BRIEFING PAPER
trade and investment series

CCPA
CANADIAN CENTRE for POLICY ALTERNATIVES
CENTRE CANADIEN de POLITIQUES ALTERNATIVES

Volume 5 Number 3 • November 2004

Thinking Outside the Trade Treaty Box

Remarks by Scott Sinclair made to the CLC Industrial Policy Conference
September 22, 2004

While trade treaties have limited many of the traditional tools of industrial and economic development policy, there is still room for manoeuvre. Canadians should take advantage of existing flexibilities and push the boundaries where it is in our interest (just as others do).

The old tools of Canadian industrial strategy – tariff exemptions linked to various performance conditions – are no longer viable within today's trade and investment treaty strictures. The June 2000 WTO Auto Pact ruling underlined this and was certainly not an encouraging decision for these who favour more active Canadian industrial policies.[1]

Nonetheless, the underlying goals of successful industrial strategies such as the Auto Pact – to encourage investment and to achieve employment, industrial and economic benefits within Canada – can arguably still be pursued through a mix of infrastructure, subsidy and other initiatives.

I want to emphasise that more active economic development policies do not mean policies designed to restrict trade. It means policies designed (like the Auto Pact) both to encourage trade and investment *and* to ensure that Canadian workers and communities share equitably in the benefits of increased trade and integrated production.

I also want to caution that while my focus today is on flexibility, that there are key aspects of the latest generation of so-called "trade treaties" that are unjustifiable and need to be changed or discarded. Moreover, trade treaty obligations do not stand still. Existing flexibilities can disappear in the next round of negotiations and sometimes even without negotiations.[2]

Infrastructure

Support for hard infrastructure (such as roads, rail, mass transit, ports, power, and water and sewer systems) is vital for the economy (including any form of manufacturing) and, if "generally available," should not pose a problem under trade treaties. That is, so long as subsidies for public investment in infrastructure are based on objective criteria or conditions governing eligibility, eligibility is automatic, and the criteria and conditions are strictly adhered to, they should be trade-treaty consistent.[3] Recent studies from Statistics Canada show a big economic payoff for every dollar invested in hard public infrastructure (an estimated 17 per cent per year benefit to the business sector).[4]

Public provision of social infrastructure (such as training, education, health care and childcare) can also result in increased productivity and significant competitive advantages. Savings from public health insurance, in the auto sector for example, amount to several dollars per hour of labour worked for employers otherwise faced with the cost of equivalent private health insurance.[5]

The most recent generation of trade treaties have intruded into many non-trade areas. One thrust has been towards commercialization of public and not-for-profit services. For example, both NAFTA's investment chapter and the GATS codify (in different ways) the objectionable idea that foreign commercial service exporters and investors should be "compensated" when public services are created or expanded.

There is a clear risk that this and certain other aspects of trade treaties (NAFTA's investment chapter, intellectual property rules, and the GATS) could erode existing public services and interfere with their evolution. This could, among other negative consequences, impose "significant costs on employers and undermine the attractiveness of Canada as a site for new investment," as the Canadian Autoworkers and the Big Three automakers pointed out in a joint letter on publicly funded health care.[6]

This is an aspect of the new trade treaty agenda that needs to be beaten back. In the meantime, Canadians should not be deterred from enhancing public services by the prospect of trade treaty challenges.[7] As the Romanow Report concluded in its consideration of trade treaty obstacles to medicare expansion: "Rather than conclude, then, that Canada is hemmed in to the current [trade treaty] system and cannot change, the more reasonable conclusion is that if we want to expand the range of services in the public system, it is better to do it now while there still is very little foreign presence in health care in Canada and the potential costs of compensation are low."[8]

Subsidies, grants and other "advantages"

One obvious option if Canada wants to encourage manufacturing investment is to provide subsidies (in one form or another.) I want to address whether, from a trade treaty perspective, Canadian governments can still attach legally enforceable conditions to ensure that public subsidies result in demonstrable employment, industrial and other benefits to Canadians. In fact, the capability to demonstrate such benefits is probably essential to gaining public support for significant spending initiatives in the first place.

There are certain subsidy practices that trade treaties clearly prohibit. Most notably, the WTO Agreement on Subsidies and Countervailing Measures (the SCM Agreement) bans subsidies contingent on export performance (Article 3.1(a)) or on the use of domestic goods over imported goods (Article 3.1(b)).

But, arguably, subsidies or investment incentives can still be linked (at a minimum) to legally enforceable commitments to create jobs in Canada (or to achieve Canadian value-added targets through direct labour costs).

For example, to qualify for support, an investor would have to 1) have a manufacturing presence in Canada and 2) a company's direct labour costs would have to meet or exceed a certain proportion of its sales (or economic activity) in Canada. Such incentives would reward investors who create jobs in Canada commensurate with their sales here.

A careful reading of the WTO Auto Pact decision supports that such a policy would very likely be consistent with the WTO SCM agreement.

It should be pointed out that the non-discrimination rules of both the GATT and the NAFTA ***do not apply*** to subsidies and grants (see, for example, GATT Article III:8(b) and NAFTA Articles 1108.7(b) and 1201.2(d)). Governments remain free to give preference to Canadian firms or firms located in Canada when they provide subsidies.[9]

Without going into too much detail, certain GATS issues also need to be flagged. The GATS non-discrimination rules, unlike those in the NAFTA and the GATT, ***do apply*** to subsidies in service sectors that Canada has committed (there are certain exemptions in Canada's GATS schedule that preserve flesibility—for example regarding R&D subsidies). Obviously any future mode 4 (temporary movement of natural persons) commitments, for example applying to the skilled trades, would undermine incentive programs linked to employment creation in Canada.

There is a need for a cautious approach to the GATS and particularly to negotiations to deepen Canadian GATS commitments. (Remember that the WTO ruled that the Auto Pact violated the GATS in addition to the WTO rules on goods.) But the GATS would not, at this point, frustrate incentives linked to direct labour costs.[10]

To sum up, it is still possible to attach legally enforceable conditions to invest and to create employment within Canada to grants and subsidies, and to link eligibility to overall sales in Canada. This could be a component of new auto-pact-type sectoral policies. Other elements — for example, support for research and development performed in Canada — could complement it.

Natural resource policies

In certain sectors there is a disconnect between the black-letter law of trade agreements and the way business is actually done. This is especially true in the resource sector.

A maximal interpretation of the NAFTA investment chapter would prohibit attaching most types of conditions (e.g. technology transfer, local processing, local purchasing) to resource licensing and approvals.[11] The NAFTA even prohibits governments from attaching performance requirements to projects by domestic investors and those from non-NAFTA countries.

The reality is rather different. Most natural resources in Canada are publicly owned. If governments are not satisfied with the economic spin-offs or the environmental sustainability of a resource development, then it likely won't proceed. Competent governments choose the investment proposal that provides the greatest economic benefits and least environmental costs. Most investors in the resource sector, understanding this, shape their proposals accordingly. There is a lot of room for negotiation, and leverage on both sides … whatever the letter of trade law says.

While NAFTA disallows export taxes, and enforces proportional sharing with the U.S. during shortages, governments still retain the latitude to set royalties. Royalties from non-renewable energy reserves, for example, could be an important source of revenues to fund conservation and renewable energy strategies.

(I'd like to commend the CLC for the leadership it has shown in strongly supporting Canada's implementation of the Kyoto Protocol. The widespread public desire for a transition to a greener industrial strategy is perhaps the most convincing argument to rally popular support for significant public investment in a more active economic development strategy.)

There is little doubt that unbalanced provisions such as those in the NAFTA investment chapter increase corporations' bargaining leverage in the resource sector. But communities and governments still have some cards of their own to play. In my view, international trade rules that clash so clearly with accepted practice, public expectations, and democratic accountability are not sustainable.

Government procurement

The majority of government procurement in Canada is ***not*** covered by international trade agreements. For now, neither the NAFTA nor the WTO procurement rules apply to provincial or local government purchasing.

The U.S. makes extensive use of "Buy America" provisions and small-business and minority "set-asides" (not to mention national security exemptions). It was careful to exempt these programs from trade treaties and continues to use them at the federal and state levels.

Canadian governments, by contrast, have largely renounced the use of government procurement as an economic development tool. But this has happened unilaterally, through the non-binding Agreement on Internal Trade (AIT), not directly as a result of international trade rules.

In my opinion, one reason the federal government has pushed the AIT is because it wants to use provincial and local purchasing as a bargaining chip to persuade the U.S. to give up its preferential procurement policies. But the U.S. has shown little interest in this and, if anything, state and federal governments are expanding the use of active procurement programs, which they believe are successful economic development tools.

Perhaps Canadian governments should consider following the U.S. example by making more creative use of procurement for economic development purposes.

Conclusion

This presentation has focussed on the policy space that still exists, even in the current trade treaty context, for more targetted policies to encourage economic development and job creation.

Again, I want to stress that labour needs to continue to take an active role to prevent ongoing trade negotiations such as the WTO Doha round from further shrinking this "policy space" for alternatives.

It's undoubtedly true that Canada's future lies in its ability to attract high-quality investment and to succeed globally in the knowledge-based and services economy. But it does not follow that every new trade rule concocted by trade lawyers, corporate lobbyists, and government negotiators will serve Canadian interests.

John Crosbie may still not have read the text of the Canada-U.S. FTA , but the terms of so-called "trade treaties" have come a long way in scope and complexity since the mid-1980s — and the devil is in the details. Excessive intellectual property protection can hamper economic innovation, while denying the needy life-saving drugs. Generating wealth to expand public services (at home and abroad) should be a goal of greater international trade, but instead trade treaties such as the GATS throw up obstacles to the creation and expansion of public services. NAFTA's investor-state procedures and copycat provisions in bilateral investment treaties have become tools for foreign corporations to attack a wide range of public interest measures.

Trade and investment treaties have pushed too far into non-trade areas, becoming external constitutions that privilege commercial over other legitimate interests. They need to be scaled back.

For this to occur, and for economic development policy space to be preserved and enhanced, Canada's trade policy needs to change.

The current global conjuncture is favourable to efforts to rebalance Canada's foreign economic policy and realign our strategic alliances. There is strong interest in emerging industrial and developing economies in preserving policy space for heterodox economic and industrial policies. There is also support in some quarters (in the north and the south) for more fully protecting the ability to preserve and expand public services. There are exciting international initiatives to promote and protect cultural diversity in the face of commercialising pressures.

There is a genuine opportunity for Canadians, and the labour movement, to take a leadership role in a new progressive internationalism that acknowledges Canada's interests in global trade, but not to the exclusion of other values and interests.

My presentation has tried to suggest ways to take advantage of existing policy flexibilities, to contest certain trade treaty limits, and to encourage a new foreign economic policy that aims at achieving more balanced rules and greater policy space.

I hope that this conference can help restore a sense that Canadians and their governments can do more to shape our economic destiny, even in the context of globalization and trade treaties. It is vital that Canadians, and Canadian policy-makers, begin "to think outside the trade treaty box." 

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Endnotes

[1] But as Canadian tariff rates fell in the post-war era, the effectiveness of import duty exemptions as an investment incentive was already diminishing — even before the WTO Auto Pact decision declared them inconsistent with Canada's WTO obligations.

[2] For example, the "green light" category of non-actionable regional development and environmental subsidies, negotiated during the Uruguay round, was designed to expire automatically after 5 years unless the WTO subsidies committee agreed to continue it. The U.S. opposed its continuation and the green light category expired after the failed Seattle Ministerial.

[3] See Article 2 of the WTO Agreement on Subsidies and Countervailing Measures which sets out the criteria for determining if a subsidy is generally available or specific.

[4] CLC, *Economy*, Winter 2003-4. Statistics Canada studies available at www.statscan.ca.

[5] "Publicly funded health care thus accounts for a significant portion of Canada's overall labour cost advantage in auto assembly, versus the U.S., which in turn has been a significant factor in maintaining and attracting new auto investment to Canada." CAW, General Motors, Ford, Daimler Chrysler, "Joint Letter on Publicly Funded Health Care," September 2002, available at http://www.caw.ca/campaigns&issues/ongoingcampaigns/save_medicare.asp.

[6] Ibid.

[7] For a full discussion see Matthew Sanger and Scott Sinclair, "Putting Health First: Canadian Health Care Reform, Trade Treaties and Foreign Policy." Final report prepared by the CCPA Consortium on Globalization and Health for the Commission on the Future of Health Care in Canada, October, 2002 (available at www.policyalternatives.ca).

[8] Commission on the Future of Health Care in Canada (Ottawa, November 2002), *Building on Values: The Future of Health Care in Canada,* p. 238.

[9] The NAFTA investment chapter (Article 1106) does, however, prohibit attaching certain performance requirements to investment. But it also provides some flexibility in the case of subsidies, grants and other so-called advantages. Performance requirements linked to employment creation and labour costs are almost certainly allowable.

[10] Even the most zealous interpretation of the GATS national treatment rule could not compel governments to subsidise economic activity or job creation undertaken outside their own territories. The legally non-binding scheduling guidelines for the GATS state that: "There is no obligation in the GATS which requires a Member to take measures outside its territorial jurisdiction. It therefore follows that the national treatment obligation in Article XVII does not require a Member to extend such treatment to a service supplier located in the territory of another Member." See World Trade Organization, Committee On Specific Commitments, "Revision Of Scheduling Guidelines," Note by the Secretariat, 5 March 1999. (S/CSC/W/19), p. 11. The logic of the GATS itself, however, contradicts this proviso. See Scott Sinclair, GATS, Canadian Centre for Policy Alternatives, 2000, pp. 87 ff.

[11] There are certain NAFTA reservations, or exceptions, to these rules - for example for aboriginal affairs (Annex II-C-1) and for "existing, non-conforming" provincial measures in place as of January 1, 1994 (Annex I).