive industry.<sup>11</sup> A compromise was agreed upon, although neither country had the intention to negotiate such a trading arrangement at that time.<sup>12</sup>

The U.S.-Canadian automotive trading problems of the early 1960's were initiated by the invocation of unilateral actions by each country.<sup>13</sup> In the late 1950's and early 1960's, the Canadian Government was concerned with the problem of its external net automotive trade deficit, as well as with the reduction of Canadian competitiveness as a producer of automobiles.<sup>14</sup> The Canadian automotive industry was small and inefficient in that it only pro-

out paying a duty. Furthermore, automobile manufacturers may access vehicles and original equipment parts duty-free. "Canadian Value Added" refers to the amount of Canadian content in an automobile manufactured in Canada. For example, 50 percent Canadian Value Added means that at least 50 percent of the Canadian manufactured automobile contains a 50 percent value of the aggregate of Canadian produced parts, manufacturing labor time, management compensation, overhead and other related expenses classified under an item that is Canadian produced. *Id.* (testimony of the International Union, United Automobile, Aerospace, and Agricultural Implement Workers of America (UAW), concerning the United States-Canada Auto Pact).

9. *See id.*

10. *Id.* The objectives of the Auto Pact were quickly achieved and the Canadian Duty Remission Program was eliminated, hence, enhancing bilateral trade between the two countries. *Id.*; *see infra* notes 11, 17 and accompanying text.

11. Reisman, *The Relevance of the Auto Pact for Other Sectoral Arrangements*, 10 CAN. U.S. L.J. 75, 76 (1985); *see also* *Hearing, supra* note 2 (opening statement of John J. LaFalce, Chairman of the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance, and Urban Affairs, concerning the hearing on U.S.-Canadian automotive trade). The Auto Pact was negotiated between the United States and Canada as a direct result of the establishment of a Canadian duty remission scheme of the early 1960's. *Id.*

12. Reisman, *supra* note 11, at 75-76.

13. *Hearing, supra* note 2 (testimony of Thomas Hanna).

14. Trezise, *The Relevance of the Auto Pact to Other Sectoral Arrangements*, 10 CAN. U.S. L.J. 63, 65 (1985); *see also* Note, *Canada-U.S. Automotive Agreement: the Sectoral Approach*, 8 J. WORLD TRADE L. 176 (1974). The alleged domination of the Canadian economy by the United States in the 1960's became a major political issue. Since the automobile industry was a prominent and maturing industrial sector in both the United States and Canada, it became the first area of concern between the two countries. *Id.*; *see also* *Hearing, supra* note 2 (testimony of the UAW). Unlike today, in 1965, automobile sales in the United States and Canada by non-North American producers were relatively small, and thus, were not of a major concern to these two economies at that time. *Id.*; *see also* CANADIAN-AMERICAN COMMITTEE, *THE CANADA-U.S. AUTOMOTIVE AGREEMENT: AN EVALUATION* (1970).

duced models in limited quantities.<sup>15</sup> The Canadian Government became increasingly concerned about the future growth of its market segment as part of the U.S.-Canadian automotive sector.<sup>16</sup>

As a result, the Canadian polity initiated a major change in the policies of its automotive industry and commenced the unilateral action of a duty remission program, "designed to increase the dollar value of Canadian content in exported automotive parts."<sup>17</sup> The duty remission scheme evolved in two stages. At first, Canadian manufacturers were allowed duty remissions on imported automatic transmissions and engine block parts.<sup>18</sup> Such remissions were equivalent to any increase achieved on a dollar for dollar basis on exported Canadian produced components.<sup>19</sup> After reviewing the apparent success of the program over a one-year period, the Sovereign of Canada commenced the second stage and broadened the duty remission program policy.<sup>20</sup> This entailed the offering of remissions on duties for any vehicle or original equipment compo-

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15. Note, *supra* note 14, at 176; *see also* *Hearing, supra* note 2 (testimony of Thomas Hanna). The deficient Canadian market operated at a 60 percent production rate compared to that of the United States. *Id.*

16. *Id.* The Canadian Government initiated consultations with those vehicle producers situated in Canada. Each manufacturer submitted a "letter of undertaking" to the Canadian Government to state its concerns. These statements contained a description of each firm's expectations of its production rates over the upcoming four years subject to the necessary governmental qualifications, market conditions and other factors beyond the individual company's control. The summations of the companies undertook to:

- (1) increase the total Canadian Value Added in vehicles and original equipment parts by an amount equal to 60 percent of the growth in the value of passenger car sales in Canada and 50 percent in the case of commercial vehicles; and (2) increase the Canadian Value Added in vehicles and original parts by a total of Canadian \$260 million over and above that achieved in model year 1964.

*Id.*

17. Reisman, *supra* note 11, at 76; *Hearing, supra* note 2 (testimony of Thomas Hanna); *see also id.* (testimony of Marc Santucci, Director of the Office of International Development of the State of Michigan, concerning the unfair trade practices instituted by the Government of Canada combined with the Canadian safeguards found in the Auto Pact).

In November of 1962, the Canadian Government instituted the first duty remission plan to reduce its growing trade deficit with the United States in the automotive sector. The plan was expanded in November of 1963 for the purpose of promoting Canadian made parts and increasing the Canadian Value Added in vehicles sold in Canada. The increase of Canadian parts to the United States rose from \$1 million in 1960 to \$45 million in 1964. *Id.*

18. Reisman, *supra* note 11, at 76; *see also Hearing, supra* note 2 (testimony of Thomas Hanna).

19. Reisman, *supra* note 11, at 76; *see also Hearing, supra* note 2 (testimony of Thomas Hanna).

20. *Hearing, supra* note 2 (testimony of Thomas Hanna). The result illustrated, that the dollar value of Canadian exports of automobiles and components subsequently increased over 700 percent between 1962 and 1964. *Id.*; *see also id.* (testimony of Marc Santucci).

ment imported, if matched by the equivalent export on any vehicle or original equipment part.<sup>21</sup>

The U.S. automotive producers' reaction to the Canadian duty remission scheme was hostile. A countervailing duty petition was filed by the Modine Corporation of the United States, an automotive parts radiator manufacturer, against the Canadian Government's automotive export program.<sup>22</sup> The petition charged that those tariff remissions under the Canadian scheme constituted a subsidy defined as a "bounty or grant, direct or indirect" pursuant to the terms of the United States Tariff Act of 1930.<sup>23</sup>

In response to the duty petition, the U.S. Treasury Department initiated a countervailing duty investigation to determine whether the Canadian export measure was equivalent to an illegal subsidy.<sup>24</sup> However, the investigation was never completed because both countries were sufficiently concerned about the impact that an illegal trade practices ruling would have had on trade and other international relations.<sup>25</sup> Thus, to avoid trading problems, U.S. and Canadian officials embarked on discussions to design an agreement for the promotion of more efficient and productive automotive industries and a more rational international automotive trade.<sup>26</sup>

After the successful completion of the Auto Pact negotiations,

21. *Hearing, supra* note 2 (testimony of Thomas Hanna); *see also* Reisman, *supra* note 11, at 176.

22. Note, *supra* note 14, at 176, 177; *see also* *Hearing, supra* note 2 (testimony of Marc Santucci). The submitted petition requested a 25 percent duty on imports of automotive components from Canada. *Id.*

23. Tariff Act of 1930, Pub. L. No. 361, 46 Stat. 590 (codified at 19 U.S.C. § 1303 (1930)); *see also* Letter from John D. Dingell (Chairman of the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce) to Clayton Yeutter (U.S. Trade Representative) (August 19, 1986) [hereinafter Letter] (discussing the Canadian Duty Remission Program). Under § 303 of the Tariff Act, imports of Canadian automotive parts which benefit from the duty remission program may be subject to countervailing duties if such imports cause or threaten material injury to the industry in the United States that provides such automotive parts. *Id.* For a more detailed explanation of Countervailing Duty Law, *see infra* notes 106-07 and accompanying text. A countervailing duty is a legal method that a country may use to defend against another country's unfair trade practice such as a subsidized export. *Id.*

24. Reisman, *supra* note 11, at 76.

25. *Id.* at 77; *see also* *Hearing, supra* note 2 (testimony of Thomas Hanna). A statement by President Johnson asserted that if additional legal trading weapons were initiated, there would have been the likelihood of "a wasteful contest of strokes and counterstrokes" between the two countries. *Id.*

26. Auto Pact, *supra* note 4; *see also* *Hearing, supra* note 2 (testimony of Thomas Hanna). If both governments did not attempt to develop an agreement to further integrate the separate national automotive industries, the continuation of unilateral actions by each country could have concluded in the creation of largely separate automotive sectors in each country with a relatively small amount of bilateral automotive trade. *Id.*

the overall objectives of the United States and Canada were outlined in the preamble to the agreement.<sup>27</sup> Both countries acknowledged the importance and influence of the automotive industry on the continued growth of the entire economy.<sup>28</sup> The two governments' foremost desire was to stimulate positive economic relations between their countries by providing a more efficient international trading policy that would increase the channels of product accessibility to the marketplace.<sup>29</sup> This objective was recognized to be best achieved by the reduction or elimination of those trade barriers which would impede the potentials of free trade.<sup>30</sup> As a result, it was decided that the agreement should not operate within any time limitations, and a termination of the agreement would only be effective 12 months from the date by which one government gives written notice to the other of its intentions.<sup>31</sup>

Under Article I of the Auto Pact, the Governments of the United States and Canada sought several objectives that would create a more affluent bilateral automotive trade. First, each government sought to establish "the creation of a broader market for automotive products within which the full benefits of specialization and large scale production can be achieved."<sup>32</sup> Second, they sought to provide for "the liberalization of the United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries."<sup>33</sup> Third, each sought to achieve "the development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production and trade."<sup>34</sup> In the conclusion of article I,

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27. Auto Pact, *supra* note 4.

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.* art. VII.

32. *Id.* art. I(a).

33. *Id.* art. I(b). The Auto Pact does not include the definition of what is "fair and equitable." See *infra* note 34.

34. Auto Pact, *supra* note 4, art. I(c); see also *Hearing, supra* note 2 (testimony of Thomas Hanna). As the Auto Pact states that the market forces shall determine the pattern of investment, production and trade, the "fair and equitable" clause of article II(b) was interpreted differently by Canada and the United States, respectively. The former understood it to mean closing the gap between the value of Canadian automotive production and the value of Canadian purchases of North American produced motor vehicles. The latter's interpretation was understood as a response to the maintenance of the U.S. trade surplus with Canada in automotive equipment that existed prior to the Auto Pact. *Id.*

each government was charged with the responsibility of avoiding those actions that would frustrate the achievement of the article I objectives.<sup>35</sup>

The core of the Auto Pact is contained in article II. Here, each government pledged to permit duty-free treatment to the imports of certain automotive products that originated in the other country.<sup>36</sup> Each government's import provisions are illustrated in the Annex to the Auto Pact.<sup>37</sup> Annex A governs those Canadian imports from the United States which permit duty-free treatment of certain vehicles and original equipment parts, when the importer qualifies as a "manufacturer."<sup>38</sup> Safeguards were incorporated into the Auto Pact by the Canadians, because of their fears that the compromises afforded to the U.S. manufacturers from the negotiations would result in a predominantly U.S. production sector serv-

35. Auto Pact, *supra* note 4.

36. *Id.*; see also *Hearing, supra* note 2 (testimony of Thomas Hanna); Gotlieb, *Canada-U.S. Relations: Legislation, Regulation, and the Management of Conflict*, 9 CAN. BUS. L.J. 485 (1985). The U.S. pledge to the Auto Pact was conditional upon Congressional approval of Public Law 80-283 (signed Oct. 21, 1965), because of the constitutional separation of powers in general international policy-making. Foreign governments are faced with a "double squeeze" as first they must negotiate an agreement in good faith with the Executive Branch of the U.S. Government, and then the process must begin anew as the Senate has to ratify those international treaties. It is evident that U.S. legislative and regulatory developments could affect Canadian interests. *Id.*

37. Auto Pact, *supra* note 4, annex A; see also *Hearing, supra* note 2 (opening statement of John J. LaFalce). The agreement permits duty-free treatment between the United States and Canada for new vehicles, including cars, trucks, buses and original equipment parts. It excludes this special treatment for off-highway vehicles, replacement parts and accessories, and batteries. The provisions differ with regard to specific parts as the United States also allows duty-free treatment on imported used cars from Canada, while they are excluded from coverage by Canada. On the other hand, Canada permits the duty-free entry of tires and tubes, while the United States excludes them from coverage under the agreement. *Id.*

38. *Id.*; see also U.S. INT'L TRADE COMM'N, OPERATION OF THE TRADE AGREEMENTS PROGRAM (No. 1871, June 1986) [hereinafter TRADE AGREEMENTS PROGRAM]. The Canadian Government's application of the Auto Pact does not fully constitute a free-trade arrangement. A duty-free status is administered only to those automotive imports from a "bona fide manufacturer" of motor vehicles. On the contrary, the United States extends duty-free treatment to all original equipment automotive imports from Canada, regardless of production by a manufacturer or an individual. *Id.* at 132; see also *Hearing, supra* note 2 (testimony of Thomas Hanna). A "manufacturer" is defined as one having produced vehicles of the specified class during each quarter of the model year of 1964. For each class of vehicles sold by the company, a maintained ratio of net sales value of its production of motor vehicles in Canada is to be preserved at not less than the ratio of the model year of 1964, and not lower than the ratio of 75 to 100. In addition, the Canadian Value Added level must be maintained in absolute dollar terms at least as great as that achieved in the model year of 1964. *Id.*

ing the Canadian market.<sup>39</sup> Automotive items shipped into the United States from Canada, include motor vehicles and those fabricated components to be used as original equipment in automobiles, with the exception of special purpose vehicles and other accessories such as tires and tubes.<sup>40</sup> These imports will be accorded duty-free treatment only if the content derived is at least 50 percent Canadian Value Added.<sup>41</sup> This provision was incorporated into the Auto Pact to prevent foreign producers with limited Canadian operations from using Canada to circumvent the U.S. tariff.<sup>42</sup> It was further reasoned that the content requirement would reduce the use of components from foreign countries by the major U.S.-Canadian manufacturers.<sup>43</sup>

The Auto Pact has been a valuable mechanism for the integration of the North American automotive industry, by limiting the trade barriers between the United States and Canada.<sup>44</sup> This resulting collectiveness has contributed to the improved utilization of both countries' automotive manufacturing facilities and the achievement of important production economies in automotive operations.<sup>45</sup> During the past twenty years, the Auto Pact has not

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39. *Hearing, supra* note 2 (testimony of the UAW); *see also* TRADE AGREEMENTS PROGRAM, *supra* note 38. The Canadian Government demanded that certain safeguards be incorporated within the agreement, for the purpose of securing their access to the greater U.S. market. This was demanded, although they refused to acknowledge that they were overly influenced by the huge size of the U.S. market. *Id.* at 132.

40. Auto Pact, *supra* note 4, annex A; *see also* *Hearing, supra* note 2 (testimony of the UAW).

41. Auto Pact, *supra* note 4, annex A; *see also* *Hearing, supra* note 2 (testimony of the UAW).

42. *Hearing, supra* note 2 (testimony of Thomas Hanna); *see also* TRADE AGREEMENTS PROGRAM, *supra* note 38. According to the agreement, the United States provides duty-free treatment for those motor vehicles that have a 50 percent North American value. Thus, Canada can incorporate duty-free components from non-North American countries into automobiles manufactured in Canada and export these products duty-free to the United States. *Id.* at 132.

43. *Hearing, supra* note 2 (testimony of Thomas Hanna).

44. *Id.*; *see also* TRADE AGREEMENTS PROGRAM, *supra* note 38. "The Auto Pact governs the most significant sectoral flow of trade between the United States and Canada." *Id.* at 132; *see also* Motor Vehicle Manufacturers Association of the United States, News Release (Sept. 23, 1986) [hereinafter News Release]. The Auto Pact fostered the growth of an integrated automotive market and has been one of the most powerful influences in the development of the North American motor vehicle industry for the past two decades. *Id.*

45. *Hearing, supra* note 2 (testimony of Thomas Hanna). Since 1964, manufacturers have reduced the number of various models of motor vehicles produced in Canada, which in turn lowered the cost of Canadian production. The reduction in the differing model production enabled the Canadian manufacturers to use their machinery more effectively through larger quantity production runs for specialization. Production of the many lower volume items had been relocated into plants where the benefits of higher volume production could

been altered since it has served as a powerful structure economically, socially and politically between the two countries.

The success of the North American automotive trading industry is apparent as bilateral automotive trade has grown more than 60 times exceeding \$45 billion, and has become the single largest product of trade between the United States and Canada.<sup>46</sup> Although the Auto Pact has been observed as statistically successful, its effectiveness may be diminishing because of intense industry competition by those non-American companies that are not cov-

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be achieved. Because of the agreement, both countries were able to locate their automotive productions in the most practical locations, thereby eliminating the duplication of production facilities. *Id.*

46. *Id.* In 1985, the United States exported 833,449 motor vehicles to Canada, a level equal to 73 percent of 1985 Canadian sales of North American produced motor vehicles (representing 7.3 percent of 1985 U.S. production); compared to 1965, the United States exported only 64,000 motor vehicles, a rate of only 8.5 percent of Canadian sales of North American produced motor vehicles (representing 0.6 percent of U.S. production). Furthermore, in 1985, Canada exported 1,556,050 motor vehicles to the United States, a level equal to 12.9 percent of the 1985 U.S. sales of North American produced motor vehicles (representing 81 percent of 1985 Canadian production); compared to 1965, Canada exported only 48,000 vehicles, a rate of only 0.5 percent of U.S. sales of North American produced motor vehicles (representing 6 percent of Canadian production). *Id.*; see also TRADE AGREEMENTS PROGRAM, *supra* note 38.

ered by the agreement.<sup>47</sup> Furthermore, the Canadian Government's current Duty Remission Program gives the foreign automotive producers, other than the United States producers, duty remission rebates of either 70 or 100 percent, contingent upon the individual company's remission order with the Canadian Government.<sup>48</sup> An

## U.S.—Canadian automotive trade, 1964-85

(In millions of U.S. dollars)

Year	U.S. imports	Canadian imports <sup>1</sup>	Canadian imports less U.S. imports
1964	76	640	563
1965	231	889	658
1966	819	1,375	556
1967	1,406	1,889	483
1968	2,274	2,634	360
1969	3,061	3,144	83
1970	3,132	2,935	-196
1971	4,000	3,803	-197
1972	4,595	4,496	-99
1973	5,301	5,726	426
1974	5,544	6,777	1,233
1975	5,801	7,653	1,842
1976	7,989	9,005	1,016
1977	9,267	10,290	1,023
1978	10,493	10,964	471
1979	9,715	12,274	2,559
1980	8,780	10,552	1,773
1981	10,618	12,055	1,437
1982	13,292	10,971	-2,321
1983	16,940	14,779	-2,161
1984	23,047	18,996	-4,051
1985	24,726	21,450	-3,276

<sup>1</sup> Canadian import data converted to U.S. dollars.

Source: Compiled from official statistics of the U.S. Department of Commerce, except as noted.

Note—Data exclude trade in materials for use in the manufacture of automotive parts and are adjusted to reflect transaction values for vehicles.

*Id.* at 133.

47. *Id.*; see also News Release, *supra* note 46. When the Auto Pact was signed in 1965, the companies that were covered by its provisions accounted for more than 99 percent of those vehicles produced in the United States and Canada. A future outlook could forecast that "given the growing number of foreign-based production facilities in both countries, the Auto Pact could apply to only 75% of the North American automobile production by 1990." *Id.*

48. *Hearing, supra* note 2 (testimony of Thomas Hanna). A "two-tiered" policy with different rules, commitments, and standards has become a clear trend in the Canadian environment, because of the declining coverage of the Auto Pact and the implementation of the Canadian Duty Remission Program. *Id.*; see also Memorandum from Alan Homer to Am-

analysis of the Canadian Duty Remission Program must be conducted to determine its legality within the operation provisions of the Auto Pact and its relationship to U.S.-Canadian trade.

### III. THE CANADIAN DUTY REMISSION PROGRAM

#### A. AN EXPLANATION

The Canadian Duty Remission Program (Remission Program), is being used by the Canadian Government to create investment incentives for non-Auto Pact countries, in order to increase the value of the Canadian automotive industry.<sup>49</sup> The Remission Program permits those foreign automotive producers who are not bound by the terms of the Auto Pact, to receive a remission of duties on the imports of motor vehicles in proportion to the exports of original equipment parts for which that producer is responsible.<sup>50</sup> "The Canadian duty remission program reduces the effective tariff advantage enjoyed by domestic automotive manufacturers under the Pact."<sup>51</sup> Presently, automobile imports into Canada require a 10.2 percent duty payment by foreign automotive manufacturers on the value of those imports.<sup>52</sup> As the duty remission rebates become more popular, foreign manufacturers pay less duties on those automobiles that are imported into Canada.<sup>53</sup> Furthermore, the duty remission benefits that are given to the foreign producers adversely affect the domestic suppliers.<sup>54</sup> It is apparent that the Canadian plan is designed to encourage foreign automotive manufacturers to establish plants and buy parts in Canada.<sup>55</sup> Thus, the traditional use of duties in international trade is now being used by the Canadian Government to provide a remission benefit in an attempt to attract automotive manufacturers.

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bassador Clayton Yeutter (July 22, 1986) [hereinafter Memorandum] (concerning the legal status of Canadian duty remission programs in the automotive sector). The U.S. based automotive producers do not receive duty remission benefits, because motor vehicles and qualified components are already imported into Canada duty-free under the Auto Pact. *Id.*

49. *Hearing, supra* note 2 (testimony of the UAW).

50. *Id.* For example, "[i]f Honda of Canada arranges for a Canadian parts producer to ship original equipment parts to its United States plant, Honda can deduct the value of those parts from its total of imports of cars into Canada; the amount of duties owed to the Canadian Government is, thereby, reduced." *Id.*

51. *Id.* (testimony of Marc Santucci).

52. *Id.* The "present" duty on motor vehicles refers to the point in time when this paper was written.

53. *Id.*

54. *Id.*

55. Letter, *supra* note 23.

## B. THE ORIGINS AND ESTABLISHMENT

The origins of duty remission programs date back to the early 1960's, but the current Remission Program was established by the Government of Canada under section 17 of the Canadian Financial Administration Act.<sup>56</sup> The statutory authority to implement this act, whereby providing the remission of duties and taxes upon imports, originated with the intention of benefiting the economy in light of a public interest.<sup>57</sup> The Canadian Cabinet established a general policy of duty remissions in the automotive sector that allows for a case by case plan to be applied separately to each company participating in the program.<sup>58</sup> Each eligible company in the program will operate pursuant to one of the two levels of the general policy, depending upon the foreign automotive producer's commitment to build significant manufacturing facilities in Canada.<sup>59</sup> Under both levels of the Remission Program, the duty remitted results from the reduction of the dutiable value of the import.<sup>60</sup> A total of 10 foreign automakers are eligible for the remission of import duties.<sup>61</sup>

## C. THE PROVISIONS AND OPERATION

The two levels on which the Remission Program operate are a duty remission level of 70 percent and another of 100 percent.<sup>62</sup> The first level applies to those non-American automakers that sell their automotive products in Canada but do not operate a major manufacturing facility within its borders.<sup>63</sup> The available duty remission credit is applied to the value of the motor vehicles imported "equal to 70% of the Canadian Value Added in its exports

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56. Canadian Financial Administration Act, § 17, S.C. 1980-81-82-83, C. 170, S.4; see also *supra* note 17 and accompanying text.

57. Memorandum, *supra* note 48.

58. *Id.*

59. U.S. DEP'T OF COM., CANADIAN DUTY REMISSION PROGRAM, U.S. DEP'T OF COM. (June 10, 1986) [hereinafter REMISSION PROGRAM].

60. *Id.*

61. Letter, *supra* note 23. The qualifying companies under the Remission Program include: BMW, Honda, Jaguar, Mazda, Mercedes-Benz, Nissan, Peugeot, Subaru, Toyota, and Volkswagen. Different remission orders apply to the individual companies. *Id.*

62. *Id.*

63. REMISSION PROGRAM, *supra* note 59; see also Memorandum, *supra* note 48. The 70 percent duty remission applies to the following with Order-in-Council Numbers: BMW P.C. 1985-818, Mazda P.C. 1985-812, Mercedes-Benz P.C. 1985-813, Nissan P.C. 1985-814, Peugeot P.C. 1985-815, Subaru P.C. 1985-816 and Toyota P.C. 1986-817; *revoking* various prior duty remission orders for those companies. *Id.*

of original equipment parts from Canada."<sup>64</sup> In other words, when an eligible manufacturer of the Remission Program exports automotive components to a destination, such as original equipment for assembly into an automobile, the manufacturer may claim a remission of 70 percent of the duties payable on motor vehicles it imports into Canada.<sup>65</sup>

The second level of 100 percent duty remission is available for those automotive production firms that make a commitment to operate or are presently operating significant manufacturing facilities in Canada, either in vehicle assembly or major parts production.<sup>66</sup>

64. See Memorandum, *supra* note 48.

65. See *id.*; see also REMISSION PROGRAM, *supra* note 59. An illustrated example:

Exports Worth:

\$10,000 (of value) x 70% (Canadian Value Added adjustment) = \$7,000

Remission:

\$7,000 x 10.2% (duty on imported automobiles) = \$714

Imports Worth:

\$100,000 (of value) x 10.2% (duty on imported automobiles) = \$10,200 (duty on imports)

Total Duty Owed:

\$10,200 (duty) - \$714 (remission) = \$9,486

*Id.*

66. REMISSION PROGRAM, *supra* note 59; see also Memorandum, *supra* note 48. The 100 percent duty remission applies to Honda, Order in Council P.C. 1986-637, Registration S.I./86-38, 120 Can. Gaz. pt. II, No. 7, at 1377 (1986). The Remission Order of March 13, 1986, is the most recent duty remission order in the automotive sector, and grants 100 percent remission of duty on automobiles and qualified parts imported by Honda Canada with two necessary conditions: (1) The Canadian Value Added of components exported by Honda must be at least equal to the customs value of the imported automobiles, and (2) Honda must purchase a Canadian location of at least 300 acres of land and build an automobile manufacturing facility on the premises and contribute to it, a total investment in machinery and equipment of at least \$100 million Canadian dollars.

Prior to this order, Honda had been receiving duty remission benefits at the rate of 70 percent under the Honda Remission Order of 1984. Order in Council P.C. 1985-810 of March 14, 1985, Registration S.I./85-49, 119 Can. Gaz. pt. II, No. 7, at 1654, *revoking* Honda Remission Order, 1980 Order in Council P.C. 1980-2066 of July 1, 1980.

A similar 100 percent duty remission also applies to Volkswagen under Order in Council P.C. 1985-1160, Registration S.I./84-61, 118 Can. Gaz. pt. II, No. 8, at 1545 (1984), which amended Order in Council P.C. 1983-1499, May 19, 1983, Registration S.I./83-104, 117 Can. Gaz. pt. II, No. 11, at 2376 (1983), *revoking* Order in Council P.C. 1978-2658 of August 23, 1978, Registration S.I./78-143, 112 Can. Gaz. pt. II, No.17, at 3627.

The Volkswagen Remission Order granted a 100 percent remission of duties and a partial remission of sales tax on automobiles imported by Volkswagen with two necessary conditions: (1) The Canadian Value Added of components exported by Volkswagen was required to at least equal the customs value of the imported values, and (2) Volkswagen was required to buy a specific existing production plant by January 1, 1982, convert it into an automotive component factory, invest at least \$102 million Canadian dollars in machinery, equipment, and improvements, and start production at that facility by the end of 1983. The 1984 amendment revised Volkswagen's investment commitment downward to \$40 million Canadian dollars. *Id.*

For these firms to receive the full credit, they must meet a minimum level of Canadian Value Added to the cost of sales at 15 percent, which must be raised to a ratio of 60 percent within five years.<sup>67</sup> For component production, a Canadian Value Added to the cost of a sales ratio of 85 percent must be maintained.<sup>68</sup> Under the 100 percent scheme, the credit on those automobiles that are imported is equal to the full Canadian Value Added of the Canadian original equipment components exported.<sup>69</sup>

*D. THE LEGALITY AND VIOLATIONS OF INTERNATIONAL AGREEMENTS WITH EVIDENT ADVERSE EFFECTS*

Whether the Remission Program violates any trade rules is a controversial issue that should be closely analyzed in accordance with several international agreements. According to the Canadian Government, an automotive producer's eligibility to receive a duty remission at the 70 percent level depends solely upon the firm's performance in the exportation of Canadian automotive components, and not upon the individual manufacturer's amount of investment in Canada.<sup>70</sup> Furthermore, the Canadian Government states that the Remission Program is similar to those programs offered by the United States, designed with the purpose of attracting foreign investment.<sup>71</sup> Thus, the Sovereign of Canada claims that

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67. REMISSION PROGRAM, *supra* note 59. Upon attaining the required ratios in addition to a production sales ratio of 1 to 1, importers receive the full duty-free status. *Id.*

68. *Id.*

69. Memorandum, *supra* note 48; see also REMISSION PROGRAM, *supra* note 59. An illustrated example:

Exports Worth:

\$10,000 (of value) x 100% (Canadian Value Added adjustment) = \$10,000

Remission:

\$10,000 x 10.2% (duty on imported automobiles) = \$1,020 (remission)

Imports Worth:

\$100,000 (of value) x 10.2% (duty on imported automobiles) = \$10,200 (duty)

Total Duty Owed:

\$10,200 (duty) - \$1,020 (remission) = \$9,180

*Id.*

70. Memorandum, *supra* note 48.

71. *Id.*

It might be alleged that duty remission is analogous to provisions in United States law, which permit remission of duties on American goods returned under items 806.30 or 807.00 of the Tariff Schedules of the United States (TSUS). This is not the case. TSUS 806.30 and 807.00 allow an importer of a product assembled abroad from United States parts to pay duty only on the difference between the assembled value of the product and the value of the United States components. Both place strict limits on the amount of foreign processing that may occur and require the incorporation of the exported good. Canadian duty remission would not meet the

this program is not in violation of any trade regulations.<sup>72</sup>

However, the United States contends that the Remission Program provides an illegal export subsidy, because the difference between the 70 and 100 percent duty remission is contingent upon a "location subsidy," one in which the producer's investment in Canada is a necessary condition to receive the greater remission.<sup>73</sup> Thus, the exporting of automotive components is a *sine qua non* for the reception of remission benefits that are proportional to the component exports; as for each one Canadian dollar of Canadian Value Added exported, the "exporter/importer" gets back 10.2 cents, or 7.14 cents under the 70 percent remission plan, in duty remission.<sup>74</sup>

The Remission Program's first international trade violation refers to Article IX of the General Agreement on Tariffs and Trade (GATT).<sup>75</sup> The Remission Program is inconsistent with the provisions of the GATT, because it appears to constitute an export subsidy where the duty remission benefits are directly attached to the

requirements of TSUS 806.30 or 807.00. For instance, it gives remission benefits for imported cars even where the cars include absolutely no reimported Canadian parts. (There is no general 806/807 - type provision in Canadian law; Canadian goods exported for processing abroad are dutiable on their full value when reimported.)

*Id.*

72. *Id.*

73. *Id.*; see also Perez, *Export Subsidies in Developing Countries and the GATT*, 10 J. WORLD TRADE L. 529, 532 (1976). A "subsidy" exists when a governmental measure, such as an expenditure or revenue, affects the return on an economic activity. Specifically, a subsidy that encourages export sales is considered a "positive" export subsidy because it is created to encourage domestic sales and originally set up to promote a domestic activity. *Id.*

74. Memorandum, *supra* note 48. Calculation of the amount of remission per Canadian dollar exported under the 70 and 100 percent plans is as follows:

70 percent plan: = 70% adjustment x 10.2% duty on automobiles x \$1 Canadian Value Added.

100 percent plan: = 100% adjustment x \$1 Canadian Value Added.

*Id.*; see e.g., *supra* notes 65, 69 and accompanying text; Perez, *supra* note 73, at 529, 532.

75. General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 187 [hereinafter GATT]. The GATT has been modified since it was opened for signature. A current version may be found, in 4 General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents (1969). The GATT deals with a subject area of commercial policy. The violation here is referring to GATT, Article IX; see also E. ROSSIDES, U.S. IMPORT TRADE REGULATION 416 (1986).

In 1947, the United States and seven other major trading nations entered into the GATT effective January 1, 1948. This Agreement froze tariffs at their current levels and laid down internationally agreed trading rules, including the most favored-nation trading principle. Pursuant to this principle, each GATT signatory country, with certain minor exceptions, afforded the lowest tariff rates to the products of any other country.

*Id.* Today, approximately 80 percent of the world trade adheres to the GATT. *Id.*

amount of exported automotive parts.<sup>76</sup> The "subsidy" is classified under Item (I) of the Illustrative List of Export Subsidies from the MTN Subsidies Agreement (Subsidies Code):

[T]he remission or drawback of import charges in excess of those levied on [imported] goods that are physically incorporated . . . in the exported product provided, however, that in particular cases a firm may use a quantity of home market goods equal to, and having the same quality and characteristics, as the imported goods as a substitute for them in order to benefit from this provision if the import and the corresponding export operations both occur within a reasonable time period . . . .<sup>77</sup>

Analyzing the Remission Program under Item (I) of the Subsidies Code, an export subsidy may be classified as "any import rebate that is linked to exports, with the exception of legitimate drawback or offshore assembly provisions."<sup>78</sup> The remissions granted by the Canadian Government's program neither qualify as a drawback nor as an offshore assembly scheme because there is no physical tracing between the products exported and the products imported.<sup>79</sup>

Alternatively, the Remission Program is in violation of those international trading rules pursuant to Item (L) of the Illustrative List of Export Subsidies from the Subsidies Code as, "any other charge on the public account constituting an export subsidy in the sense of Article XVI of the GATT."<sup>80</sup> Article XVI of the GATT defines an export subsidy as, "any subsidy . . . which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory . . . ."<sup>81</sup> The Canadian Duty Remission Program would apply the GATT Article XVI

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76. Memorandum, *supra* note 48.

77. Agreement on Interpretation and Application of Articles VI, XVI, XXIII of the General Agreement on Tariffs and Trade, MIN/NTM/W 236 (done Apr. 12, 1979) [hereinafter Subsidies Code], *reprinted in* AGREEMENTS REACHED IN THE TOKYO ROUND OF THE MULTILATERAL TRADE NEGOTIATIONS, H.R. DOC. NO. 153, 93rd Cong., 1st Sess., pt. 1, at 257 (1979). The Subsidies Code is based on GATT. *See* GATT, *supra* note 75. The subject area here refers to the Subsidies Code, as "import charges" that include such fiscal charges as tariffs and duties which are levied on imports. *Id.*

78. Memorandum, *supra* note 48; *see also* WEBSTER'S THIRD INTERNATIONAL DICTIONARY 687 (3d ed. 1981) [hereinafter WEBSTER'S]. A drawback is defined as, "money remitted after being collected: . . . customs or other duties refunded on (1) an imported product subsequently exported, (2) an imported product used in production of a product for export, or (3) on the part of an imported product which becomes scrap in the manufacturing process." *Id.*

79. Memorandum, *supra* note 48; *see also* WEBSTER'S, *supra* note 78, at 687.

80. Subsidies Code, *supra* note 77; *see also* Memorandum, *supra* note 48.

81. GATT, *supra* note 75, art. XVI.

export subsidy definition to the current situation.

Most importantly, the Remission Program is violating the United States-Canadian Auto Pact.<sup>82</sup> The heart of the Auto Pact is found in article II, as automotive bilateral trade receives duty-free border access.<sup>83</sup> The Remission Program is not inconsistent with the provisions of article II, because the U.S. automotive manufacturers do not receive any remission benefits.<sup>84</sup> However, the Remission Program violates the Auto Pact in article I.<sup>85</sup> Those pertinent provisions of article I, provide that the Governments of the United States and Canada shall achieve objectives where "the industries of both countries participate on a fair and equitable basis" and provide for "the development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade."<sup>86</sup>

The agreement further states, that each country's government will "avoid actions which would frustrate the achievement of these objectives."<sup>87</sup> Nevertheless, the Canadian Government's Remission Program undermines the U.S. automotive industry's ability to compete for foreign investment in automotive plant locations, and is inconsistent with the above-mentioned provisions of the Auto Pact.<sup>88</sup> In addition, the unfavorable effects will be reflected by the

82. See Auto Pact, *supra* note 4.

83. *Id.* art. II.

84. *Id.*; see also Memorandum, *supra* note 48.

85. Auto Pact, *supra* note 4, art. I.

86. *Id.*

87. *Id.*

88. *Hearing*, *supra* note 2 (testimony of the UAW). The lopsided share of new investment in Canada would adversely affect the final assembly and parts production segments of the automotive industry. *Id.*; see also *id.* (testimony of Thomas Hanna). As was stated at the hearing:

For example, the GM-Suzuki announcement of their intention to locate a joint assembly facility in Canada, rather than in the U.S., is probably attributable to the Pact. By locating in Canada, GM-Suzuki would be able to import the engine and drive train duty-free as a qualified manufacturer. Furthermore, the autos produced at the facility can enter the U.S. duty-free if they contain at least 50% U.S./Canadian content. However, if the facility is located in the U.S., GM-Suzuki could pay the duty on the engine and drive train imported into the U.S. Also GM could and probably does import their captives from Japan into Canada duty-free.

Mazda, which is building its plant in Flat Rock, Michigan, right across the river from Windsor, Ontario, and using 50% North American content, will not be able to ship cars into Canada duty-free. Most of the Japanese companies producing cars in Canada will not only be able to ship into the U.S. duty-free but will get a kickback as well. Small wonder why Canada has been so successful in attracting foreign assembly plants.

In addition, Japanese automakers in the U.S. have encouraged Japanese original equipment parts suppliers to locate near their U.S. facilities. Many of these

disproportionate share of job losses in automotive production employment.<sup>89</sup> Given the importance and size of the automotive industry and the future outlook of the foreign firms to continue exporting the increasing numbers of motor vehicles, the Canadian investment incentive would increase the U.S. trade deficit in the automotive sector.<sup>90</sup> The long-term impact of the duty remission benefits provided by Canada would most probably create a negative and distorting effect on investment and balance of trade for the United States.<sup>91</sup> The background of the Auto Pact negotiations supports the proposition that the Remission Program is inconsistent with the U.S.-Canadian trading relationship, because the elimination of the original duty remission scheme was a major motivation *quid pro quo* for the Auto Pact's negotiation and subsequent conclusion.<sup>92</sup>

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suppliers will locate in Canada and export parts to the U.S. duty-free in order for the Japanese auto manufacturer to receive a duty remission on auto exports from Japan to Canada. This action will further reduce sales by domestic original equipment parts suppliers. At the same time, Japanese or American suppliers with U.S. locations will not be able to export duty-free to Honda or Toyota in Canada.

*Id.*

89. *Id.* (testimony of the UAW). The "average monthly employment of automotive workers in the United States in 1985 reached 872,000, of which 676,700 or 77.5% were production workers." *Id.*; see also *id.* (testimony of Thomas Hanna).

90. *Id.* (testimony of the UAW). In 1985, the U.S. automotive trade deficit with Canada was \$7.5 billion. *Id.*; see also Syracuse Herald American, Apr. 5, 1987, at A9, col. 1. Representative William Gray, Chairman of the House Budget Committee, noted that, in 1986, the U.S. trade deficit with Canada reached \$20 billion in automotive trade. *Id.*; see also *Hearing, supra* note 2 (testimony of Thomas Hanna).

The United States has historically sustained a net deficit annually in trade with Canada in assembled vehicles. The balance has varied year to year, reflecting changing consumer demands for varying makes and models produced in the two countries. However, the resulting deficit from this net U.S. importation of assembled vehicles through most of the life of [the] Auto Pact was more than compensated for by the large U.S. surplus in original equipment parts exported to Canada. Since 1982, however, Canada has recorded a growing surplus in total automotive trade with the United States due to the strength of the U.S. dollar, strong U.S. demand for models built in Canada, and a stronger U.S. economic recovery from the recession of the early 1980's. These trends have led to a cumulative U.S. automotive trade deficit with Canada of \$8.7 billion between 1982 and 1984, which offset all but \$700 million of the accumulated U.S. automotive trade surplus with Canada during the 1966-1981 period.

*Id.*

91. *Hearing, supra* note 2 (testimony of Thomas Hanna).

92. Memorandum, *supra* note 48; see also *Hearing, supra* note 2 (opening statement of John J. LaFalce).

#### IV. PLANNING AND ACTION WITH THE IMPOSED CANADIAN DUTY REMISSION PROGRAM

There are many prospective European and Asian automotive manufacturers that are planning to invest in the United States and Canada.<sup>93</sup> Because the provisions of the Auto Pact do not apply to these new producers, their choice of location may be influenced by the attractiveness of the Canadian Duty Remission Program. Furthermore, due to the "worldwide duty-free import privileges available to Canadian producers, and the Canadian restriction of duty-free importing to producers that reach a high level of Canadian content, new entrants wishing to sell cars in Canada as well as the United States have good reasons for locating a large proportion of their North American investment in Canada."<sup>94</sup>

There is little incentive to produce motor vehicles and automotive parts in the United States, especially with the application of the Canadian remission rebates.<sup>95</sup> Those few advantages that do exist include, trading in the larger U.S. market which establishes the benefit of goodwill for the particular automotive manufacturing company, and reduced transportation costs due to the immediate access to major U.S. markets.<sup>96</sup>

To promote healthy trade competition and obtain the various advantages that each country may contribute to the interests of the automotive industry, it is essential that the Governments of the United States and Canada attempt to accommodate each other's societal structures and differences, and build from those already existing strengths and values.<sup>97</sup> The separate governments may choose to take unilateral actions, which may include retaliation by the United States in response to the Remission Program,

93. Letter, *supra* note 23 (concerning the Canadian Duty Remission Program with respect to automotive parts). Every automotive manufacturer is planning to locate in North America. For example, every major Japanese automotive manufacturer plans to build at least one assembly facility in the United States by the end of the decade. Such an example includes the joint venture of Isuzu and Fuji (the makers of Subaru). *Id.*; see also *Hearing, supra* note 2 (testimony of Marc Santucci).

Japanese automotive manufacturer's motor vehicle assembly in the United States is increasing at a rapid pace. By 1990, approximately 1.7 million motor vehicles will be assembled in the United States and approximately 600,000 motor vehicles will be assembled by Japanese or Korean automotive manufacturers in Canada. These foreign producers will be receiving a fairly large Canadian duty remission as at least 300,000 of those motor vehicles assembled in Canada could be exported to the United States. *Id.*

94. *Id.* (testimony of the UAW).

95. *Id.*

96. *Id.*

97. Gotlieb, *supra* note 36, at 496.

or alternatively, the negotiation of an agreement which would encourage the enhanced integration of the automotive industry.

The best means of negotiation would be to address the Canadian Remission Program in an appropriate forum and at the earliest possible opportunity. The U.S.-Canadian Free Trade Negotiations would provide a useful opportunity to address these issues and concerns.<sup>98</sup> The primary objective of the U.S. Government during these negotiations would be to reduce or eliminate all Canadian trade barriers to U.S. exports and those Canadian programs or practices that impede trade with the United States.<sup>99</sup>

Throughout these trade talks, it is important that those associated with the automotive industry, particularly the Motor Vehicle Manufacturers Association and the Motor and Equipment Manufacturers Association, actively participate and closely communicate with those governmental officials who have the authority to negotiate international policy.<sup>100</sup> Industry participation is par-

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98. *Hearing, supra* note 2 (testimony of Thomas Hanna); see also TRADE AGREEMENTS PROGRAM, *supra* note 38. The evolution and formalization of the proposal to the United States to enter into a free trade arrangement between the United States and Canada in 1985 was a major policy development for Canada. Following the March 1985 Quebec Summit between President Reagan and Prime Minister Mulroney, where the notion of bilateral trade liberalization was endorsed, the initiation of talks received further support from the Royal Commission on the Economic Union and Development Prospect for Canada and from the Canadian Trade Ministry. *Id.* at 131; see also ROSSIDES, *supra* note 75, at 487.

The U.S. Trade Representative is the President's chief agent, and is responsible for all the trading functions and international negotiations. This position was established by that name under Exec. Order No. 12,188, 45 Fed. Reg. 989 (1980). The U.S. Trade Representative is formally the Special Trade Representative for Trade Negotiations (acquiring the rank of ambassador), and is the principle coordinator of all tariff and trade agreement activities, as well as acting as the principle liaison with the legislative branch. *Id.*

99. Letter, *supra* note 23 (concerning the Canadian Duty Remission Program with respect to automotive parts); see also TRADE AGREEMENTS PROGRAM, *supra* note 38. The free trade negotiations could lead to the formation of the world's largest free-trade area, both geographically oriented and in terms of trade turnover. *Id.* at 131.

100. *Hearing, supra* note 2 (testimony of Thomas Hanna). The MVMA represents U.S. automobile, truck and bus manufacturers producing more than 98 percent of all the domestic motor vehicles. MVMA members include: American Motors Corporation, Chrysler Corporation, Ford Motor Company, General Motors Corporation, Honda of America Manufacturing, Inc., LTV Aerospace and Defense Company, AM General Division, M.A.N. Truck and Bus Corporation, Navistar International Corporation, PACCAR Inc., Volkswagen of America, Inc., and Volvo North America Corporation. *Id.*; see also *id.* (testimony of James J. Connor, Executive Vice President for the Motor and Equipment Manufacturers Association (MEMA), concerning the United States-Canadian motor vehicle parts trade).

Throughout MEMA's 83-year history, it has "provided services and programs to meet the needs of American motor vehicle product manufacturers' . . ." and has been representing approximately 750 companies of U.S. automotive manufacturers producing regular and heavy vehicle parts, equipment, accessories and other products. *Id.*; see also ROSSIDES, *supra* note 75, at 494.

ticularly important in trade negotiations because any changes in trade policy may offset the competitive effects of those automotive manufacturers involved.<sup>101</sup>

In negotiating a settlement, a sectoral approach that would meet the full provisions of the GATT may be the most effective attempt at achieving a comprehensive free trade arrangement between the United States and Canada.<sup>102</sup> However, the fact that there have been no new sectoral arrangements ratified by both governments since the creation of the Auto Pact of 1965, indicates the difficulty of achieving the successful negotiations necessary to produce an agreement.<sup>103</sup> Furthermore, with regards to the ensuing

The most common of the formal opportunities that are available to an industry to contribute to the treaty-making process include: appearing before congressional committees to provide testimony, serving on advisory committees established to permit representation of an industry, and responding to the published invitations on pending proposals. *Id.* With respect to the Canadian Duty Remission Program, it is evident that giving testimony before congressional committees was a popular method of industry participation, as several organizations appeared before the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance and Urban Affairs.

101. *Hearing, supra* note 2 (testimony of Thomas Hanna); *see also id.* (testimony of James J. Connor). Presently, original equipment manufacturers and suppliers have established corporate strategies based upon the existence of the Auto Pact, and an internationally negotiated course of action may alter these plans. *Id.*

102. Note, *supra* note 14, at 176; *see also* Syracuse Herald American, Apr. 5, 1987, at A9, col. 1. In the April 1987 meeting between President Reagan and Prime Minister Mulroney, President Reagan acknowledged that "much hard bargaining lies ahead," but added, "we are optimistic that a comprehensive plan mutually beneficial and advantageous to both sides can be hammered out . . . ." *Id.*

103. Trezise, *supra* note 14, at 63; Wall St. J., Sept. 24, 1987, at 2, col. 2. As of September 24, 1987, the United States and Canada were unable to create a free-trade agreement that would be mutually beneficial to both countries. At that time, the Canadian officials broke off talks with the U.S. negotiators as Canadian Prime Minister Mulroney stated that "the negotiations are at an impasse because the United States hasn't moved on the most basic issue of all — a way of resolving disputes satisfactorily between the two countries." Canada's demand throughout these trade talks has been to create a "special binding dispute-solving mechanism" to resolve trade problems involving the North American market. *Id.* It was hoped that this session of trade talks would have expanded and resolved the dispute-settling mechanism that Prime Minister Mulroney and President Reagan had devised in the Ottawa trade talks of April. *Id.*; *see* N.Y. Times, Oct. 6, 1987, at D1, col. 2.

The mechanism so demanded by Canada consists of an arbitration panel which would review acts of the U.S. Congress and allow unilateral Canadian retaliatory actions when those Congressional acts "violate the spirit" of the trade agreement. N.Y. Times, Oct. 6, 1987, at D8, col. 2. The rationale encompasses the Canadian requirement to "safeguard against arbitrary American opposition of import penalties against Canadian products. The panel would review trade cases involving [the] imposition of penalty duties by either country. The review of American decisions would be under the substantial evidence rules used in the Federal court system." *Id.*; *see also* Wall St. J., Sept. 24, 1987, at 2, col. 2. Prime Minister Mulroney further stated that the negotiations will continue to be suspended until the United States addresses the issue of this dispute-settling mechanism. Wall St. J., Sept. 24, 1987, at 2, col. 2. Take cognizance, that time is of the essence and there is no time for a

## Free Trade Negotiations, the United States does not anticipate to

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walk-out by either negotiating party. *See id.*

Congressional advocates of the free-trade pact were disappointed by the Canadian officials attitude and "walkout" of the trade talks, but supported President Reagan's views. As the House of Representatives Ways and Means Chairman Dan Rostenkowski phrased it, "I am concerned about the breakdown of these negotiations, but I fully support our negotiators' position on the contentious issue of dispute-settlement." Furthermore, "that position accurately reflects the political consensus here in Washington as to what is an achievable agreement." In addition, Senate Finance Chairman Lloyd Bentsen stated that Canada's position was not surprising because "we've seen increasing political opposition in Canada to the idea of free-trade with the United States." Nevertheless, "I would hope we could get these talks back on track towards a mutually beneficial agreement, though time is short. If these efforts fail, it would be a tragedy for both countries." *Id.*

The rough road during the trade talks between the United States and Canada in September of 1987, further exemplifies the difficulty of a compromise solution between the two countries for an effective and operational free-trade arrangement. *See Wall St. J.*, Oct. 5, 1987, at 3, col. 1. In one last attempt, a proposed free-trade agreement was written and signed between the United States and Canada after "hectic last-minute bargaining," but now must be approved through a "politically tough ratification process" by the U.S. Congress and Canadian Parliament. The agreement is considered a unique pact and was devised in a quick fashion to solely satisfy the October 3, 1987, midnight deadline required by Congress for expedited review.

Both countries' governmental officials and concerned parties will be carefully analyzing the proposed treaty's system for settling disputes to confirm the elimination of loopholes. This particularly concerns "an area where the U.S. made concessions by agreeing to a new bilateral commission whose rulings would be binding in certain cases." The U.S. lawmakers main intention is "to kill any pact if it exempts Canada from provisions of U.S. unfair-trading-practices law in favor of a new mechanism." On the other hand, Prime Minister Mulroney will have to convince 10 provinces to approve the agreement and "overcome a deep public skepticism about his ability to protect Canada's interests in negotiating with the U.S." This is a tough feat, as a poll showed only 50 percent of Canadians are in favor of a free trade agreement with the United States, and while other polls had proven that the Canadian people feel that Prime Minister Mulroney is not an effective negotiator with the United States. *Id.*; *see also* N.Y. Times, Oct. 6, 1987, at D1, col. 2.

After 16 months of unsuccessful free trade negotiations, the proposed accord, which provides for the elimination of all tariffs and the reduction of many non-tariff barriers between the United States and Canada by January 1, 1999, is the subject of mixed emotions. N.Y. Times, Oct. 6, 1987, at D1, col. 2; *see id.* at D8, col. 2. With regard to the automotive industry provisions of the agreement, the general Congressional concern was that these provisions "fell short of original expectations," while the Canadian feeling strongly expressed objection to any "provision that would force renegotiation of the 1965 auto pact." It is, thus, apparent that the agreement's objective, to integrate the two nations' economies, will receive very close attention before any finalization. *Id.* at D1, col. 3.

Since the proposed trade pact, the Canadian feeling has been split with regard to the U.S.-Canadian agreement. Generally, Canadian businesses are supporting the free-trade arrangement and trade unions and nationalist groups are steadfastly resisting it. Business leaders are enthusiastic about the prospects of competing freely in the U.S. markets, which dwarf Canada's own, and they see the agreement as providing at least a measure of security against growing American protectionism. Opponents say the new system for regulating trade disputes gives no real protection against American industries' increasing propensity to seek trade penalties against imports, and they forecast severe damage to Canada as a result of changes in automotive trade arrangements, investment review practices and energy policies that Canada has pledged. *Id.*

accede to a reduced subsidy or similar substitute.<sup>104</sup> There are U.S. officials who have serious doubts about the success of these negotiations, because with the belief that the subsidy itself is illegal, there would be no terms to negotiate.<sup>105</sup>

Instead, a unilateral, retaliatory action may be implemented by the United States in the form of a countervailing duty.<sup>106</sup> Countervailing duty law would be applicable to the Remission Program's schemes if those Canadian-manufactured automotive components are: (1) determined by the Commerce Department to be benefited from subsidies that are more than *de minimus*, and (2) determined by the International Trade Commission that those subsidized imports cause or threaten material injury to the U.S. automotive industry in the production of such automotive components.<sup>107</sup>

Negotiations should also be considered in conjunction with the

The Canadian Government expects this "highly contentious issue," to be an issue of much debate with little room for each side to compromise. However, this was somewhat expected as the three past attempts of a free-trade agreement with the United States in the past century, had proven a failure. *Id.*

Another obstacle for the free-trade agreement's approval, in addition to the U.S. Congress' opposition to the dispute mechanism, is internal opposition within Canada by the Provincial Premiers. *Id.*; see Syracuse Post Standard, Oct. 10, 1987, at B3, col. 1. Clayton Yeutter, the U.S. Trade Representative, stated that the United States will not ratify the negotiated free-trade pact unless all 10 Canadian Provinces agree to its binding effect. He further stated that the United States will not deal separately with the individual Provinces as only the Federal Government in Canada has the power to effectuate international treaties with the United States. However, it appears that there is sparked Provincial opposition to the free-trade agreement. Such Provincial Premiers as David Peterson of Ontario and Howard Pawley of Manitoba have expressed their opposition to acceptance of the future treaty. Their resistance stems, in part, from the foreseen loss of Canadian identity due to the closer interaction with the American economy. Syracuse Post Standard, Oct. 10, 1987, at B3, col. 1.

Clayton Yeutter has indicated that approval of the agreement would benefit the Canadian economy moreso than that of the United States and has predicted "an expansion in the \$135 billion annual volume in what already is the world's biggest trading partnership." Finally, he concluded by stressing the importance of the treaty's approval by stating that, "the world will never be the same and our bilateral relations will never be the same . . . ." without it. *Id.*

104. Letter, *supra* note 23.

105. *Id.* Dingell states that, "it is not at all clear what there is to negotiate when the subsidy is illegal." *Id.*

106. See Tariff Act, *supra* note 23. For a further explanation of countervailing duties, see *infra* note 107 and accompanying text; see also ROSSIDES, *supra* note 75, at 241. A domestic producer of a similar product may have a remedy in the form of a countervailing duty when the foreign manufacturer's export is subsidized. *Id.*

107. Trade Agreements Act of 1979, Pub. L. 96-39, § 1(a), 93 Stat. 44 (July 26, 1979) (amending 19 U.S.C. § 1303 (1930)). This act added title VII, Countervailing and Anti-Dumping Duties, which would apply to exports from a "country" under the agreement. *Id.*; see also Letter, *supra* note 23.

Auto Pact. Since the Auto Pact has provided a stable trading framework from 1965 to the present, simple modifications may be all that is needed to uphold its operating effectiveness between the United States and Canada.<sup>108</sup> One such suggestion to modify the Auto Pact is proposed by the United Auto Workers (UAW), stating that the minimum North American Value Added for duty-free entry of motor vehicles and original equipment components into the United States should be raised to 75 percent from the present 50 percent.<sup>109</sup> Due to the growing interest of foreign automotive manufacturers selling their products in the North American market, the percentage increase would reduce the potential for the use of components imported into Canada from non-U.S. locations.<sup>110</sup> Those imported components are assembled into motor vehicles in Canada and continue to be granted duty-free access to the United States.<sup>111</sup> Thus, the change in the domestic content requirement would more effectively reduce the benefits of the Auto Pact to the foreign producers selling in the North American market.<sup>112</sup>

#### V. CONCLUSION

Recent events, including the potential investment of foreign automotive producers in North America, the Canadian Duty Remission Program, the ensuing U.S.-Canadian Free Trade Negotiations and the unbalanced bilateral automotive trade, raise a question as to whether a retaliatory or a compromising approach should be pursued to preserve the joint goals of a fair and equitable North American automotive trade industry. A unilateral or retaliatory strategy applied by each country in the bilateral trading environment, would more than likely terminate the Auto Pact or at least reduce the scope of its terms.<sup>113</sup> This approach would not be the best solution, as it would generate a political controversy between the two countries and result in a substantial reduction of U.S.-Canadian trade and investment.<sup>114</sup>

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108. *Hearing, supra* note 2 (testimony of the UAW).

109. *Id.* The UAW proposal for the increase to 75 percent is appropriate because where those foreign based manufacturers set up operations in the United States, experience has illustrated that "only a minimal number of domestically sourced parts can be transformed into 50% of the final products value by the addition of assembly labor, management compensation, overhead and profits." *Id.*; see also *supra* note 8 and accompanying text.

110. *Hearing, supra* note 2 (testimony of the UAW).

111. *Id.*

112. *Id.*

113. *Id.* (testimony of Thomas Hanna).

114. *Id.*

Alternatively, if the U.S. and Canadian Governments work toward the development of an integrated automotive industry, the automotive trade industries of both countries will prosper, as well as the general welfare of their respective economies. Should an agreement be reached between the United States and Canada, the UAW proposes the addition of certain provisions to require the automatic initiation of continuing talks upon the finding of a specified imbalance of automotive trade or with regards to any product group not maintaining a minimum level for any calendar year.<sup>115</sup> These negotiations would act as a “stop-gate” before the imbalance gets any worse and, in turn, determine its causes and suggest steps for its correction.<sup>116</sup>

The U.S.-Canadian Free Trade Negotiations are presently the center of attention for the continued success of U.S.-Canadian bilateral trade. To provide for a mutually beneficial outcome of this trade problem, each government must consider the changing conditions of the automotive industry and evaluate the entire motor vehicle manufacturing sector in light of its importance to both countries' economies.<sup>117</sup> Only through such dedication and cooperation, can the United States hope to maintain Canada as a vital trading ally.

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115. *Id.* (testimony of the UAW). The product level refers to the categories of commercial vehicles, cars, or parts. *Id.*

116. *Id.* The U.S. automotive trade deficit with Canada is too important an issue, and if it should grow, it cannot be disregarded. The international agreement would be temporarily suspended if the imbalance is not reduced below the target level within the subsequent year, and until such time it is adequately reached. *Id.*

117. *Id.* (testimony of Thomas Hanna).