

**O
C
C
A
S
I
O
N
A
L

P
A
P
E
R**

**ANALYSIS OF INTERNATIONAL
TRADE DISPUTE SETTLEMENT
MECHANISMS AND IMPLICATIONS
FOR CANADA'S AGREEMENT
ON INTERNAL TRADE**

*Occasional Paper Number 19
November 1997*



Industry Canada Industrie Canada

**ANALYSIS OF INTERNATIONAL
TRADE DISPUTE SETTLEMENT
MECHANISMS AND IMPLICATIONS
FOR CANADA'S AGREEMENT
ON INTERNAL TRADE**

*by E. Wayne Clendenning and Robert J. Clendenning,
E. Wayne Clendenning & Associates Inc.*

*Occasional Paper Number 19
November 1997*

Canadian Cataloguing in Publication Data

Clendenning, E. Wayne

Analysis of International Trade Dispute Settlement Mechanisms and Implications for Canada's Agreement on Internal Trade.

(Occasional paper)

Text in English and French on inverted pages.

Title on added t.p.: Analyse des mécanismes de règlement des différends commerciaux internationaux et conséquences pour l'Accord canadien sur le commerce intérieur.

Includes bibliographical references.

ISBN 0-662-63225-7

Cat. no. C21-23/18

1. Canada -- Commercial treaties.
2. Arbitration and award, International.
3. Foreign trade regulation.

I. Clendenning, Robert J.

II. Canada. Industry Canada.

III. Title.

IV. Series : Occasional Paper (Canada. Industry Canada).

HF1479.C53 1997

382'.971

C97-980410-8E

The views expressed in this Occasional Paper do not necessarily reflect those of Industry Canada or of the federal government.

The list of titles available in the Research Publications Program and details on how to obtain copies can be found at the end of this document. Abstracts of Industry Canada research volumes, working papers, occasional papers, discussion papers and the full text of our quarterly newsletter, *MICRO*, can be accessed via STRATEGIS, the Department's online business information site, at <http://strategis.ic.gc.ca>.

Comments should be addressed to:

Someshwar Rao, Director
Strategic Investment Analysis
Micro-Economic Policy Analysis
Industry Canada
5th Floor, West Tower
235 Queen Street
Ottawa, Ontario
K1A 0H5

Telephone: (613) 941-8187

Fax: (613) 991-1261

E-Mail : rao.someshwar@ic.gc.ca

TABLE OF CONTENTS

INTRODUCTION	1
1. INTERNATIONAL MECHANISMS	3
The European Union	3
<i>Outline of the EU Mechanism</i>	3
<i>Evolution and a Shifting Balance</i>	5
<i>The EU Experience</i>	6
The World Trade Organization	7
<i>The GATT Mechanism</i>	7
<i>Evolution to the WTO</i>	8
<i>The WTO Dispute Settlement Body</i>	11
<i>Evaluating the WTO Initiative</i>	15
The North American Free Trade Agreement	18
<i>The NAFTA Mechanism</i>	18
<i>Evolution of the NAFTA Mechanism</i>	20
<i>The FTA/NAFTA Experience</i>	22
2. NATIONAL MECHANISMS	29
Australian Interstate Trade and the Constitution	29
<i>The Australian Federalism Debate</i>	29
<i>Experience of Australia's High Court</i>	31
Canada's Agreement on Internal Trade	35
<i>The Road to the AIT</i>	36
<i>AIT Provisions and Procedures for Dispute Settlement</i>	37
<i>Critiques of the AIT Dispute Settlement Procedures</i>	39
3. COMPARISON AND ASSESSMENT OF THE MECHANISMS	45
Comparison of the Mechanisms	45
Effectiveness of the Mechanisms	48
<i>Scope</i>	48
<i>Frequency of Use</i>	49
<i>Credibility of Decisions and Rulings</i>	50
<i>Enforceability Record</i>	51
<i>The Need for Evolution</i>	52
Implications for the Internal Trade Mechanism	53
<i>Implications of WTO and NAFTA Changes</i>	53
<i>Lessons from the EU and Australian Mechanisms</i>	55
<i>Key Issues and Recommendations</i>	56
BIBLIOGRAPHY	59
INDUSTRY CANADA RESEARCH PUBLICATIONS	61

INTRODUCTION

The purpose of this study is to provide an update of recent developments and changes to international and national dispute settlement mechanisms, as well as an analysis of the implications for the dispute settlement mechanism established under the Canadian Agreement on Internal Trade (AIT). The international mechanisms, in particular, have evolved in response to new requirements imposed on them and the experience gained with their operations over the years. The result has been the development of new structures added to the mechanisms, and of new procedures and processes for enhancing their operations and strengthening their credibility in dispute resolution. Substantial differences have emerged in the structure and operation of the various mechanisms; these range from court-based mechanisms, with very legalistic structures and procedures, to more informal panel-based systems. The analysis will include the Australian constitutional approach for ensuring free trade within a federal state similar to Canada. The AIT mechanism has borrowed heavily from a number of other mechanisms and its further evolution will undoubtedly reflect the changes and improvements implemented in them. This study will analyse the changes and their implications for the AIT mechanism; it will also offer recommendations for improvements to the AIT mechanism, based on the changes to and experience with other national and international mechanisms.

1. INTERNATIONAL MECHANISMS

The European Union

The European Union (EU), an economic union of sovereign European states, is the most economically and institutionally integrated of the international organizations we are examining. In essence, it is a mechanism for removing internal trade barriers through positive integration legislation in order to ensure the free movement of goods, people, services and capital between the member countries. The authority to undertake integration was initially provided by the 1957 Treaty of Rome, which established the EU (then known as the European Economic Community), and later by a 1986 amendment to the treaty entitled the Single European Act (SEA), which accelerated the removal of barriers in order to achieve a single market by the end of 1992. The authority has been further enhanced by the Maastricht amendments; when these are fully implemented and ratified, they will significantly advance economic and policy integration. To achieve its goals, the EU has established a complex compliance mechanism for implementing and enforcing the removal of all types of internal barriers in accordance with the underlying legislative and constitutional provisions.

Outline of the EU Mechanism

The establishment of the EU has been undertaken by means of institutional supervision and secondary legislation that elaborates and implements the primary legislation in the Treaty of Rome. The institutional structure for enforcing the principles of the Treaty and ratifying secondary legislation comprises four elements: the Commission, the Council, the European Parliament and the Court of Justice. The Commission, a body of officials appointed by member states, has the sole right to propose secondary legislation; the Council, made up of ministers from member states, enacts the legislation. The European Parliament has a limited but increasing input into the legislative process; it can amend but not initiate legislation. In contrast, the Court of Justice has played a key role in interpreting and enforcing EU law, primarily through its ruling that community law takes precedence over national law.

The EU compliance regime provides for the use of five types of instruments to ensure compliance with secondary legislation. The instrument with the most intrusive effect on national law is the *regulation*; this replaces national rules with EU rules and becomes effective in member states without any action on the part of national governments. A *directive* is less intrusive in that each member state can choose how to achieve an objective prescribed by it, and each is allowed a period of time to transpose the

directive into national law or administrative practice. A *decision* is an administrative measure taken by a Union institution and targeting a particular member state, firm or individual; it is equivalent to action by a government to apply the provisions of a statute to an individual case. *Recommendations* and *opinions* are non-binding measures that enable EU institutions to express their views on specific matters.

The process of removing or preventing trade barriers within the Union involves the application of the Treaty articles and the secondary legislation that gives them practical effect. In numerous cases the Court of Justice has interpreted the basic Treaty articles to establish the general principle of non-discrimination on the basis of nationality or country of residence. New secondary legislation is needed on a continuing basis to give the articles practical effect, particularly in resolving differences between national rules and regulations, which can create technical barriers favouring domestic producers of goods and services. Secondary legislation dealing with these barriers is now based on the principle of mutual recognition by member states of each other's rules and regulations.

In settling disputes, the Treaty articles, secondary legislation, directives and decisions are enforceable against member states not only by other member states but also by business firms and individuals. The rulings of the Court have established that certain of the Treaty provisions have "direct effect" and thereby give firms and individuals rights that they may invoke in national courts exactly as they would invoke the provisions of national law. The principle of direct effect has become one of the pillars of the EU legal order, and the Commission relies upon the support of firms and individuals who assert their rights in the resolution of disputes. The Commission also has the legal duty to intervene if directives are not transposed within the time provided, if they are not transposed correctly, or if member states infringe on the provisions of the Treaty or secondary legislation. It is usually the Commission that takes action but, if it declines to do so, the aggrieved member state can take the Commission to court. In acting, the Commission follows a well-defined and escalating process that starts with informal contacts, followed by a letter of formal notice and finally by court proceedings. In practice, the majority of complaints are settled before court action. An ongoing problem with this process is that there are no serious sanctions that can be applied if a member state refuses to respond or delays its response to a Commission notice; compliance ultimately depends on the willingness of the member states to uphold the principles of the Union.

Evolution and a Shifting Balance

The most recent changes to the EU have been those initiated through the adoption of the Maastricht Treaty. This has wide social and political dimensions, including the achievement of monetary union and EU-wide fiscal harmonization. It has also shifted the balance between EU political and bureaucratic institutions. Specifically, the Maastricht Treaty has increased the power of the European Parliament vis-à-vis the Commission and Council. It gives the legislative body limited veto power over certain issues, although the Parliament clearly remains subordinate to the other two institutions. Nevertheless, the increased power of the legislature might create institutional barriers to economic integration. To our knowledge, this possibility has not materialized under the current structure, although the general trend toward increased Parliamentary power certainly makes it an important future consideration. The ability of EU institutions to facilitate co-operation could depend to a greater degree on domestic political outcomes, although the EU institutions might create some momentum encouraging co-operation.

There are indications that the emphasis of EU decision makers has shifted from creating secondary legislation to enforcing it. According to the 1995 *General Report on the Activities of the European Union*, "While there was a considerable reduction in the number of new legislative measures proposed in this area, non-legislative activity was stepped up."¹ There is a substantial degree of consensus on implementation of legislation, but there are problems with the institutional mechanisms that attempt to apply and enforce the legislation between nations. The situation underlines the need for constant progress on common market policies. The Maastricht Treaty has responded to this need by giving the Court of Justice the power to impose penalties on member states that do not comply with the judgments of the Court — for instance, states that do not transpose directives within the specified time. The Maastricht Treaty also deals with the issue of subsidiarity: it adopts the principle that the Union, through secondary legislation, should not take any action unless it can do it better than the individual member states. In other words, in areas within its exclusive competence, the Union will take action only if and so far as the objectives of the proposed action cannot be satisfactorily achieved by the individual member states, and can therefore be better achieved by the Union. It is still unclear, however, whether this limitation is enforceable in court.

¹ *General Report on the Activities of the European Union: 1995*, Luxembourg: Office for Official Publications of the European Communities, 1996, p. 50.

The EU Experience

Throughout its history, the European Union has undergone continual change and evolution via the Single European Act and the Maastricht Treaty provisions amending the Treaty of Rome articles, plus a continuous stream of secondary legislation and Court of Justice rulings. Of particular interest is the important role played by the Court of Justice. In the majority of cases, involving areas such as harmonization of regulations, tax policy in relation to labour mobility, the free movement of capital, and even the validity of free agency among soccer teams from different nations, the Court has held that EU laws supersede national ones. However, the Court has not indiscriminately upheld requests by the Commission. For example, in the case *Commission v. Greece*, the Court ruled that a Greek law permitting modified milk for infants to be sold only by pharmacies did not constitute a barrier to the access of goods to the Greek market (as the Commission had claimed). The tribunal argued that the policy was discriminatory neither *de facto* nor *de jure*. The Court here upheld the principle of GATT Article III, which maintains that laws are not discriminatory so long as they are applied equally to products of foreign and domestic origin, irrespective of their market share within a nation.

In another interesting case involving the freedom to provide professional services permanently across national borders, the Court found that there were no Union rules laid down on this issue. It subsequently ruled that, in the case of a lawyer wishing to establish a permanent service in another member state, national arrangements governing the profession should not go beyond what was necessary to achieve their objective. The Court also held that member states should recognize diplomas obtained in other member states, accept the equivalence of diplomas and conduct examinations of the qualifications concerned, provided that they were applied in a non-discriminatory manner and where appropriate. These rulings were later included in the Maastricht Treaty provisions amending the Treaty of Rome, thereby indicating that the Court not only enforces EU rules but also plays an ongoing role in the evolution of the Union's rules and mechanisms.

The experience of the European Union has been one of continuous evolution and clarification of the original articles and the amendments to them through the enactment of secondary legislation and the rulings of the Court of Justice. The evolution, however, has aroused intense controversy, often making this a very difficult and unclear path. Nevertheless the process has gone ahead because the Commission, its member states, business firms and individuals can all take action directly to enforce EU provisions with the certainty that Union law will supersede any national law. The weaknesses of the EU mechanism are the limited penalties for non-compliance with secondary legislation on the part of member states and the uneven

administration of secondary legislation by the different member states. The Maastricht Treaty attempted to deal with these issues but further action will be required to resolve them. However, with the coming into force of the Maastricht Treaty provisions on establishment of a single currency and the requirement for fiscal and monetary harmonization, the enforcement and administration problems may lessen because member states will then have a greater incentive to meet all EU commitments in order to remain part of the highly unified community structure.

The World Trade Organization

The World Trade Organization (WTO), the successor organization to the General Agreement on Tariffs and Trade (GATT), came into being after the Uruguay Round of trade negotiations initiated under the GATT. The inclusion of services under the GATT necessitated a more formalized and rules-based system of dispute settlement procedures, and this was established within the WTO to provide scope for dealing with the more diverse and complex disputes expected after completion of the Uruguay Round. The purpose of the GATT/WTO mechanisms has been to resolve trade disputes between member countries regarding the application of and adherence to the trading rules established in the General Agreement. All disputes are dealt with on a government-to-government basis, with each government representing the interests of complainants from its own jurisdiction.

The GATT Mechanism

The GATT mechanism was not documented as part of the General Agreement. Instead it was developed over the years through consensus and experience, and was codified through a series of decisions. The process operated via two alternative rules frameworks. First, panels were established by the GATT Council, with fixed membership of GATT signatories. Second, panels were established under the GATT Codes; these had limited and varying membership, and provided elaboration of specific GATT articles, such as government procurement, anti-dumping and countervailing duties. Depending on the purpose and urgency of the complaint it lodged, a government could choose between the two frameworks. Under each approach, however, the process involved the lodging of a complaint, the establishment of a panel to investigate the complaint, the reporting of findings, the making of recommendations and the implementation of the recommendations. The panel reports sought primarily to terminate inconsistent action rather than reward tangible remedies. The implementation of the recommendations was left up to the non-complying country, with a deadline for reporting on proposed implementation action to

be undertaken within a reasonable time. The main deterrent against non-compliance was the provision for retaliation by the injured country; such action was approved only once during the history of the GATT.

Evolution to the WTO

To strengthen the GATT system, in 1994 the WTO superseded the “old GATT,” adopting a much more precise and clear wording of procedures. The WTO consolidates the original 1947 GATT with all of the agreements and rules subsequently added, including those of the Uruguay Round, into a “single undertaking”; it thereby makes the Uruguay agreements a take-it-or-leave-it package for signatories. It should be noted, however, that many of the provisions relating to services are found in each individual member’s schedule and vary considerably from country to country. Aside from the complexities of implementing the trade in services section of Uruguay, the WTO has managed to circumvent the problems posed by the old GATT’s amending clause. The old GATT never formally defined what constituted consensus; in contrast, the WTO incorporates a formal definition of consensus for decision making. This new definition states that consensus does not necessarily mean unanimity. It simply requires that no member physically present vote against the decision. Abstentions or those not present do not count. The new process thus retains the “one member, one vote” basis for decision making in the WTO, and it makes it easier to legalize agreements such as those reached during the Uruguay Round of negotiations. In essence, with the “single undertaking” approach and the ability to reasonably predict when adoption of a resolution is imminent, it is possible to avoid the practice of selective adoption (commonly referred to as “GATT à la carte”). Moreover, as Sarah Hogg, director of London Economics, commented, “Such a process has its advantages; only those decisions are made which have a good chance of being implemented.”² The adoption of the “single undertaking” approach and the formal definition of consensus clearly reflect the desire of WTO members for the institution to evolve in a consistent and positive manner. Similarly, the mechanism for rejecting panel reports has been strengthened to prevent delays in implementation of panel findings. In contrast to the amended procedure for member voting, the rejection of a panel report requires a “negative consensus”; in other words, all members must vote against the panel report, including the complainant. The WTO has thus evolved in a manner that complements the new structures of its dispute settlement procedures, which

² Sarah Hogg, “The Political and Economic Prospects of the WTO,” paper presented at the WTO Dispute Resolution Conference, Brussels, June 14, 1996.

seek to prevent defection, cheating and the imposition of domestic politics by member states.

Efforts to strengthen the dispute settlement provisions were prompted by what many saw as an undue tendency on the part of major players to shirk their GATT responsibilities at the expense of poorer nations. Under the old GATT, dispute settlement procedures were rather amorphous: there was no single way to resolve disputes and the process operated primarily on an informal basis. When observers refer to formal dispute settlement under the old GATT, they are often referring to practices that developed around Articles XXII and XXIII of the Agreement. Article XXII requires Contracting Parties to consult with each other in the event of a dispute on any matter affecting the operation of the old GATT, and to give consideration to each other's representations. If consultations under the article fail, Article XXIII is applicable. Referring more generally to the Contracting Parties at large, this is commonly known as the nullification clause. It comes into effect if a Contracting Party feels that the attainment of any objective of the Agreement is being impeded as the result of: (1) the failure of another Contracting Party to carry out its obligations under the Agreement; (2) the application by another Contracting Party of any measure, whether or not it conflicts with the provisions of the Agreement; or (3) any other situation. If consultations fail, the aggrieved Contracting Party may request the Contracting Parties to investigate the complaint and, if they find it justified, to authorize the aggrieved Party to suspend concessions or other GATT obligations to the Party complained against as they deem appropriate should the latter fail to modify its offending policies or practices.

Under these two articles, the old GATT would use a panel mechanism to resolve disputes. However, the use of the words "mechanism" and "procedure" are misleading as applied to practices under Articles XXII and XXIII because such practices did not amount to a well-defined legal process, as both Trebilcock and Howse caution.³ They write, "The precise legal status — the authority — of documents like the 1979 Understanding, which purport to codify panel practice, is still unclear; and difficulties remain concerning the precise status of past practice."⁴

Like its GATT predecessor, the WTO mechanism is open only to Contracting Parties to the Agreement. As with the old GATT dispute resolution mechanism, individuals or firms with grievances have to persuade

³ Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade*, New York: Routledge 1995, p. 386.

⁴ Ibid., p. 387.

their own governments to take up their cause. Members need not demonstrate that any particular article has been violated; instead they need only show that benefits “reasonably” expected from the Agreement have been impaired or nullified. Despite this fact, customary practice has made action less likely under non-violation complaints. Therefore, of the conditions justifying nullification or impairment, governments have been most likely to pursue disputes that demonstrate a breach of the Agreement as they imply nullification, regardless of the existence of adverse trade effects at that particular time. Once a Contracting Party has made its claim, the disputants are required to enter into consultations before formation of any panel. Indeed, the disputants are strongly encouraged to solve their disputes at this stage before appealing to the Contracting Parties in general. Many trade experts state that this informal process has been indispensable to the GATT’s evolution, although little evidence can be compiled showing how many disputes have been resolved in this phase. During consultations, Parties were left to determine the style of negotiations largely on their own, with whatever degree of formality they deemed appropriate. As a result, transparency was often lacking in the consultation process and the other Contracting Parties were often not fully aware of pending disputes. Once the request for consultations had been made, Parties to the dispute were required to respond “promptly” and to attempt to conclude consultations “expeditiously.” Key concerns providing impetus for the WTO process were the loose terminology and lack of specific guidelines; these left the process open to untold delays and less-than-honest tactics on the part of disputants.

After consultations, Parties were permitted to use the good offices of the Director-General and allowed to request a third Party to act as conciliator. If consultations failed, under the old GATT the complaining Party could bring the matter before the GATT Council of Representatives, which would offer the complainant the choice of a working party or panel to hear the dispute. The normal practice of the Council was to allow the formation of a panel; however, it did have the discretion to defer a decision in order to give the responding Party time to study the complaint. Very different is the present WTO panel formation process, under which a panel is automatically selected after the filing of a request. Under WTO, responding Parties are given relatively short and strict deadlines for entering their comments before the start of panel proceedings and oral submissions.

Except for time frame allowances, the WTO differs little from the old GATT in the area of panel procedures. First and foremost, old GATT panels were free to set their own working procedures. Like the WTO panel process, the old GATT panels typically elicited information in written form from the complainant and the respondent, and were given the liberty to request written submissions from interested third Parties or external experts. The old

GATT format had no specific guidelines on how long deliberations could last. As a result, there was growing dissatisfaction with overly lengthy panel deliberations and late panel reports, despite the requirement that these be submitted “without undue delay.” Once a panel submitted a report, under the old GATT format its implementation depended on a consensus of the Contracting Parties; in other words, a report would become a decision if no Contracting Party voiced an objection. As a result, Parties to the dispute became judges in their own cause. Accordingly, adopted reports had no legal status in GATT law and their implementation relied exclusively on moral suasion and/or suspension of concessions by the complaining Party.

A prime objective in negotiation of the WTO was removal of ambiguous and loose terms such as “undue delay” and “promptly or expeditiously,” and their replacement with specific guidelines on intentions and purposes of the various stages in dispute resolution. By this account, the WTO provisions deserve much praise for raising international dispute resolution to a new level of specificity and predictability. In addition, the old GATT system was heavily criticized as ineffective in developing meaningful case law; in response to this criticism, the WTO has added the Appellate Body and frequent consultations on broad issues of GATT law interpretation. However, not all world trade experts praise the changes. The WTO structure has many advantages; in particular, it makes Contracting Parties aware of what they are undertaking. Nevertheless, some observers have suggested that the WTO may have gone too far in enjoining formal procedures on its members. In addition, despite the renewed efforts to depoliticize the WTO mechanism, the Organization remains a political forum and has been criticized for inadequately confronting access issues. Thus, while the WTO agreement has made it much more difficult for members to ignore GATT or avoid implementation and adoption of GATT rulings, there remains a problem: the question of how to strike a new balance between formal and informal dispute settlement.

The WTO Dispute Settlement Body

Of the dispute settlement mechanisms examined in this study, the new WTO Dispute Settlement Body (DSB) is one of the most legalistic approaches, surpassed only by that of the European Union. Reinforcing what many trade lawyers have seen as a push to a true rules-based system of international law, the WTO has confronted the deficiencies of a GATT dispute settlement process viewed by many as overly vulnerable to shirking. In general, the WTO dispute settlement procedures have had to come to grips with the realist paradigm in international relations, under which sovereign states often abandon negotiations in favour of unilateral action. For this reason, much emphasis has been placed on the need for specific operating procedures

and transparency in dispute settlement. The aim is to integrate a dynamic contracting approach with institutional arrangements designed to make defection from the process increasingly expensive in terms of international legitimacy among member nations and domestic trade representatives.

The normal process for hearing a dispute follows five stages that are not unlike other panel review processes under the GATT and the North American Free Trade Agreement (NAFTA). The first stage involves consultations and mediation with the optional use of good offices, conciliation or mediation by the Director-General. The request for consultations must be made in writing, and details must be given as to the content and purposes of the process. If the disputing parties are unable to reach a settlement from this stage within 60 days, a request can be made for a panel to secure a solution. Once the request is made, the formation of a panel ensues automatically. With three panelists sitting to hear the dispute, the process goes through eight steps:

1. presentation of the facts and arguments (memorandums);
2. meetings with the disputants and third parties;
3. rebuttals;
4. additional meetings and submissions, if required;
5. preparation of a report on the facts and the arguments presented;
6. submission of a factual interim report for review by the parties;
7. drafting of conclusions and recommendations; and
8. submission of the final report.

After the final report is released, the decisions must be adopted by the DSB within 60 days unless a Notice of Appeal is filed with the DSB's Appellate Body. If an appeal is filed, the Appellate Body undertakes a panel process and submits a report that can modify, revise or uphold the panel's decision.

Created to reinforce the changes discussed above, the Dispute Settlement Body and its accompanying Appellate Body offer a faster, more transparent and thorough process for resolving disputes. Paramount to the DSB's success is its adoption of the principle of automaticity: the formation of panels, the adoption of reports and the victor's right to retaliate are all automatic. This change reflects a similar advance under the NAFTA: if disputing parties are unable to reach a consensus on the forum for resolving the dispute, all of them are automatically required to undertake proceedings under a NAFTA dispute process. In contrast to the old GATT, where procedures varied from sector to sector, the WTO dispute settlement procedure is unified under a single system. This unified approach, along with the principle of automaticity, is intended to streamline the entire dispute

process so that member nations can easily read the potential risk factors in pursuing discriminatory practices in the face of one central authority.

The institutional framework for dispute resolution in the WTO involves two separate review processes under the Dispute Settlement Body and the Appellate Body. The two bodies are to serve different roles: panel proceedings are to be more open to broad arguments and presentation of facts, while Appellate hearings are to be discussions of legal issues via court-like proceedings. These two roles have led to differences in panel composition and functioning; in addition, Appellate Body panelists are forbidden to have any governmental affiliation. In pursuing this goal of unbiased panelists, the Appellate Body has gone to great lengths to ensure that no inappropriate relationship exists between disputants or issues at hand and panelists.

The Appellate Body represents a unique addition to what is a relatively common panel process under the DSB. It serves as a quasi-judicial last resort for members who disagree with the interpretation or implementation of any GATT principle ruled upon during a panel procedure. It is composed of seven persons, who are required to be “of recognized authority, with demonstrated expertise in law, international trade and the subject of the covered agreements generally”; they are appointed for a four-year term, renewable once. The Appellate Body offers disputants a chance to clarify the legal principles of the relevant GATT articles. It appoints three of its members to hear individual cases and is given the authority to uphold, modify or reverse the legal findings and conclusions of a panel and its report. Given its powerful role in legitimizing and implementing DSB panel rulings, the Appellate Body has had to integrate extensive measures to ensure the impartiality of its panelists.

The working procedures have also been strongly bolstered with measures to ensure a collegial atmosphere among Appellate Body members. First, the Appellate Body is required to hold at least four general meetings of its members throughout the year, so that they may keep up to date on dispute settlement activities and relevant WTO developments. Moreover, even though each appointed panel of three is given absolute authority to determine the issues and decisions of an individual appeal, the panelists are required to meet with the other four members of the Appellate Body for an “exchange of views” session in Geneva during the deliberations phase. These measures ensure consistency in rulings and interpretation, and they minimize the possibility of conflicts with previous rulings. Upon receipt of an appeal, members of the Appellate Body are required first to determine whether they have any interest in the issue that might jeopardize their impartiality. If any conflict of interest is discovered, the member must disclose it to the Appellate Body as a whole. Members found to be in conflict

are removed entirely from the proceedings, including discussions in the exchange of views. After this initial determination of eligibility for duty on a particular appeal, the Appellate Body proceeds to choose the three members on a rotating basis, while taking into account the principles of random selection, unpredictability and opportunity for all members to serve regardless of national origin.

After panel selection the process advances quite rapidly, with strict time lines for submissions and deliberations. The Appellate Body allows appeals to be heard within 60 days, with an absolute upper limit of 90 days for any one case. Appellants are given a maximum of 10 days to make their written submissions after filing a Notice of Appeal with the Appellate Body. The appellee is given 15 days to make written submissions after the filing of the appellant's written submission, or 25 days from filing of the Notice of Appeal. Generally one month after the initial Notice of Appeal, oral proceedings will be held that are open to the appellee, appellant and any third party who has made a submission to the Body. Finally, there are provisions for written responses to questions or additional written memorandums requested by the panel at any stage in the appeal proceeding. This provision has been praised by experts because it affords panels the opportunity for seeking out expert advice on more technical issues.

In sum, by taking a heavily judicial approach to proceedings and emphasizing due process and the right of all concerned WTO members to be involved, the Appellate Body has established a desirable level of flexibility and transparency without shirking potentially controversial decisions in favour of diplomatic geniality. As for deadlines, the Appellate Body must make its decision within a scant 90 days, after which the DSB is compelled to adopt the report within 30 days. From this point the offending Party is monitored for compliance, the lack of which is grounds for retaliatory actions.

Overall, disputants under the WTO have few "legitimate" options once the process has been carried through. Moreover, they have little time to formulate alternative strategies for stalling proceedings. Under the DSB, disputants can expect to have a panel report issued and adopted by the DSB within 430 days, including the time allotted for consultation and mediation. The entire process, then, if it were to include an Appellate review and adoption of Appellate Body decisions, would extend to approximately 550 days. Compared with the NAFTA procedure, under which it takes approximately four to five months for panel reports to be issued, the WTO process is somewhat more drawn out. However, it must be noted that the WTO procedures offer less latitude for political deal making once decisions are finalized. In contrast, parties to Canada's AIT dispute settlement procedures can expect to wait up to 545 days alone for the submission and

implementation of a panel report, and a further 365 days for meetings to discuss non-compliance — or a total of up to 940 days.

Not surprisingly, the Appellate Body is setting the most important early trends in dispute settlement under the WTO. First, it has established that the Body members themselves believe in collective decision making and collegiality in general; and second, the members have taken great pains to preserve impartiality, integrity and independence. They have stated clearly that nationality should play no role in member selection or panel proceedings, and have shown some real fortitude in the few early decisions. Before we discuss these cases, we must point out that opinions vary on the DSB's achievements or potential for success.

Evaluating the WTO Initiative

As indicated, dispute settlement under the WTO has taken great strides in delineating a rules-based international trade dispute settlement mechanism. By the 1980s, it was becoming increasingly apparent that dispute settlement under the GATT needed strengthening. It was not until the conclusion of the Uruguay Round (with the inclusion of trade in services) and the signing of the Understanding on Dispute Settlement that a consensus was reached about the need for a common forum to hear disputes of increasing diversity and complexity. As a result, we have seen the development of a more elaborate institutional support network for GATT proceedings, especially with the development of the Appellate Body and increased staffing for the Secretariat. Yet perhaps the most urgent item on the agenda after development of the institutional structure has been a quick transition to the WTO in order to prevent nations from resorting to outside means while the GATT/WTO is in flux.

Many international trade experts have stated that the DSB must quickly build a presence in order to establish international confidence in a renewed GATT platform. Indeed, as was noted at a June 1996 conference in Brussels on WTO Dispute Settlement, an early dispute between the United States and Japan over automobiles and automobile parts offered the potential for submerging the WTO before it got started. As we have seen, the WTO mechanism has been framed in such a way that parties to a dispute can obtain results quickly; however, there are some doubts about whether the theory behind the new institutions can work out in practice. For instance, we have seen repeated statements by the U.S. Congress to the effect that no U.S. government can allow domestic policy to be dictated from outside American borders. Accordingly, the criticisms we discuss below take into account the urgent need to establish confidence in the WTO; they also recognize that nations, and particularly the United States, will continue to

harbour hostility toward mechanisms binding them to compliance and potentially able to reverse domestic legislation.

The WTO process has met with some criticism even though it was constructed to maximize efficiency and minimize the opportunity for members to shirk their responsibilities. At the Brussels conference on WTO Dispute Settlement, opinions varied from enthusiastic support for the DSB to reserved optimism about its enduring effect. The first and most commonly discussed topic was the degree of formalism or legalism found in the DSB and its Appellate Body. Experts offered opinions on the limits of judicialization versus efficiency; in particular, they stressed the overburdening effect of automatic formal dispute settlement. Excerpts from the conference proceedings offer important insights into possible problems from both an EU and North American perspective. We will discuss the criticisms beginning with what some experts saw as deficiencies in the original GATT that were not addressed, and continuing with more pointed criticisms of specific WTO procedures.

As far as panel selection is concerned, the Brussels conference suggested that panel selection remains heavily biased toward the selection of (ex-) governmental officials over non-governmental and academic persons. It was asserted that the Secretariat, its diplomats and civil servants continue to exhibit an undue fondness for their own kind. Accordingly, there is a dwindling supply of panelists who will satisfy the non-partisan requirements, while over the next several years the number of panels will grow and typically will involve the United States and the European Union. To circumvent this problem, it was suggested that the DSB consider an early revision that would establish a true Court of International Trade (CIT) consisting of full-time judges sitting on the Appellate Body. This recommendation also addresses another problem: the fact that few believe the panel selection can remain unbiased in light of an ever-increasing case load as more countries opt for settling before a panel. Doubts also surfaced about the Appellate Body's ability to remain beyond the realm of economics and politics. Specifically, some forecast that the politicians will fight back against the WTO to save face during domestic political crises or other junctures. As one speaker suggested, "The WTO could evolve like the League of Nations. The key question is always what happens when the decision goes against a major player? Will the major player settle out of court rather than allowing a decision?"⁵

⁵ Michael Hindley, "Opening Comments of the WTO Dispute Resolution Conference," Brussels, June 14, 1996. p. 7.

Another area of concern was the degree to which panels for disputes followed consistent procedural guidelines. As was pointed out during the conference, the DSB panels that first hear a dispute (unlike Appellate Body panels) have no formal rules and procedures to follow when examining a case. In particular, there is a lack of formality surrounding the presentation of evidence: parties to the dispute may submit evidence, including reports and studies, throughout the process. In all likelihood, this presentation of facts and new evidence up to the last minute of panel proceedings is a serious threat to expeditious settlement. Furthermore, there still exist some contradictions between provisions for the operation of panels and their effect on Appellate Body proceedings.

Criticism was also voiced about review of the preliminary legal findings of a panel in the interim report. Such a provision was criticized as going beyond the previously established provisions for verifying the presentation of facts, since it allows the disputing Parties to make remarks and comments on legal interpretation of the panel's preliminary draft decision. These comments are included for the sake of potentially contributing to the quality and transparency of panel reports; nevertheless, concerns have arisen about the review process's tendency to act like a pre-Appellate Body hearing. In short, the possibility for the interim review to turn into a kind of early appeal highlights two problems: First, parties tend to return to or, indeed, resubmit whole briefs to the panel and actually re-plead a case during interim reviews; and second, only parties that have appeared to win in the interim review draft report might offer comments, with the loser holding in reserve any deficiencies as material for appeal with the Appellate Body. Routes for reform suggested at the Brussels conference were the removal of the interim review process and the restriction of review to mere presentation of facts.

Aside from procedural issues, fundamental questions were raised concerning direct effect and direct access to the dispute settlement mechanism. While some speakers suggested that the WTO lacks the kind of direct effect and access to the mechanism enjoyed by EU member states via national courts, doubt persists about whether this kind of access is feasible under the WTO. Under the European Union, all Treaty rules that are worded unconditionally have "direct effect"; that is, they confer rights directly on firms and individuals, and these rights may be invoked by them in national courts in the same way they would invoke the provisions of national law. Admittedly, this has been one of the pillars of the EU legal order and has indeed been very valuable in hearings on public procurement cases, but it is unclear how desirable it would be under the WTO. First, the WTO's membership is far more diverse, presenting the formidable task of harmonizing national court systems. Second, it would create a huge number

of cases and could limit the effectiveness of the WTO dispute settlement mechanism by slowing rulings and complicating enforcement.

The North American Free Trade Agreement

The Canada–U.S. Free Trade Agreement (FTA) established a free trade area between Canada and the United States in conformity with the GATT. The Agreement eliminated barriers to trade in goods and services between the two countries within the context of fair competition and liberalized investment. In effect, it took various GATT commitments, bilateral arrangements and ad hoc understandings and transformed them into a treaty-based relationship that governed the trade and economic relationship between the two parties. The FTA established a mechanism for settling disputes about the interpretation or application of any element of the Agreement. The North American Free Trade Agreement (NAFTA) extended the FTA to cover trade with Mexico, while keeping intact all the basic elements of the FTA and adding a number of provisions and improvements.

The NAFTA Mechanism

Two separate parts of the NAFTA address dispute settlement: Chapter 19 provisions govern the settlement of anti-dumping and countervailing duty cases, while Chapter 20 provisions (formerly under Chapter 18 of the FTA) cover the resolution of all other disputes under the Agreement. The principal structures established in both chapters are binational panels that deal with general disputes after the failure of consultations between the two parties to a dispute, and with appeals on anti-dumping and countervail cases after determinations have been imposed under national laws through national trade remedy procedures. The process under Chapter 20 involves government-to-government proceedings, while that under Chapter 19 deals directly with private-sector complainants affected by the measure at issue. Jurists from both disputant countries sit on panels.

The NAFTA dispute settlement mechanism is multi-staged and allows for resolution at any point within the process. Each government can request consultations on an actual or proposed measure. The parties attempt to arrive at a resolution through these consultations but, if they fail to do so, either may request a meeting of the NAFTA Commission, composed of the trade ministers of the three parties to the Agreement. If the Commission cannot resolve the dispute, either party can request that it form a binational panel of experts to consider the matter. The panel sets its own rules of procedure, including at least one hearing before the panel as well as the opportunity for each party to submit written submissions and rebuttal arguments. The panel then issues initial and final reports. After receiving

the final report the Commission must agree on the way to resolve the dispute; normally its decision accords with the recommendation of the panel. If the Commission fails to reach an agreement within 30 days, the aggrieved party is free to retaliate against the other party by suspending the application of benefits of equivalent effect until settlement of the dispute.

Under Chapter 19, the parties may opt for a binational panel review in place of judicial review of final anti-dumping and countervail duty determinations reached by national trade remedy procedures. They can initiate a binational panel review of a final agency determination within 30 days of publication of the agency's decision. Once the request for a panel has been made, the two parties to the dispute each choose two members from the roster of eligible panelists and jointly agree on another member, making five in all. The panel conducts a review of all evidence filed with the national trade remedy entities, and of briefs presented to it by private-sector parties to the dispute. It then hears arguments in accordance with court procedures. Overall, the panel is directed "to determine whether [the challenged agency] determination was in accordance with the anti-dumping or countervailing duty law of the importing Party." Furthermore, the panels are instructed to "apply the standard of review ... and the general legal principles that a court of the importing Party otherwise would apply to a review of a determination of the [agency]." The panel may uphold a final determination or may remand it for action in accordance with the panel's decision, in which case the panel establishes a deadline for compliance by the offending party. On the specific matter before it, the decision of a panel is binding on the parties. However, the Chapter 19 procedures allow for what is called an Extraordinary Challenge Procedure. This has been requested three times by the United States for countervailing duty determinations by its Department of Commerce on pork and lumber issues. While all three cases have been controversial, the softwood lumber case has been singled out as potentially the most harmful to the legitimacy of the Chapter 19 process.

Meant to be rarely invoked, the Extraordinary Challenge Procedure serves as a way of verifying the legitimacy or correctness of a panel decision. Under the procedure, either party may allege that certain types of misconduct by a panelist occurred, that the panel departed from a fundamental procedural rule or that it manifestly exceeded its powers, authority or jurisdiction. The allegations are reviewed by a committee of three judges selected from a panel of five U.S. federal judges and five Canadian Superior Court judges. The committee has authority to reverse the panel decision or remand the decision to the panel for further action in light of committee findings. Of the three extraordinary challenges filed under the FTA, all were launched by the United States; in each case the committee

determined that the criteria for vacating or remanding the panel decision were not fulfilled.

Evolution of the NAFTA Mechanism

The dispute settlement provisions under NAFTA Chapter 20 are little changed from those under Chapter 18 of the FTA. The most significant modifications have to do with the institutional structure surrounding the panel process, and with the method of panel selection. On the institutional front, the changes seek primarily to strengthen the capacity of the Binational Secretariat to aid the Commission by contributing logistical support to all dispute settlement panels. In addition, a restriction was inserted on the choice of forum open to disputing parties; this is an effort to avoid tension over possible abandonment of NAFTA proceedings in favour of the GATT. Previously, FTA Chapter 18 left the choice of forum for a dispute to the complaining party. NAFTA Chapter 20 requires the disputing parties to agree on the appropriate forum; if they cannot do so, the dispute automatically goes to a NAFTA panel. This provision is a built-in incentive forcing the disputing parties to harmonize their perceptions of panel proceedings.

Under FTA Chapter 18 dispute settlement, two panelists each were chosen from separate rosters of experts provided by each party, with the fifth panelist chosen by the Free Trade Commission. In contrast, under NAFTA Chapter 20 the parties are required to reach a consensus on a 30-member common roster. From this list they jointly select a chairman, and in a reverse selection process each party then chooses panelists who are citizens of the other disputing party. A further modification to the FTA Chapter 18 process is that panels are permitted access to third-party consultations and reports. Moreover, parties not involved in a dispute may assume intervenor status with rights to attend all hearings, make written and oral submissions, and receive submissions from the disputing parties.

The changes found in the Chapter 20 provisions on dispute resolution address the criticisms of national bias levelled at earlier Chapter 18 decisions. In theory, the reverse selection process prevents panelists from being chosen for political reasons. Experience with the FTA Chapter 18 panel disputes suggest that early decisions are of fundamental importance in establishing the legitimacy of the process. As indicated, the first two major decisions of FTA panels aroused accusations of national bias, making both parties reluctant to utilize the panel process. Nevertheless, the panel process was incorporated nearly unchanged into the NAFTA, a fact suggesting that political dissatisfaction had to do more with the specific

rulings in a few cases rather than the process's effectiveness in defusing disputes.

NAFTA Chapter 20 provisions address the issues of biased panel selection and establish a stronger institutional presence for the proceedings, but it is not clear how effective the modifications have been. As part of this study we will consider recent work by Charles Doran of Johns Hopkins University, examining some 50 cases under NAFTA and utilizing an empirical approach to determine national bias in the panel process. Although the study is still incomplete, initial observations from Doran suggest that, to a significant degree, the voting pattern in NAFTA panels still might be seen as reflecting national bias. A majority of cases are decided unanimously and dissent is not always split purely along national lines, but even a minority of such decisions is enough to create a perception that the process lacks legitimacy.

Under the FTA and the NAFTA, Chapter 19 provisions are largely similar with only minor modifications primarily to address Mexico's less developed legal system. First, NAFTA Chapter 19 has no sunset provision limiting the continuation of the binational process. This change removes the seven-year projection made under the FTA and makes the Chapter 19 process as permanent as the Agreement itself. The NAFTA text also adds a provision that outlines desirable approaches in the administration of anti-dumping and countervailing duty law. This addition was made because, under Chapter 19, it is assumed that the binational panel will apply the domestic law of the party whose agency's determination is being challenged. Doubts had been raised about whether the disputing parties could receive equal treatment or due process under the Mexican legal system, as they might reasonably expect under U.S. or Canadian national review. A similar amendment was made to the composition of panel rosters: it is suggested that panelists be "sitting or retired judges to the fullest extent practicable." However, there is some concern over the effect this move might have on the quality of the factual and legal analysis. The replacement of trade experts with sitting or retired judges could in fact lead to greater deference to U.S. agency determinations in place of expert analysis of the issues at hand. As Howse has commented, from a Canadian perspective this shift would entirely undermine the rationale behind substituting Chapter 19 panels for appeals before the Court of International Trade.⁶

Overall, the NAFTA Chapter 19 provision attempts to further legal harmonization across borders and prevent lengthy delays arising from

⁶ The authors express their thanks to Robert Howse for reviewing this paper and clarifying the pitfalls of the move to placing sitting or retired judges on panels.

conflicting standards of review. Unfortunately, the desired effect may not be achieved in practice.

The FTA/NAFTA Experience

In general, the dispute settlement provisions under Chapter 18 of the FTA have succeeded in defusing disputes and alleviating uncertainties surrounding interpretation of the Agreement. A comprehensive study by William Davey surveyed the performance of FTA panels in all disputes up to the time that the FTA was replaced by the NAFTA.⁷ Davey notes that controversy surrounded some of the final reports; in particular, on the salmon/herring and lobster disputes, the panel split 3 to 2. On average, however, he finds that panel decisions and reports were issued near the four-month deadline prescribed by the Agreement. Those issued later involved extenuating circumstances. In comparison, GATT panel reports and national court adjudications take much longer. For instance, the goal of the WTO/GATT system under the new WTO Dispute Settlement Understanding is to issue panel reports within six to eight months after selection of the panelists.⁸ Thus much of the criticism of FTA panel proceedings concerns the findings rather than the timeliness of reports. In the lobster dispute, for instance, Davey criticizes the panelists for adopting a diplomatic role going beyond their mandate of interpreting and clarifying the Agreement's provisions. In the salmon/herring dispute, he suggests that the arguments of Canadian officials were inappropriate and failed to highlight the pertinent issue. A closer look at the issues Davey notes in FTA reports is instructive in determining the various factors that affect the legitimacy of dispute resolution.

The salmon/herring landing rights issue involved an export restriction imposed by the Canadian Department of Fisheries: 100 per cent of the Pacific salmon and roe herring caught in Canadian waters was required to be landed in Canada. The justification given was that the restriction allowed fisheries stations to record catch size and make reasonable estimates of fish stocks. The measure had been adopted despite a 1986 GATT ruling that such restrictions violated GATT Article XI. The United States claimed a violation of the FTA under Article 407 (1). In its defence Canada argued that even if such a restriction violated GATT Article XI, it fell under Article XX (g),

⁷ William J. Davey, *Pine and Swine: Canada–United States trade dispute settlement: The FTA experience and NAFTA prospects*, Ottawa: Centre for Trade Policy and Law, Carleton University, 1996.

⁸ Ibid., p. 65, note 5.

or the conservation of exhaustible natural resources exemption.⁹ The panel concluded that the 100-per-cent landing requirement presented only minimal advantages for stock monitoring and imposed on foreign fisheries costs far in excess of what the Canadian government would, if applicable, impose on Canadian processors. Therefore, in accordance with the panel's logic and the FTA, the Canadian export measure should have been removed. However, while the panel's report rejected the Article XX defence, it recommended that perhaps a 10- to 20-per-cent exception to the landing requirement would be within the scope of the FTA (i.e., up to 20 per cent of catches could be directly exported without being landing in Canada). In other words, the panel rejected the 100-per-cent landing requirement but endorsed an 80-per-cent requirement. As Davey describes it, the decision seemed to be an ill-judged attempt to give something to both sides in the dispute, and it went beyond the panel's specified terms of reference. By going further than simply ruling on the measures under dispute, the decision was of questionable legitimacy. It attempted to placate one side by suggesting specific remedies, which partially justified the offending measures; in doing so, it seriously compromised the panel's impartiality. It also demonstrated that, in some cases, panels were willing to take on a distinctly policy-oriented interpretation of their duties by steering more in the direction of political deal making rather than judicable decision making.

In the lobster dispute, Canada objected to measures restricting imports of undersized lobsters into the United States. According to the United States, the measure was imposed without exception on all international and interstate trade in lobsters, and therefore fell under GATT Article III's national treatment provision and the Article XX (g) exception. The Canadian complaint claimed that the U.S. restriction violated Article XI principles because it knowingly banned lobster sizes that constituted a large proportion of lobsters coming from Canada. The Canadian disputants based their case on GATT Article XI and failed to challenge the measure under Article III or Article XX (g). The panel was thus left to determine which article applied to the measure in question. It found that Article XI did not apply. Instead the panel determined that, since the measure did not disadvantage or solely affect foreign goods but also applied equally to domestic goods, it fell under Article III. Thus, with a 3-to-2 decision, the measure was found to be acceptable under the FTA.

Overall, the lobster decision was an appropriate ruling in that the panel clearly sided with only one of the parties to the dispute and ruled strictly on the application of the Agreement. In doing so it provided a clear

⁹ Ibid., p. 35.

interpretation of the Agreement's provisions. However, dissatisfaction with the decision arose from what was assumed to be a split along national lines. This perception was compounded by the salmon/herring decision and by the fact that the panelists on the lobster case constituted the highest concentration of former trade and external affairs officials on both sides. As Davey notes, it took two years until the next panel would be requested by either party. He writes, " Except for the initial use in the Salmon/Herring cases ... Chapter 18 panels have not been used in significant disputes... More of these issues have ended up before GATT and Chapter 19 panels."¹⁰ The Chapter 19 review process offers more room for interpreting a dispute along historical foundations of national law; however, it has produced as much controversy as Chapter 18 reviews.

Chapter 19 proceedings have been very successful, with some 49 panels requested under the FTA and some 30 of them resolved by mid-1995.¹¹ Working with a long history of anti-dumping law in both the United States and Canada, Chapter 19 panels have an extensive body of precedent to follow. As a consequence, panels are charged with the task of ruling on specific agency determinations concerning anti-dumping and countervailing duty disputes. The process involves rulings on determinations from Revenue Canada, the Canadian International Trade Tribunal (CITT), the U.S. Department of Commerce and the U.S. International Trade Commission (ITC). Under Chapter 19 either the government or a third party can bring an agency determination before a panel.

A key aspect of the panel process is that specific standards of review are outlined by each party to the Agreement. For example, the standard of review to be applied when a panel reviews a U.S. agency determination is as follows: "The court [panel] shall hold unlawful any determination, finding or conclusion found ... to be unsupported by substantial evidence on the record, or otherwise not in accordance with the law." In addition, panels are required to follow U.S. Appellate Court decisions that establish standards for review of agency action. In the case of a review of a Canadian agency determination, the panel is instructed to follow the standard of review contained in the Federal Court Act. This states that a panel may reverse or remand an agency decision when an agency has:

- failed to observe a principle of natural justice or otherwise acted beyond or refused to exercise its jurisdiction;

¹⁰ Ibid., p. 77.

¹¹ Ibid., p. 92.

- erred in law in making its decision or order, whether or not the error appears on the face of the record; or
- based its decision or order on an erroneous finding of fact that it made in a perverse or capricious manner or without regard for the material before it.¹²

In Davey's evaluation, the standard applied in reviewing determinations by Revenue Canada, the U.S. Commerce Department, the CITT and the ITC on anti-dumping and countervail has generally been in line with what could be expected from domestic courts.¹³ Furthermore, when agency determinations have been remanded or reversed, the decisions and their results have not stirred up much controversy, and remands have led to only minor adjustments. The one notable exception has been the softwood lumber dispute.

Nonetheless, it is instructive to establish the frequency of remand in order to obtain some indication of agency deference. If remand rates are far higher than what would normally be the case in national courts, there is a different standard of review at work. If rates are more or less on par, in all likelihood the level of review is what one would expect to find in domestic courts. In the Canadian case, binational review panels have generally been more intrusive than what would otherwise be the case in Canadian courts. The higher remand rate, however, reflects more on the state of judicial activism in Canada than it does on the process itself. In overall comparison with rulings by the Court of International Justice and Canada's Federal Court, remand rates in Canada for determinations by the CITT and Revenue Canada are only slightly higher than would be expected. In the case of the CITT, 72 percent of determinations were affirmed under binational panel review, although considerable controversy has arisen over the standard of review applied by binational panels to CITT determinations.¹⁴ In general, Canadian agencies have willingly complied with the panel directives, which (as it turns out) have been relatively inconsequential in their impact on the calculation of dumping margins.

Decisions against U.S. agency determinations have been upheld approximately one third of the time. Roughly 50 per cent of the International Trade Commission's and Commerce Department's decisions on dumping

¹² Ibid., p. 137–38.

¹³ Ibid., p. 264–68.

¹⁴ Ibid., p. 265–66.

have been upheld, but no Commerce Department decisions on subsidies have been affirmed without remand.¹⁵ In addition, the number of multiple remands under U.S. agency decisions is higher than that in Canada. Overall, the U.S. agencies have not been subject to abnormally lower affirmation rates than under the Court of International Justice, although the United States has been the only one to request Extraordinary Challenge panels. Evidently the United States has been less satisfied with countervailing duty panel reviews. This more marked opposition can be attributed to a fundamental difference between the U.S. and Canadian views of the role or purpose of panels. As was indicated at the signing of the Agreement, U.S. trade representatives made it clear to Congress that the standard of review to be applied in anti-dumping and countervailing duty determinations was strictly whether the relevant agency had applied national law appropriately. In other words, the notion of changing or reversing U.S. decisions was not seen as part of the role or purpose of the Chapter 19 panel. The Canadian view seemed to be more open to this kind of intrusive panel review, and during FTA ratification debates proponents stated that the intended effect of Chapter 19 was to guarantee “more secure access” to the U.S. market and restrict the use of U.S. trade remedy laws.

The countervailing duty panels have been somewhat more controversial in their determinations. As mentioned earlier, the most controversial decision concerned softwood lumber subsidies. The case is interesting because it represents the first major attempt by the United States to significantly question the standard of review. Aside from U.S. disappointment with the outcome of the dispute, the most serious criticisms have questioned the composition of votes in both the original Chapter 19 panel and the Extraordinary Challenge Panel. The panels upheld the Canadian softwood lumber subsidy program, voting 3 to 2 under the Chapter 19 panel and 2 to 1 under the Extraordinary Challenge Panel. In both instances, the dissenting votes were cast by the American panelist(s); there was thus a distinct division along national lines. In a similar manner to the lobster decision under Chapter 18, this split raised the spectre of “political” panel rulings, with suspected prodding from the Canadian government. In general, like the lobster dispute, the softwood lumber case presents some interesting challenges for the dispute settlement process. Even though little evidence has surfaced to prove or disprove the accusation of bias in these panel decisions, the damage is already done. In similar terms to Davey’s reservations about Chapter 18 panels, Charles Doran suggests that the perception of political bias in politically sensitive cases is enough to damage the process, whether or not the perception accords with the reality.

¹⁵ Ibid., p. 266.

Until recently the United States continued to press the lumber issue after the Extraordinary Review Process; as Doran puts it, the U.S. tendency never to accept defeat reared its ugly head. In fact, after the decision by the Extraordinary Challenge Panel, the United States once again made known its intention to pursue the issue, claiming that the Canadian panelists had failed to report conflicts of interest and thus had denied the United States its right to due process. The focus was thus narrowed simply to a question of national bias and whether Canadians were taking advantage of the process; at the same time the cost and length of the dispute reached new heights, with no resolution in sight. As a result, the two governments decided to settle the issue in an outside agreement to manage trade in softwood lumber. In essence, to avoid further expense and delay in resolving the dispute, the Canadian government agreed to impose export quotas curbing softwood lumber exports to the United States; in return, it was allowed to maintain stumping fees at their current levels. The Canadian government thus opted to lower the volume of trade, a course that would net more revenue than lowering stumping fees.

In Doran's opinion, this was the first serious blow to the Chapter 19 dispute resolution system. Aside from being a very unpopular move in the eyes of the Canadian lumber industry, the removal of the dispute from the FTA process sent disturbing messages to the international trade community. First, it suggested that the FTA panel process was an open door, with one side always able to commence a new action if not satisfied. Still more serious, it indicated that binational panel decisions are temporary at best; and it affirmed or at least failed to quell the U.S. view of the Extraordinary Challenge Panel as an appeals process. It thereby supported the notion of managed rather than free trade in politically sensitive areas.

Thus the FTA's, and now the NAFTA's, biggest challenge remains continued insinuations by the media and isolationist members of the U.S. Congress to the effect that the process contains inherent biases favouring the nation with the majority of panelists. Whether this position accords with the facts or represents domestic political rent seeking, it does not seem likely that U.S. opinions on the process are going to change dramatically. Indeed, the United States challenged the softwood lumber panel decisions on the grounds that the entire concept of substituting binational panels for domestic judicial review was unconstitutional, even though the United States had earlier signed the WTO agreement; it thereby showed its unwillingness to commit to measures restraining unilateral action. As we have already seen with the WTO, there may be a need for more elaborate institutional support for mechanisms that try harder to remove bias or suspicions of it. Of the measures recommended for addressing this issue, certainly the establishment of a permanent body of panelists, or at the least term panelists

along the lines of the WTO Appellate Body, could help remove the friction. Even more pointed criticisms have suggested that the NAFTA is in need of an appeals process under Chapter 19, superseding the use of Extraordinary Challenge Panels. In essence, this would achieve two results. First, it would make room for what is standard practice in American administrative law. Second, it would remove the message implied by Extraordinary Challenge proceedings: that the process is biased and somehow ineffective. Instead, an appellate body could confront the issue of interpretation rather than gross misconduct.

2. NATIONAL MECHANISMS

Australian Interstate Trade and the Constitution

To illustrate how a federal state with strong constitutional and court powers could ensure free internal trade, the Australian experience will be examined. Section 92 of Australia's constitution declares that trade between states of the federation will be free, and court interpretations of the section have resulted in a de facto outlawing of trade barriers between Australian states. The Constitution also does not allow for intergovernmental disputes to be settled through negotiations between federal and state governments; as a result, any internal trade disputes must be dealt with in the country's federal courts, and ultimately they usually involve decisions by the High Court of Australia. Disputes are normally brought before the courts by private-sector entities objecting to particular barriers, and these court proceedings serve as the formal mechanism for settling disputes in internal trade matters. Accordingly, our study of Australia will focus on judicial decisions of the country's High Court made under Section 92 and its surrounding provisions under the trade and commerce section of the Constitution, including Section 51, which is similar to Canada's federal trade and commerce power.

The Australian Federalism Debate

Before we discuss some cases with particular relevance to our overall study, we need to spell out the current Australian debate concerning the High Court, the states and federalism in Australia. First, like their Canadian counterparts, Australian legal experts have had to wrangle with the dichotomy of Parliamentary supremacy and judicial activism. Constitutional experts are concerned that an increased role for the latter will further undermine state jurisdictional authority.¹⁶ Thus, as in Canada, jurists and lawyers have debated the High Court's role: whether interpreter or maker of law. Essentially, there are two visions of the High Court, one being classical or traditionalist, and the other being political and federalist. The classical vision casts the High Court in the role of protector of the states, which could use the body to challenge the Commonwealth (i.e., Australia's federal government) and keep its powers limited. On the other hand, political federalists see no such role for the High Court; instead they view the Senate as the appropriate forum for state voices. Of the two competing views, most

¹⁶ Some opinions on the constitutional debate in Australia, including conferences on specific issues, can be found at the Samuel L. Griffith Society Website at <http://exhibit.com.au/griffith>.

legal experts and students of federalism will admit that historical fact and writings of the Founding Fathers support a traditionalist High Court that enforces the Constitution and strike down any attempt by the federal government to legislate *ultra vires*. The High Court was thus intended specifically to support and protect the states in the event that all other checks, such as the Senate, failed to assuage the Commonwealth's thirst for more power over state affairs. However, while this is the consensus on how the High Court should operate in theory, many legal experts see its role as radically different in practice.

Australia's High Court has a poor reputation as protector of the states. According to some critics, the court has failed to uphold its constitutional obligation to the states and has even collaborated actively in the expansion of central powers by successive Commonwealth governments. Referred to as literalism or ultraliteralism, the High Court's interpretation of constitutional provisions has focused on the terms of the specific legislative powers conferred upon the Commonwealth Parliament, and increasingly it has leaned toward an activism that supports federalist concerns.

Similar opinions have been expressed concerning Section 92, which declares, "Trade, commerce, and intercourse among the several States shall be absolutely free." The High Court has been less than consistent in applying this section. It has protected individual rights to participate in trade and commerce under Section 92, but it has also upheld marketing and restrictive licensing schemes in the name of an overarching public character to constitutional provisions. As one observer has put it, the High Court's literalism has consistently been strong and contingent on a desired result, namely the reinforcement or expansion of powers of the Commonwealth. The court has continued this practice under Section 92 by placing two fundamental restrictions on Section 92 interpretations. First, the Court has restricted the scope of Section 92 so as to exclude antecedent commercial activity from its protection, even where such activity is essential to the exercise of free interstate trade.

The court has also ruled in such a way that its literalist interpretation conflicts with the wording of the section itself. For example, the High Court has ruled to permit regulatory impediments to interstate trade, stating that regulation in the public interest is not inconsistent with freedom and is in fact necessary to preserve freedom. According to some, this ruling is clearly opposed to the term "absolutely free" used in Section 92, and it indicates the court's tendency to take a policy-oriented approach in its literalist doctrine. More recently, the court has interpreted Section 92 to provide immunity from Commonwealth or state laws that impose discriminatory burdens on interstate trade of a protectionist nature. It has once again been seen by many states as granting the Commonwealth Parliament unlimited regulatory

power so long as it treats all states uniformly. As many sceptics say with reason, the court seems generally reluctant to characterize “national” trade barriers as barriers at all, even though few arguments exist to justify their imposition. Instead, it has tended to characterize such “barriers” as regulatory measures that serve a broad, amorphous public interest. This unwillingness to confront such Commonwealth practices, including marketing boards and restrictive licensing schemes, has led many to believe the court is wrong-headed in embracing outmoded economic doctrines of state intervention on a grand scale.

Experience of Australia’s High Court

The following High Court cases involve Section 92 of the Australian constitution, which guarantees that all interstate trade shall be free. The two cases chosen are of interest because one confronts the issue of legitimate state objectives versus disguised discriminatory measures, while the other examines national legislation under a marketing board scheme and addresses the applicability of constitutional provisions to individual citizens engaged in interstate trade. In particular, we need to examine how Australia’s constitutional provisions on interstate trade and commerce, and their relatively strong interpretation, mesh with the functioning of a federalist system. More generally, we seek to determine whether, given the current political context for the High Court, interstate trade barriers can be addressed effectively merely by a strongly enforced constitutional provision on free trade.

The first case, *Castlemaine Tooheys Ltd. v. South Australia* (1990), involves a dispute concerning changes made to the applicable state policy of refunds for returnable bottles, both refillable and non-refillable, used by beer brewing companies in different states.¹⁷ The case is particularly relevant because it involves what appears to be a legitimate state policy objective of waste disposal and energy conservation. The plaintiff raised competitiveness concerns and alleged unfair discrimination against an out-of-state brewery with a growing market share, selling its beer predominantly in non-refillable bottles. From the defendant’s perspective, the issue was not a construed scheme of barriers to protect local brewing companies; instead it was the problem of waste management and the extra energy consumed in processing non-refillable bottles. From a constitutional point of view, the case concerned the protection of intrastate over interstate trade and the interpretation of Section 92.

¹⁷ All High Court of Australia cases cited in this paper can be found at the Website of the Australian Legal Information Institute (AustLII), <http://www.austlii.edu.au>.

The court ruled that, in the case of a state law favouring intrastate over interstate trade, the competitive disadvantage imposed on out-of-state producers is non-discriminatory if it is a necessary means for achieving natural resource conservation or another public objective protected or promoted by the legislation. Discriminatory practices, then, would fail to have a conservationist rationale, or would be applied unevenly or disproportionately on out-of-state entities. The defendant argued that all of the above conditions applied, and that what was at issue was unfair advantage simply because the out-of-state brewing company was not equipped to use refillable bottles.

However, this is not how the High Court saw the case. Its interpretation of Section 92 in the case closely resembled interpretations under the GATT Article XX (g) exception, which can be used as a legitimate reason for violating Article XI. It is interesting that, to bolster its ruling, the High Court cited U.S. Supreme Court interpretations on interstate barriers to trade under the negative commerce clause. Under this clause, the U.S. Supreme Court has established that discriminatory state legislation may be valid so long as its aim is to protect legitimate local interests. However, even with legitimate objectives under the state's unquestioned power to protect the health and safety of its people, the law is invalid if there is a reasonable non-discriminatory alternative that can adequately conserve legitimate local interests. The Australian court introduced a key modification to the U.S. ruling. Under the U.S. alternative means test, any legislation that burdens interstate trade but does not pursue a legitimate local concern is invalid. In the Australian interpretation, legislation imposing a burden in the protectionist sense interferes with the freedom guaranteed in Section 92.

Accordingly, the High Court ruled that the unfair burden placed on the Queensland-based Bond Brewing Company for using non-refillable bottles was in conflict with Section 92 because the refund policy imposed was excessive, creating (in the Court's words) a burden in a protectionist sense. The excessive return rate imposed by the 1986 legislation decreased in the company's market share by creating a disincentive for retailers to stock the firm's bottles. However, this ruling poses the question, what freedom do states have in pursuing legitimate objectives? As far as can be discerned, the reasonable alternatives test the High Court has adopted relates more to issues of competition policy than constitutional interpretation. Indeed, the High Court's interpretation leaves far greater room for court intervention in policy, whether or not a legitimate objective is being pursued. Unsurprisingly, this kind of interpretation has further solidified perceptions among state officials and legal experts that the High Court is pursuing an approach that subverts states' freedom or rights. Therefore, even though state legislation in this case was a clear attempt to solve pressing public problems, such as

litter and energy conservation, the law was invalidated because the refund charges were excessive and thus constituted a burden, despite the stated legitimate objective. It must be stressed that the legitimate objective was not rejected in this case, as would have to be the case in the United States; instead, the refund scheme in place was overturned. In other words, the legislation on containers could be revised to include less severe refund disparities between non-refillable and refillable containers, without violating Section 92.

The second case was filed by the C. and J. Uebergang Company, a wheat growing business in the state of New South Wales, and another plaintiff, a Queensland manufacturer of poultry feed containing wheat. Under a contract between the two parties, the feed producer purchased wheat from Uebergang for delivery to Queensland. The case turned on the Wheat Board's (the defendant) intent, under the Wheat Industry Stabilization Act, to require that all wheat destined for interstate trade be delivered to the Wheat Board for direction and marketing. The plaintiffs claimed that the Act violated Section 92 of the Constitution since it required compulsory regulation and control of all trade in wheat, restricted individual producers from engaging in interstate trade and thus denied their freedom of interstate trade guaranteed in Section 92. The case is useful in that it highlights the struggle encountered by various judges of the court in trying to determine individual rights versus some implied public interest obligation to Section 92.

The High Court was faced with two challenges in this case and it appears that on one it failed. First, it had to establish whether or not the Commonwealth government's objectives constituted *prima facie* a reasonable definition of "absolute freedom" as guaranteed in the section. In essence, if the Wheat Marketing Board was not the only justifiable, viable way to protect wheat growers and the public interest in wheat marketing, was the Commonwealth's legislation constitutionally invalid? Second, the court had to determine whether the relevant sections of the Constitution on the actions of individuals engaged in interstate trade were central or incidental to interstate trade, and thus to determine their right to operate outside of the Marketing Board.

Further, the Court had to clarify its intent by defining the basic components of trade and the individual. From the plaintiffs' perspective, Section 92 protects interstate trade of the individual, and while they conceded that a measure of regulation may be consistent with the absolute freedom guaranteed in the section, they argued that prohibition is not regulation. Accordingly their claim rested on the assertion that the Wheat Stabilization Act created a monopoly in favour of the Australian Wheat Board and deprived growers of any freedom to sell their wheat as they chose. Opposing this view, the defendant proposed two interpretations of

Section 92. First, it argued that the section is essentially a declaration of a public right, from which the individual trader derives freedom as is compatible with the public interest. Second, it suggested that prohibition of individual rights may be a form of regulation consistent with the section. Counsel for the Wheat Board suggested that consistency could be derived from a determination of regulation as “essential in the interests of the community,” while the Solicitor General stated that in a case in which prohibition formed part of a larger plan, such as a marketing scheme, the test of reasonableness was sufficient; the scheme must be shown to be the only reasonable and practical course.

Faced with the daunting task of ruling in the abstract rather than on fact, the court expressed a clear uneasiness about the prospect of diverging from previous High Court decisions by radically narrowing or expanding the boundaries of the section. The dissenting views on interpretation of Section 92 revolve around the public versus private character of the section. During the case in question, several of the judges expressed disagreement with previous rulings, raising concerns as to the validity of situating the individual as incidental to and consequential upon the protection of the entire concept of interstate trade. On the contrary, one judge expressed the opinion that the individual was central to the entire concept and inextricably involved through use of the word “intercourse” in trade discussions.

In defining what was acceptable in regulating interstate trade, commerce and intercourse, the High Court stressed that the question should be the following: Is the legislation or executive scheme ultimately focused on the freedom of individual citizens to engage in interstate trade, commerce and intercourse, and is the regulation the only reasonable and practicable way of securing that freedom? In posing the question thus, the High Court placed the onus for reaching an affirmative answer on those supporting the measure. In this case, it was up to the Commonwealth to prove that it was valid to restrict individuals from interstate trade outside of the Marketing Board on the grounds that “facts” existed, which (the Court could admit) made any other means impracticable or unreasonable. It is not too hard to see that the Court had landed itself in a precarious position. It could clearly establish that the individual was indeed a fundamental aspect of intra- or interstate trade. Moreover, other cases had established that if prohibition is to be considered a justifiable regulatory framework, it must be proven to serve a greater public interest.

The conclusion of the Court is interesting in that it decided that the individual was indeed an indispensable part of interstate trade and commerce. Nevertheless, the Court had no wish to strike down an Act of Parliament that was supposed to serve greater public interests. Thus, in determining the balance between citizens’ rights and so-called legitimate

social objectives of the state, the High Court would appear to have endorsed the former over the latter; but it refused to carry its individualist interpretation through and invalidate the Marketing Board scheme, finding that factual arguments on the practicality of the regulatory regime had not been presented.

The Court's conclusion clearly indicates that, despite the justified criticism of so many legal experts, it is difficult to overcome deference to Parliament. Unable to rule on such matters without specific facts to justify the defendant's position or the plaintiffs' claim, the Court did nothing to clarify the applicability of Section 92 to marketing boards. In other words, the Australian experience suggests that courts will not uphold any constitutional provision of free trade as superseding acts of legislatures. Moreover, any attempt to clarify principles or abstract meaning quickly becomes an exercise in political theory that seeks to balance the individual's rights against the government's obligations to society. This is indeed a considerable limitation to court-enforced free trade provisions, particularly if provinces or states are as independent and militant as they are in Canada. On the other hand, Canada may have more success given its Charter of Rights and Freedoms, and in light of the Supreme Court's recent tendencies to reinvigorate the peace, order and good government clause and the trade and commerce powers of the federal government.

Finally, perhaps the best lesson we can extract from the Australian cases is the fact that the confusion surrounding Section 92 of the Constitution has prompted the Australian government to look to other mechanisms for enhancing interstate trade. As a first step in this process, the government has struck an Industrial Commission to provide a comprehensive micro-economic review of all sectors of the Australian economy. Under the review, the Commission is examining possible mechanisms (including the Canadian Agreement on Internal Trade) that could accelerate and expand interstate trade and thus avoid Section 92 confusion. According to officials at the Australian High Commission in Ottawa, the priorities for the Commission's examination of alternative internal trade mechanisms are to alleviate the high cost of pursuing litigation, provide a more comprehensive understanding of interstate barriers, and address the need for more informal dispute resolution.

Canada's Agreement on Internal Trade

As a recent paper published by the Canadian Chamber of Commerce suggests, Canadians have more incentives than ever to further liberalize internal trade. Citing the Provincial Economic Accounts, the paper points out that interprovincial trade, including exports and imports, amounted to more

than \$314 billion in 1995. At the same time, a study published in the *American Economic Review* showed that interprovincial trade in Canada was greater than that between similarly sized and spaced U.S. states.¹⁸ It is undeniable that Canada has already achieved a great deal of harmonization and interdependence in trade, fiscal policy and legal systems. According to many observers of Canada's internal trade situation, however, there must be a renewed effort at strengthening Canada's economic union and more needs to be done along the lines of intergovernmental commitment to free trade. As it stands now, the Agreement on Internal Trade (AIT) is the obvious means for creating greater enforcement of trade liberalization; however, opinions differ on how to accomplish this. Suggestions range from strengthening the federal government's use of its constitutional authority to leaving the Agreement as is and letting it develop along the lines of international law through suasion by condemnation. Most of the solutions advanced lie somewhere between giving priority to enforcement/legalization and emphasizing ease of access, timeliness and conformity with international experience.

The Road to the AIT

First and foremost, the AIT is partly a product of constitutional deadlock in Canada. The Agreement on Internal Trade has come into existence in the face of persistent difficulties in strengthening Canada's economic union via Sections 91(a) and 121 of the Constitution. Canada's constitution, much like that of Australia, contains provisions for the regulation of interprovincial trade. Section 121 states, "All articles of the Growth, Produce, or Manufacture of any one of the Provinces shall from and after the union, be admitted free into each of the other Provinces." But the section does not specify internal trade issues involving non-tariff barriers, capital, services or labour, each of which has been the focal point of many interprovincial trade flow restrictions. To remedy this situation, the AIT has attempted to include a much broader spectrum of issues within its provisions.

As a result, the AIT has rightly become the target for proponents of free trade within Canada. However, there exists some confusion about why and under what circumstances the Agreement on Internal Trade was introduced. Depending on which perspective they take, observers either overestimate the role of the AIT and express indignation about its vague wording and many escape provisions, or they prefer to wait and see whether the Agreement by itself can force governments to act. For example, Robert

¹⁸ Canadian Chamber of Commerce, "The Internal Trade Agreement and Interprovincial Trade Flows: Building a Strong United Canada," September 1996, p. 3.

Howse writes, "It is worth recalling that the AIT did not emerge out of intergovernmental anarchy, as do international trade treaties, but in the context of a single nation ... with a constitution that ... can be interpreted as already implying or requiring an economic union within Canada."¹⁹ While his statement is partly valid, it nonetheless appears to ignore the evolutionary path taken by Canadian federalism. In fact, this path has focused more on independence than co-ordination of spheres of influence. Unlike Howse, we view the AIT as emerging from a context more akin to that surrounding international negotiations.

Accordingly we note that discussions on the Agreement on Internal Trade began in March of 1993, after what can best be described as a constitutional maelstrom. Unlike past efforts, the round of negotiations leading to signing of the AIT sought to address all existing interprovincial trade barriers at the same time, with one proviso: no parties to the Agreement would bind themselves to any limitations on legislative power. By departing from the sectoral approach, discussions unfolded much more along the lines of negotiations on an international agreement, with an almost inordinate sensitivity shown to provincial independence as opposed to co-ordination. In our opinion, therefore, the context of the Agreement more closely approximated international rather than domestic negotiations. As a result, the commitment to freer trade was made only in principle. While this approach succeeded in getting all 10 provinces to sign the first comprehensive agreement on internal trade barriers, it nonetheless attracted criticism as backroom dealing.

AIT Provisions and Procedures for Dispute Settlement

AIT dispute settlement falls under Chapter 17 of the Agreement. The procedures derive largely from those in the GATT/WTO framework and under the NAFTA. Much like these, AIT dispute resolution proceedings under Chapter 17 may be initiated only after the parties have resorted to dispute avoidance and resolution mechanisms provided in applicable chapters of the Agreement. If the efforts fail, the parties may turn to the chapter's general dispute resolution process by beginning conciliation and mediation; if these do not produce agreement, a panel can be struck. Under the provisions, a governmental party to the Agreement can request a panel on its own initiative or at the request of a private party. Alternatively, a private-sector party can request a panel if its government refuses to act on

¹⁹ Robert Howse, "Securing the Canadian Economic Union: Legal and Constitutional Options for the Federal Government," *The Canadian Union Papers*, C.D. Howe Institute, No. 81 (June 1996), p. 7.

its behalf. A government may request a panel on behalf of a private party if it can establish a “substantial and direct connection” with the private party. According to the definition of direct connection in Article 1704(7), a private party must have suffered an economic injury or denial of benefit, and must reside or carry on business in the province where the “consequences of the economic injury or denial of benefit are being felt.” The federal government is restricted from action on behalf of a private party unless that party receives treatment contravening the Agreement because it is a federally constituted and regulated entity.

Should a government refuse to act on behalf of a private entity, that private party has the option of pursuing action on its own. However, access to the mechanism is far from certain by pursuing this course of action. First, the private party must submit the complaint to a screener who is instructed to determine whether the complaint is frivolous, whether it has been instituted merely for the purpose of harassment, and whether there is a reasonable case of injury or denial of benefit.

Once the decision or request to form a dispute panel is made, parties choose panelists from a pre-selected roster of 65 nominees. Each province is allowed to nominate five panelists to the roster and, in the case of a dispute, it may not choose from among its own nominees. When a panel is struck, the two disputing parties each may choose two panelists from the roster, and these four panelists then agree on a fifth person from the roster to act as chairperson. After the naming of a panel, the rules of procedure to deal with all aspects of the panel process are established by the Committee on Internal Trade. The basic principles to be followed in developing the operating procedures include the following: transparency is to be maintained for all panel documents as public record; anonymity is to be preserved for majority and dissenting opinions of the panelists; party submissions are to be confidential; all third parties joining the process for substantial related interest reasons have the right to attend all hearings and receive copies of submissions; panels may seek expert advice; and proceedings before the panel are to be dealt with as informally and expeditiously as the circumstances and considerations of fairness permit. The principles espoused clearly seek to make dispute resolution expeditious, fair and transparent; nevertheless, the last principle of informality of submissions may be cause for concern, as it has been under the WTO.

The panel then proceeds to hear the dispute and is instructed that its final report must contain findings of fact, determinations of whether the measure in question is inconsistent with the provisions of the Agreement, and determinations as to whether the measure has impaired trade or caused injury. Unlike NAFTA panels, the AIT panel may also issue recommendations to the parties for solving the dispute if it has been

requested to do so by one of the disputing parties. Again, this may be cause for concern in view of recent criticisms of FTA panels. Within 60 days of issuance of the panel's report, parties are to comply with it by either following the recommendations it contains or coming to a mutually acceptable arrangement. If a party refuses to comply with the report's determinations, Chapter 17 allows for two possible courses of action.

First, the secretariat will make the report public if no mutual agreement is reached within the 60-day time frame; this may be extended to a maximum of 120 days provided both parties agree. In addition, the unresolved dispute will be added to the Committee on Internal Trade annual agenda for future discussions. Essentially, this action is intended to subject the non-complying party to public scrutiny; it borrows from the long-standing principle of moral suasion used in international law. The second course of action is retaliation if more than one year passes from the issuance of the panel report. After a party makes a written submission to the Internal Trade Secretariat, the Committee on Internal Trade will meet to discuss the options for retaliation. The complaining party is then entitled to suspend benefits of equivalent effect or, if this is impractical, it can impose retaliatory measures of equivalent effect. As a precaution, certain restrictions have been placed on the above action. For instance, retaliatory measures must be imposed within the same industry as the measure found to be in non-compliance. In addition, any retaliatory measures must be in accordance with the Constitution.

Before surveying opinions about the effectiveness of the dispute resolution process, we must note some differences between the process discussed above and one initiated by a private party on its own. In the event that a private party successfully launches a panel review, the chapter makes no provisions for third-party participation; and if compliance is not forthcoming after a panel report, no retaliation or compensation measures are permitted. Aside from these changes, the process continues as would any other incident of non-compliance with a panel report.

Critiques of the AIT Dispute Settlement Procedures

The Agreement on Internal Trade is simply an agreement to agree to freer trade in principle. In accordance with the principle of Parliamentary sovereignty, it has no direct legal effect on legislatures at the provincial or federal levels. For this reason alone, many critics have characterized the AIT as moribund before it has been put to the test. The Statement of Objectives gives the impression that the parties lack conviction; it declares that the objectives of the Parties are to:

reduce and eliminate, *to the extent possible*, barriers to the free movement of goods, services, persons and investments within Canada and to establish an open, efficient, and stable domestic market. All Parties recognize and agree that enhancing trade and mobility within Canada would contribute to the attainment of this goal. [Our italics]

In the view of both Trebilcock and Behboodi, the use of the term “to the extent possible” raises some serious questions. They characterize it as a tentative approach that sorely lacks the “vigour” of undertakings in international agreements. In contrast to the Treaty of Rome’s unequivocal commitment “to establish ... a common market and approximate the economic policies of the Member States,” the AIT’s objective of removing barriers to the extent possible seems rather vague and non-committal.²⁰

The AIT sets out fairly clear principles: to refrain from establishing new barriers to trade; to facilitate the cross-boundary movement of persons, services and investment in Canada; to treat persons, goods, services and investments equally regardless of place of origin in Canada; and to attempt to reconcile standards and regulations to provide for the free movement of persons, goods, services and investments. Nevertheless, whether these principles can be applied is uncertain given the weak initial commitment to the AIT itself. Further, the Agreement’s definition of “legitimate objectives” undercuts these principles and raises doubts about the extent of compliance with them. The Agreement’s section on General Definitions explains that legitimate objectives essentially safeguard any government’s right to legislate for the good of its constituents as it sees fit. Such objectives may include:

- public security and safety;
- public order;
- protection of human, animal or plant life or health;
- protection of the environment;
- consumer protection;
- protection of the health, safety and well-being of workers; and
- affirmative action programs for disadvantaged groups.

The definition of legitimate objectives, combined with the fact that the Agreement has no foundation in Canadian law, has led some critics to suggest that few if any government initiatives could be restrained under the Agreement. Donald Lenihan has noted that, while some of the exceptions under legitimate objectives (e.g., public order) are uncontroversial, others

²⁰ Michael J. Trebilcock and Daniel Schwanene (eds.), *Getting There: An Assessment of the Agreement on Internal Trade*, C.D. Howe Institute, Policy Study No. 26 (1995), p. 40.

(e.g., protection of the well-being of workers) could balloon into sweeping justifications. Lenihan writes:

Each province has its own economic, demographic, and geographic features, the consideration of which will affect government regulations — hence the idea of legitimate objective. But in this framework, the goals of federalism are treated as an afterthought that can be reconciled with the goal of economic integration by means of a short and tidy list of “legitimate objectives.” This is simply wishful thinking, and it fails to do justice to the complex ways in which the goals of federalism interact with economic interests.²¹

Lenihan suggests that there is a need to be able to refer to a party’s intentions when dealing with disguised barriers versus legitimate objectives; however, he offers no specific proposals. Perhaps the legitimate objectives section could be made more palatable through adoption of the legal practices found in the United States and Australia; thus legitimate objectives claims of provinces would be subject to reasonable non-discriminatory alternative means tests under judicial review or via an independent committee established by provincial consensus.

The most forthright suggestions for improving the AIT have called for legalization of its articles to make them binding on legislatures. Many supporters of this idea suggest that the threat of judicial review and enforcement of AIT principles could make governments comply more readily with panel reports. However, legalization is not so easy to achieve. Both Robert Howse and Katherine Swinton acknowledge that the AIT needs bolstering, but they differ on the prospects for legalization. Howse’s basic assertion is that AIT legalization must provide for direct applicability to Canada’s existing legal framework. He examines two ways of achieving this: through positive integration, as in the EU practice of enabling legislation for Commission directives; and through negative integration via constitutional litigation. Of the two, he appears to prefer the latter to the former.

Howse points to two fundamental obstacles to the first approach. First, he and many others see little likelihood of constitutional amendment to include reference to the AIT. The process of constitutional amendment is itself difficult, and the provinces and the federal government evince little readiness to undertake lengthy constitutional debates. Second, if legalization were to be in the form of a statute that could supersede any and all conflicting statutes and regulations, nothing in Canada’s legislative process would prevent subsequent governments from rescinding that statute at a later date. After all, the long-standing tradition of Parliamentary sovereignty prevents the legislature from binding future governments. Finally, as Howse

²¹ Ibid., p. 116.

admits, in the various types of provincial legislation implementing the AIT, there is little to suggest any connection between the Agreement, the courts and existing law. Therefore, Howse sees constitutional litigation as a more promising avenue.

Discussing negative integration via constitutional litigation, Howse raises the important question of whether such a move would serve to replace or supplement the AIT. He offers several paths of litigation that could strengthen the effectiveness of Canada's economic union, and concludes that the AIT could play an important role in refining and narrowing court interpretation of constitutional provisions. The first path of litigation falls under mobility rights in Section 6(2) b of the Charter of Rights and Freedoms, which states that any Canadian has the right to take up residence and earn a livelihood in any province. Section 6 has already been used in several cases to challenge provincial and federal restrictive trade practices. One case in particular, *Canadian Egg Marketing Agency v. Richardson*, is especially pertinent to the present study in view of our interest in the Australian experience. In the egg marketing case, the Northwest Territories Court of Appeal held that the federal interprovincial egg marketing scheme violated Section 6 since, by prohibiting egg producers in the Territories from selling their eggs elsewhere in Canada, it prevented the applicant from pursuing a livelihood in another province.²² Thus, it would seem that the courts are willing to interpret Section 6 to mean that earning a livelihood in a province need not include residing there. In this light, the principles outlined in the AIT could serve as a reasonable standard of review in Section 6 litigation.

Aside from achieving a certain amount of legal force, Howse's proposal would open the dispute settlement process to private parties on a much broader scale. More access for person-to-government disputes would achieve two results: first, it would expose the system to a greater number of cases and better capture media attention by its obvious David-and-Goliath appeal; and second, it would demand the utmost transparency so that individuals could understand and fairly assess the outcome of the panel process. Howse also recommends the drafting of a Citizen's Charter of Economic Rights, explaining the AIT provisions in terms of Charter rights. Together, these two innovations could substantially raise the profile of freer trade in Canada and reinforce the commitment to it.

Some caution is in order, however. As Katherine Swinton points out, there are compelling reasons why governments would like to keep the AIT out of the courts. As our look at Australia suggests, judges may not be well

²² Robert Howse, "Securing the Canadian Economic Union," p. 8.

suited to overseeing the many obligations contained in the AIT. In addition, Swinton explains that governments are understandably reluctant to trust the courts' interpretations of complex public policy considerations. Indeed, such interpretation and enforcement would run counter to the relationship between Canada's Parliament and the courts. This is exactly the problem Australian authorities face, especially when passing judgment on national programs. Another point Swinton raises is that the Agreement itself has a far greater scope precisely because of the non-binding political nature of its enforcement. There is a lot to be said for this kind of perspective. Swinton reminds critics of the AIT that public international law contains very few "laws" of the enforceable kind, and asserts that this does not necessarily have to translate into ineffectiveness. Indeed, more often than not, voluntary compliance rests on the legitimacy of the rules, which have been developed along the lines of generally accepted principles of right process.²³

Overall, the present report's findings tend to support Swinton's view. Most important, her acknowledgment of real difficulties in legalizing an agreement of this nature accords with the experience in Australia under that country's Section 92 free trade clause. This is not to say, however, that the AIT can be left as it is in the hope that evolution can take place without the need for fine tuning. A good starting point would be to bring the terms and provisions of the Agreement under a single dispute settlement procedure. In addition, it certainly wouldn't hurt to have a formal mechanism for the right to appeal panel decisions, along the lines of the WTO's Appellate Body. Without a doubt these kinds of reforms would accord with Howse's and other observers' suggestions that the AIT be more accessible for all Canadians.

²³ Katherine Swinton, in Michael J. Trebilcock and Daniel Schwanene (eds.), *Getting There: An Assessment of the Agreement on Internal Trade*, p. 104.

3. COMPARISON AND ASSESSMENT OF THE MECHANISMS

Comparison of the Mechanisms

Our study of dispute settlement mechanisms has highlighted the overlap of national and international bodies of law as a result of increasing speed and scope of coverage. This has created pressure among national leaders to sign on to international agreements in the hope that they will have more bargaining power than other signatories; but it has also prompted nationalist elements, particularly in the United States, to decry international initiatives as involving undue submission to foreign powers. The task of all the mechanisms is to prevent backsliding into unilateralism, and also to lessen temptations to manage rather than liberalize trade. As we have seen in our study of dispute settlement mechanisms, meeting the challenge involves designing and fine-tuning a dispute settlement mechanism that strikes a balance between credible enforcement and informal dispute resolution. All of the international dispute settlement mechanisms (except that of the EU) have relied on panel-based systems, which first were used under the GATT. We will briefly recap the changing balance in our five cases to highlight some of the similarities and differences in approach. Invariably, our discussion shows that each mechanism has not developed in a vacuum or from first principles. To a great extent, the designers have borrowed bits and pieces from regional, national and international trade dispute mechanisms.

Of the five examples studied, the European Union offers the most advanced mechanism in that it provides direct access for both private and public parties through national courts and the European Court of Justice. In addition, it provides for the direct effect of secondary legislation and allows Commission directives to supersede national legislation in the establishment of the economic union. Indeed, the EU has made continuing strides in expanding the scope of the economic union through amendments to the Treaty of Rome, the adoption of Commission directives, and compliance precedents established by Court of Justice rulings. The EU mechanism is very rules-based and is ultimately enforced through the court system; however, means of ensuring compliance with directives and Court rulings are still a significant concern and will be an area for further evolution in the EU mechanism.

The WTO must deal with a more complex co-ordination game than the European Union, the NAFTA or Canada's AIT; nevertheless, it has been able to start confronting the possibility of creating an international court of trade — a body that can legitimately solve disputes and institutionalize standards of procedure. The WTO structure is instructive because it provides a clear impetus for rules-based systems even at the most complex

level of trade relationships. Thus, under agreements such as the NAFTA and the Canadian AIT (both of which have significantly fewer signatories with more harmonized legal systems), we can speculate that more can be done along the lines of formal procedures. As discussed earlier, the most significant change to the panel process under the WTO is the creation of the Appellate Body, representing a move away from the traditional GATT ad hoc approach to hearing disputes. The WTO has opted to appoint panelists to four-year terms (renewable once) on the Appellate Body. In addition, the WTO has taken extra steps to promote a collegial relationship between panelists; this will harmonize and clarify the use of previous panel decisions and legal interpretations to keep pace with international trends.

Ultimately, the test for the WTO's new Dispute Settlement Body will be to make formal dispute settlement procedures and panel rulings a credible threat to nations that tend to resort to unilateral action. A rigorous, transparent and binding formal dispute resolution process may prove to be the best incentive in persuading parties to settle their disputes through consultations and mediation. Such a process appears to us to be lacking in the Canadian AIT and we will point to this deficiency later in our discussions of the implications for the AIT. Suffice it to say that the WTO is leading the way in establishing a trend in international trade law, and international law in general, toward a rules-based system less tolerant of domestic law conflicts and aberrations. As we have seen, however, some observers feel that the WTO has only begun to establish the required legitimacy needed for an effective rules-based system. Issues such as direct effect and direct access, along with continued dissatisfaction with levels of transparency, all point to continued evolution of the WTO in the near future.

Looking at the FTA/NAFTA dispute settlement provisions, we can see that a smaller number of signatories to the agreement can permit more flexibility in the process. However, while the smaller number makes it easier to close discussions, it raises the issue of sustained bias in the system. Particularly instructive in this respect is the relative decline in the use of FTA Chapter 18 panels in favour of Chapter 19 panel review. Steps taken to address the problem have yet to prove their efficacy. For instance, cross-selection of panelists removes the possibility of biased panel selection, but it addresses bias only at an early stage in the process. The kind of bias accusations that have surfaced in the softwood lumber case are directly tied to panel findings. Not surprisingly, most of the bias claims will be made by the losing party, if only to protest an unfavourable ruling in a politically sensitive dispute. Therefore, even though the NAFTA has sought to address some of its earliest stumbling blocks, it appears that further evolution will be needed along the lines of the WTO appeals mechanism. This is especially true with Mexico's inclusion in the NAFTA and Chile's possible accession.

Concerning Chapter 19 panels, the accession of Latin American countries to the Agreement has also bolstered the commitment to a true rules-based system. An example is the amendment made to the the system of naming panel rosters, requiring them to be composed of “sitting or retired judges to the fullest extent practicable”; this shift indicates that the original parties to the Agreement would rather take chances with formality than leave themselves exposed to the caprice of South American political agencies.

The Australian experience of constitutional litigation is particularly instructive in indicating the feasibility of bolstering the AIT by the same route. The first cautionary note to be heeded, however, is that Australia differs from Canada in the way that the division of powers between federal and provincial orders of government has evolved. In Australia today there is no ascertainable line of division between the powers of the Commonwealth and those of the states. The Commonwealth can potentially invade any field of governmental activity. In fact it has invaded many, with an expensive duplication of bureaucracies. This situation presents a stark contrast to the Canadian division of powers and the long-standing provincial autonomy interpretation of Section 92 of the Canadian Constitution. It thus comes as no surprise that the Australian government is looking to Canada’s AIT to further liberalize internal trade. Moreover, as Howse points out, since the adoption of the Charter of Rights and Freedoms the Supreme Court has shown greater confidence about taking on a more activist role in Canadian social policy, including stronger interpretations of the peace, order and good government clause and the disallowance powers of the federal government. However, these interpretations seem to us not necessarily compatible with the political climate in Canada; it is more than likely that they would diffuse support for the principles contained in the AIT.

As we have seen, the AIT has opted for a dispute settlement approach strongly emphasizing scope and breadth, with few specific commitments to enforcement. In fact, the goals and commitments in principle differ from what is found in the most recent international agreements; however, the dispute settlement process reflects more a mixture of the “old” GATT with the FTA. Of course, both of these agreements have been updated and modified, and that simple fact points to a clear need within the AIT. Aspects of the mechanism make the AIT more complex and cumbersome than it should be (for example, limited private-party access, lack of a right to appeal, and dubious enforceability measures, not to mention multiple procedures for different industries).

Effectiveness of the Mechanisms

In resolving trade disputes between parties to a trade agreement, the effectiveness of a dispute settlement mechanism depends on its scope for dealing with disputes, the frequency of its use by the parties to the agreement, the credibility of its decisions and rulings, its enforceability record, and the extent to which it can be improved and strengthened through change and evolution. This section will compare and assess the ability of the mechanisms examined in the present study to deal with such issues and increase their effectiveness.

Scope

The international mechanisms examined in this study now have broad scope to deal with disputes involving trade in both goods and services, but this has not always been the case. In particular, the GATT /WTO mechanism had not been applied to services prior to the Uruguay Round and the creation of a new mechanism. Even the EU mechanism, which is the most comprehensive, was at first involved primarily in settling disputes related to trade in goods; through the years it has evolved to deal with all types of disputes over goods and services, including those arising from regulation, competition policy and state aid to industries. From its inception the NAFTA mechanism was applied to both goods and services trade; however, its experience has largely been confined to dealing with disputes involving trade in goods, and it has not really been tested in dealing with disputes over services. As a result, although international mechanisms now have broad and relatively comprehensive scope, their effectiveness in dealing with disputes over services is still somewhat unknown and will remain so until they have the opportunity to deal with such disputes in actual cases. The EU mechanism has clearly led the way in this regard; it now routinely deals with disputes between the member countries on issues such as services, labour mobility, regulatory and competition policy, and state aid.

The Australian and Canadian national mechanisms have the scope to deal with disputes over trade in both goods and services, but again experience and capabilities display a bias toward dealing with disputes involving goods. In Australia, the majority of cases dealt with by the High Court have been disputes involving goods, including (as examined in this study) disputes over the impact of regulation on the freedom of trade in goods. As a result, the Australian mechanism has been used to deal with a number of methods, such as regulation and government monopolies, by which interstate trade can be restricted through governmental action. Experience with the Canadian AIT mechanism is still minimal and it is difficult to assess how widely this will be used to settle various types of internal trade

disputes in Canada. In theory the scope of the AIT mechanism should be very broad, but some areas of the Agreement may not be developed sufficiently to provide the criteria and rationale for dealing with certain types of disputes, such as those pertaining to trade restrictions resulting from the application of non-harmonized government regulations. To a large degree, the AIT is still a work in progress, and there will be additional scope for the operation of the dispute settlement mechanism as various parts of the AIT are expanded and strengthened through further negotiations and agreements.

Much of the credibility and effectiveness of any dispute settlement mechanism depends on whether it can be employed to settle a wide array of trade disputes involving both goods and services as well as many different types of barriers. If it is applicable solely to a limited range of disputes and particularly those involving trade in goods, the mechanism will be effective only in a small part of economic activity, and barriers in major economic sectors will persist. Clearly, the comprehensive nature of the EU mechanism, which covers all sectors and types of barriers, has been a major factor in achieving the high degree of freedom of movement of goods, services, capital and people throughout the Union. Even in the EU case, however, the dispute settlement mechanism is still used actively across a broad range of activities to ensure that freedom of movement is maintained and expanded. The WTO and NAFTA mechanisms are broad in scope but their overall effectiveness is still in question: complainants are uncertain about the mechanisms' little-tested ability to deal with disputes involving trade in services as well as a wide range of other issues. The internal mechanisms in Canada and Australia also suffer from underuse of their provided scope. In reality, the effectiveness of a dispute settlement mechanism depends not simply on its scope but also the use of that scope in resolving disputes across a wide range of economic activity.

Frequency of Use

Another measure of the effectiveness of a dispute settlement mechanism is the frequency of its use in resolving disputes between parties to a trade agreement. If a mechanism is too costly or takes too long, it will be used less frequently, only for disputes that warrant the cost and time involved, and only by parties that can afford to use it. As a result, to be effective a mechanism should be relatively low-cost and prompt in producing decisions and rulings on disputes. Also determining its frequency of use and hence effectiveness is the degree of access that various parties have to the mechanism. If only governments have access, as in the case of the WTO and Chapter 20 provisions of the NAFTA, effectiveness is reduced. In the EU mechanism, which has the highest frequency of use, actions on the part

of firms and individuals account for a substantial portion of the cases dealt with, particularly through the national courts in member states. Another example of wider access to the mechanism are the provisions under NAFTA Chapter 19, which allow firms to take action in appealing anti-dumping and countervail rulings imposed by national trade remedy procedures. This part of the NAFTA mechanism has proven to be the most frequently used and the most effective in resolving disputes under the Agreement.

As far as costs are concerned, generally the more formal and legalistic a mechanism is, the more costly it will be in resolving disputes. Because of the legal process and procedures involved, the EU's and Australia's court-based mechanisms tend to be more costly than the more informal WTO and NAFTA panel-based systems. In terms of timeliness, it is not clear whether court-based or panel-based mechanisms are most efficient in promptly resolving disputes. Court-based systems may be less expeditious in arriving at initial determinations because of the more extensive legal procedures involved in their operation; on the other hand, panel-based mechanisms generally provide more time to allow for consultations and mediation before and during the process, and for implementation and compliance procedures. As a result, when both cost and timeliness are taken into account, there may not be much difference between court-based and panel-based systems.

Credibility of Decisions and Rulings

To be effective over the longer term, a dispute settlement mechanism must establish credibility for its decisions and rulings among the parties to a trade agreement. If the parties are not convinced that a mechanism's decisions and rulings are reached without bias through proper procedures and processes, the mechanism will soon lose credibility and the parties will avoid using it to resolve disputes. For disputants to feel confident about using the mechanism, the procedures and process must provide for equal access by all parties and for a full presentation of the facts from both sides of a dispute. The mechanisms analysed in this study provide equal access by the parties permitted to bring disputes before the mechanism, and they allow for a full exchange of information and positions before the mechanism. In most cases, particularly in the WTO and NAFTA mechanisms, extensive provisions have also been made for consultations and mediation, with a complete exchange of facts and positions, before formal procedures are instituted to deal with a dispute. As a result, the mechanisms studied generally do not suffer from any lack of credibility arising from the procedures and processes used in dispute resolution.

The most significant concern facing any dispute settlement mechanism is the degree to which it can show that decisions and rulings are arrived at in an unbiased way, with neither party being in a position to exert influence over the decision-making process. As we can see from the charges of bias in NAFTA rulings, the concern is more urgent in panel-based mechanisms than in court-based mechanisms; this is because of the non-judicial nature of panels, and the need to choose panelists from each party to serve on panels resolving disputes by majority vote. In a court mechanism, jurists serving on the court tend to be more legalistic in their view of the facts and have a tradition of neutrality toward the parties appearing before them. In contrast, in a panel mechanism, panelists are generally drawn from lists presented by the two parties; bias can arise if the majority of panelists are affiliated to one party, and particularly if the panelist lists are politically oriented.

The panel-based mechanisms, particularly the WTO and NAFTA mechanisms, have attempted to develop selection processes that minimize the risk of bias in decisions and rulings by adopting techniques such as reverse choice of panelists (with each party selecting panelists from the other party's list) or by having the panelists chosen appoint a neutral chairperson. One of the most advanced of these techniques is that followed in choosing panels under the new WTO Appellate Body, which is made up of recognized experts in law and international trade: three panelists are drawn from the seven-member body (excluding any member who declares a conflict of interest) on an unpredictable random rotation basis that provides for all members to serve regardless of national origin. Because of the problems in choosing panelists and the risk of political influence in these choices, panel-based mechanisms have generally suffered from a lower level of credibility than court-based mechanisms.

Enforceability Record

Ultimately, the credibility of a dispute settlement mechanism rests on its ability to enforce decisions and rulings on the parties to a trade dispute. If it cannot do so, the mechanism becomes simply a forum for expressing disputes and attempting to resolve them by developing a consensus between the parties, rather than a mechanism for resolving disputes on which consensus cannot be reached. If a party knows that a mechanism lacks the teeth to enforce rulings, it soon becomes impossible to resolve disputes through consensus: neither party will compromise, knowing that it will suffer no consequences from refusing to resolve a dispute. The major problem in the enforcement of rulings made by a mechanism arises from the difficulty in taking or threatening action that would make it too costly for the offending party to ignore the ruling. Either the offended party is permitted to take trade

action against the offending party, or defined penalties are imposed against the offending party by the mechanism itself. Generally, panel-based mechanisms have used the threat of trade action as the major means of enforcement. The risk is that this approach could lead to retaliatory trade action by the offending party; the result could be a whole round of trade restrictions, which would be costly to all members of a trade agreement. Court-based mechanisms, on the other hand, have been more willing to use penalty payments as an enforcement technique, but for any specific infraction it is difficult to determine how heavy a penalty would make it too costly for an offending party to ignore a mechanism ruling.

Enforcement continues to be a major weakness of dispute settlement mechanisms; in most of them, resolution of a dispute must rely on the willingness of the parties to accept dispute settlement mechanism rulings. This is why all mechanisms provide informal means of resolution before formal procedures are used to deal with a dispute. There is a much higher probability that an offending party will change its behaviour and abide by the terms of an agreement if a dispute can be resolved by consensus without requiring a ruling, and a much lower probability of compliance if the mechanism must try to enforce an official ruling on the offending party. The more a mechanism can achieve informal resolution through consensus, the more effective it will be in resolving disputes and maintaining the commitment of members to the trade agreement. If disputes must always be resolved through the enforcement of rulings, both the mechanism and the trade agreement will soon be endangered and liable to collapse. Accordingly, an effective mechanism will use enforcement only as a last resort. That being so, the lack of clear enforcement techniques may not seriously undermine effectiveness. The key is that the parties must be committed to the trade agreement and see value in resolving disputes either by consensus or through rulings; if they do, the economic value of the trade agreement is maintained. If enforcement procedures are included in a mechanism, they must be usable and effective; otherwise, failure to enforce rulings will seriously damage the credibility of the mechanism and reduce its effectiveness in dealing with disputes.

The Need for Evolution

Except for the Australian constitutional mechanism, all the dispute settlement mechanisms examined in this study have undergone evolutionary changes to make them more effective in resolving disputes. In all of these cases it was acknowledged by the parties to trade agreements that the mechanisms initially put into place were not adequate and that improvements and changes were required in an evolutionary manner. The EU mechanism has undergone continual change and strengthening through amendments to the

Treaty of Rome and precedents established by court rulings, particularly the Court of Justice. The original GATT mechanism has evolved substantially through refinements and major additions, which resulted in the establishment of the WTO mechanism. Similarly, the original FTA mechanism was modified and improved as it evolved into the NAFTA mechanism. These evolutionary changes were stimulated partly by changing contexts for the original trade agreements (e.g., the inclusion of services under the GATT and the expansion of the FTA to include Mexico) and partly from experience in operating the mechanisms (e.g., the need to minimize bias in arriving at decisions, and to reduce costs and improve the timeliness of rulings). Some of these changes involved the introduction of wholly new structures (e.g., the Appellate Body in the WTO mechanism); others involved improvements to procedures and processes (e.g., the methods of choosing of panelists under the NAFTA mechanism). In the case of the EU, much of the evolution of the mechanism has involved broadening its scope by extending it into new areas of economic activity not included in the original Treaty of Rome. Even in the case of Australia, a desire has developed to explore additional structures that could be used in conjunction with the court-based constitutional mechanism to deal with disputes in a more informal, less costly and more timely manner.

Implications for the Internal Trade Mechanism

The purpose of this study was to examine the international and national dispute settlement mechanisms operating under the major international trade agreements and in other national markets, in order to determine what implications could be drawn from recent changes to these mechanisms for Canada's Agreement on Internal Trade mechanism. The AIT mechanism has already been influenced substantially by the international mechanisms, particularly the original GATT and FTA mechanisms, and it is now important to determine how recent changes to these mechanisms could be adopted to strengthen and improve the AIT mechanism. In addition, analysis of the EU and Australian court-based mechanisms could offer lessons that might influence future directions in the evolution of the AIT mechanism. On the basis of these analyses, this section will determine and outline the key issues to be considered in the evolution of the AIT mechanism. It will also present recommendations for dealing with these issues.

Implications of WTO and NAFTA Changes

A number changes in the evolution from the GATT to the WTO mechanism have implications for the future development of the AIT mechanism. The WTO mechanism represents a move toward a rules-based system that removes ambiguous and loose terms and replaces them with specific guidelines for various stages of the process; the intended results are specific

operating procedures and transparency in the settlement of disputes. As part of this process the WTO has adopted a uniform approach to disputes in all sectors under a single system for dispute resolution, and it has applied the principle of automaticity to the formation of panels, the adoption of reports and retaliation rights. In addition, the WTO has attempted to deal with the issue of bias and panelist impartiality by ensuring that there are no undue relationships between disputants and panelists. One of the most innovative aspects of the WTO mechanism is the appeals process: the newly created Appellate Body accepts appeals against rulings by panels established under the Dispute Settlement Body and deals with them through a judicial approach under very tight timelines. In fact, the Appellate Body is the most distinguishing feature of the new WTO mechanism and it has been instrumental in establishing the WTO's impartiality, integrity and independence in the few initial decisions made under the mechanism. It would seem appropriate then that these leading-edge developments in the WTO should be considered in examining ways of improving and strengthening the AIT mechanism.

A number of changes instituted in the establishment of the NAFTA mechanism parallel developments in the WTO mechanism, particularly with regard to the automaticity of the process and the selection of panelists. Under the NAFTA, if a settlement cannot be reached through consultations and negotiations, disputants are automatically required to undertake proceedings under the NAFTA mechanism. To avoid bias in panel composition, the Chapter 20 panelist selection process has also been strengthened by requiring the parties to the Agreement to establish by consensus a 30-member common roster of panelists. When a panel is formed, the disputants must unanimously choose a chairperson from the roster and then select panelists through a reverse selection process, with each party choosing panelists who are citizens of the other party. In addition, under Chapter 19 it is suggested that panelists be sitting or retired judges wherever practical so as to ensure that they have sufficient knowledge of the legal systems in each of the countries. The two most common criticisms of the NAFTA mechanism have to do with concerns about bias in panelist selection and the need for more formalized appeals processes. With regard to panel bias, the main recommendations for change involve establishing a permanent body of panelists or appointing term panelists, as with the WTO Appellate Body. In fact, there have been suggestions that the NAFTA needs an appeals process similar to that instituted under the WTO Appellate Body. These changes and suggested changes again highlight the need to reconsider the AIT and look at how the latest innovations in international mechanisms could be used to improve and strengthen it.

Lessons from the EU and Australian Mechanisms

Business firms and individuals have access to the EU and Australian dispute settlement mechanisms, and this feature offers a major lesson for the AIT. The wider access has been a principal reason why these mechanisms have been used extensively; in particular, the EU mechanism can be accessed readily through the national court systems in the member states. In Australia, most cases taken to the courts and the High Court involve private complainants taking action against either the state or Commonwealth governments and their agencies. This approach provides much more direct access to the mechanism, and private-sector entities can relate much more to the purpose and results of the mechanism than would be the case if all disputes involved only governments dealing with other governments. The mechanism is also open to smaller, more focused disputes; these do not have to be overarching concerns of governments but can, in a very real sense, establish precedents and case law for dealing with future disputes. In addition, access by businesses and individuals can build broader support for the mechanism among voters, and can place more pressure on governments to ensure its effective operation and use.

Another feature of the Australian experience is relevant to Canada: the realization that a constitutionally based mechanism does not necessarily resolve all the problems involved in enforcing free trade within a federation. The Australian constitution clearly states that trade between the states must be free, and Australians have used the court system vigorously to enforce this constitutional provision; but the mechanism has still not always operated effectively or without controversy. The High Court has had great difficulties in balancing state and Commonwealth interests, and has found it hard to rule definitively on a number of cases involving government regulations and their impact on freedom of trade. Many regulations imposed for sound public policy purposes result in discriminatory trade barriers, the cost of which must be balanced against other public policy benefits. The High Court has attempted to resolve these issues through such approaches as the application of alternative means tests to specific regulatory measures being challenged as restrictions to trade. However, the Court has been less than successful in a number of cases and it is still not clear how the constitutional provision can be upheld. The Court has also had difficulty in defining the rights of individuals under the constitutional provision, and gaps remain in the interpretation of these rights. Such problems, and the apparent desire to develop more informal means of dealing with disputes in Australia, must be considered in assessing suggestions in Canada that the AIT be replaced or supplemented by stronger use of constitutional provisions through the court system.

Key Issues and Recommendations

The analyses we have presented indicate a number of key issues regarding the structure and operation of the AIT mechanism — issues that require attention if the mechanism is to evolve in a manner consistent with international and other national experience with dispute settlement mechanisms. The following is an outline of these issues, along with recommendations for dealing with them:

- At present, the various chapters of the AIT each specify separate dispute settlement mechanisms to be used first by disputants. This provision results in an overly complex and confusing mechanism that creates uncertainty and reluctance on the part of complainants who need to use it. International experience, particularly within the WTO, indicates that one mechanism to deal with the entire agreement is preferable to a number of mechanisms pertaining only to specific areas of the agreement.

Recommendation: Provide the option for disputants to go directly to the AIT Chapter 17 mechanism without being required to use the individual chapter mechanisms.

- The international trend, established by the WTO, is toward stronger rules-based procedures and processes in dispute settlement mechanisms, particularly with regard to panel selection as well as operating rules and procedures. The AIT mechanism has established a panel selection process, but operating procedures and processes are to be determined largely on an ad hoc basis for each panel. The credibility of the AIT mechanism would be increased by ensuring minimal bias in panel selection and consistency in panel operating procedures and processes.

Recommendation: Establish clearer rules and procedures surrounding the panel process. For example, set a minimum level of standardization of the areas that panels must review in every case, and adopt even stronger methods of avoiding panel selection bias by establishing procedures for disclosure of conflicts of interest on the part of panelists, similar to the procedures used in the WTO Appellate Body.

- Private-party access to a dispute settlement mechanism has proven to be an effective means of increasing the use of the mechanism and strengthening its credibility in resolving disputes; this has been the case particularly in the EU mechanism. Under the AIT, private parties can initiate complaints through the mechanism but the process is complex and the Agreement does

not provide for rights of retaliation and compensation. Given the difficulties facing private parties in launching action under the AIT, probably few if any private cases would ever be dealt with under the mechanism.

Recommendation: Provide greater scope for private-party access to the AIT dispute settlement mechanism by simplifying and harmonizing the processes and procedures for government and private-party access. Provision of the right to compensation would also encourage private-party use of the system.

- The most significant innovation in international mechanisms has been the establishment of an appeals process in the WTO through creation of the Appellate Body. The AIT does not provide for an appeals process after a panel report has been issued, and this deficiency can lead to enforcement difficulties if one party feels it was not treated properly during the panel process. The ability to appeal a panel decision would afford parties the opportunity to protest against any real or perceived improper treatment under the panel process, and it could serve to bring closure to the dispute.

Recommendation: Establish an appeals process that addresses parties' concerns about panel findings, with the power to remand or reverse report decisions. The scope of the appeals process would have to be defined and limited, as it is under the WTO Appellate Body, and clear appeals procedures would have to be developed giving finality to the process.

BIBLIOGRAPHY

High Court of Australia cases cited in this paper can be found at the Australian Legal Information Institute (AustLII) Website, <http://www.austlii.edu.au>.

Cameron May Ltd. June 14, 1996. "Conference on Dispute Settlement in the WTO." Brussels.

Canadian Chamber of Commerce. September 1996. "The Internal Trade Agreement and Interprovincial Trade Flows: Building a Strong United Canada."

Davey, William J. 1996. *Pine and Swine: Canada–United States Trade Dispute Settlement: The FTA Experience and NAFTA Prospects*. Ottawa: Centre for Trade Policy and Law, Carleton University.

Doran, Charles. November 1996. "The Softwood Lumber Case under NAFTA," *The International Journal*.

European Commission. 1996. *General Report on the Activities of the European Union: 1995*. Luxembourg: Office for Official Publications of the European Communities.

Globerman, Steven, and Walker, Michael. 1993. *Assessing NAFTA: A Trinational Analysis*. Fraser Institute.

Howse, Robert. June 1996. "Securing the Canadian Economic Union: Legal and Constitutional Options for the Federal Government," *The Canadian Union Papers*, No. 81. C.D. Howe Institute.

Samuel L. Griffith Society Website at <http://exhibit.com.au/griffith>.

Trebilcock, Michael J., and Howse, Robert. 1995. *The Regulation of International Trade*. New York: Routledge.

Trebilcock, Michael J., and Schwanene, Daniel, eds. 1995. *Getting There: An Assessment of the Agreement on Internal Trade*. Policy Study No. 26. C.D. Howe Institute.

INDUSTRY CANADA RESEARCH PUBLICATIONS

INDUSTRY CANADA WORKING PAPER SERIES

- No. 1 **Economic Integration in North America: Trends in Foreign Direct Investment and the Top 1,000 Firms**, Industry Canada, Micro-Economic Policy Analysis Staff including John Knubley, Marc Legault and P. Someshwar Rao, 1994.
- No. 2 **Canadian-Based Multinationals: An Analysis of Activities and Performance**, Industry Canada, Micro-Economic Policy Analysis Staff including P. Someshwar Rao, Marc Legault and Ashfaq Ahmad, 1994.
- No. 3 **International R&D Spillovers Between Industries in Canada and the United States**, Jeffrey I. Bernstein, Carleton University and the National Bureau of Economic Research, under contract with Industry Canada, 1994.
- No. 4 **The Economic Impact of Mergers and Acquisitions on Corporations**, Gilles McDougall, Micro-Economic Policy Analysis, Industry Canada, 1995.
- No. 5 **Steppin' Out: An Analysis of Recent Graduates Into the Labour Market**, Ross Finnie, School of Public Administration, Carleton University and Statistics Canada, 1995.
- No. 6 **Measuring the Compliance Cost of Tax Expenditures: The Case of Research and Development Incentives**, Sally Gunz, University of Waterloo, Alan Macnaughton, University of Waterloo, and Karen Wensley, Ernst & Young, Toronto, under contract with Industry Canada, 1996.
- No. 7 **Governance Structure, Corporate Decision-Making and Firm Performance in North America**, P. Someshwar Rao and Clifton R. Lee-Sing, Micro-Economic Policy Analysis, Industry Canada, 1996.
- No. 8 **Foreign Direct Investment and APEC Economic Integration**, Ashfaq Ahmad, P. Someshwar Rao and Colleen Barnes, Micro-Economic Policy Analysis, Industry Canada, 1996.
- No. 9 **World Mandate Strategies for Canadian Subsidiaries**, Julian Birkinshaw, Institute of International Business, Stockholm School of Economics, under contract with Industry Canada, 1996.

- No. 10 **R&D Productivity Growth in Canadian Communications Equipment and Manufacturing**, Jeffrey I. Bernstein, Carleton University and The National Bureau of Economic Research, under contract with Industry Canada, 1996.
- No. 11 **Long-run Perspective on Canadian Regional Convergence**, Serge Coulombe, Department of Economics, University of Ottawa, and Frank C. Lee, Industry Canada, 1996.
- No. 12 **Implications of Technology and Imports on Employment and Wages in Canada**, Frank C. Lee, Industry Canada, 1996.
- No. 13 **The Development of Strategic Alliances in Canadian Industries: A Micro Analysis**, Sunder Magun, Applied International Economics, 1996.
- No. 14 **Employment Performance in the Knowledge-Based Economy**, Surendra Gera, Industry Canada, and Philippe Massé, Human Resources Development Canada, 1996.
- No. 15 **The Knowledge-Based Economy: Shifts in Industrial Output**, Surendra Gera, Industry Canada, and Kurt Mang, Department of Finance, 1997.
- No. 16 **Business Strategies of SMEs and Large Firms in Canada**, Gilles McDougall and David Swimmer, Micro-Economic Policy Analysis, Industry Canada, 1997.
- No. 17 **Impact of China's Trade and Foreign Investment Reforms on the World Economy**, Winnie Lam, Micro-Economic Policy Analysis, Industry Canada, 1997.

INDUSTRY CANADA DISCUSSION PAPER SERIES

- No. 1 **Multinationals as Agents of Change: Setting a New Canadian Policy on Foreign Direct Investment**, Lorraine Eden, Carleton University, 1994.
- No. 2 **Technological Change and International Economic Institutions**, Sylvia Ostry, Centre for International Studies, University of Toronto, under contract with Industry Canada, 1995.
- No. 3 **Canadian Corporate Governance: Policy Options**, Ronald J. Daniels, Faculty of Law, University of Toronto, and Randall Morck, Faculty of Business, University of Alberta, 1996.

- No. 4 **Foreign Direct Investment and Market Framework Policies: Reducing Frictions in APEC Policies on Competition and Intellectual Property**, Ronald Hirshhorn, 1996.
- No. 5 **Industry Canada's Foreign Investment Research: Messages and Policy Implications**, Ron Hirshhorn, 1997.

INDUSTRY CANADA OCCASIONAL PAPER SERIES

- No. 1 **Formal and Informal Investment Barriers in the G-7 Countries: The Country Chapters**, Industry Canada, Micro-Economic Policy Analysis Staff including Ashfaq Ahmad, Colleen Barnes, John Knubley, Rosemary D. MacDonald and Christopher Wilkie, 1994.
Formal and Informal Investment Barriers in the G-7 Countries: Summary and Conclusions, Industry Canada, Micro-Economic Policy Analysis Staff including Ashfaq Ahmad, Colleen Barnes and John Knubley, 1994.
- No. 2 **Business Development Initiatives of Multinational Subsidiaries in Canada**, Julian Birkinshaw, University of Western Ontario, under contract with Industry Canada, 1995.
- No. 3 **The Role of R&D Consortia in Technology Development**, Vinod Kumar, Research Centre for Technology Management, Carleton University, and Sunder Magun, Centre for Trade Policy and Law, University of Ottawa and Carleton University, under contract with Industry Canada, 1995.
- No. 4 **Gender Tracking in University Programs**, Sid Gilbert, University of Guelph, and Alan Pomfret, King's College, University of Western Ontario, 1995.
- No. 5 **Competitiveness: Concepts and Measures**, Donald G. McFetridge, Department of Economics, Carleton University, 1995.
- No. 6 **Institutional Aspects of R&D Tax Incentives: The SR&ED Tax Credit**, G. Bruce Doern, School of Public Administration, Carleton University, 1995.
- No. 7 **Competition Policy as a Dimension of Economic Policy: A Comparative Perspective**, Robert D. Anderson and S. Dev Khosla, Economics and International Affairs Branch, Bureau of Competition Policy, Industry Canada, 1995.

- No. 8 **Mechanisms and Practices for the Assessment of The Social and Cultural Implications of Science and Technology**, Liora Salter, Osgoode Hall Law School, University of Toronto, under contract with Industry Canada, 1995.
- No. 9 **Science and Technology: Perspectives for Public Policy**, Donald G. McFetridge, Department of Economics, Carleton University, under contract with Industry Canada, 1995.
- No. 10 **Endogenous Innovation and Growth: Implications for Canada**, Pierre Fortin, Université du Québec à Montréal and the Canadian Institute for Advanced Research, and Elhanan Helpman, Tel Aviv University and the Canadian Institute for Advanced Research, under contract with Industry Canada, 1995.
- No. 11 **The University-Industry Relationship in Science and Technology**, Jérôme Doutriaux, University of Ottawa, and Margaret Barker, Meg Barker Consulting, under contract with Industry Canada, 1995.
- No. 12 **Technology and the Economy: A Review of Some Critical Relationships**, Michael Gibbons, University of Sussex, under contract with Industry Canada, 1995.
- No. 13 **Management Skills Development in Canada**, Keith Newton, Industry Canada, 1995.
- No. 14 **The Human Factor in Firm's Performance: Management Strategies for Productivity and Competitiveness in the Knowledge-Based Economy**, Keith Newton, Industry Canada, 1996.
- No. 15 **Payroll Taxation and Employment: A Literature Survey**, Joni Baran, Industry Canada, 1996.
- No. 16 **Sustainable Development: Concepts, Measures, Market and Policy Failures at the Open Economy, Industry and Firm Levels**, Philippe Crabbé, Institute for Research on Environment and Economy, University of Ottawa, 1997.
- No. 17 **Measuring Sustainable Development: A Review of Current Practice**, Peter Hardi, Stephan Barg, and Tony Hodge, International Institute for Sustainable Development, 1997.
- No. 18 **Reducing Regulatory Barriers to Trade: Lessons for Canada from the European Experience**, Ramesh Chaitoo and Michael Hart, Center for Trade Policy and Law, University Carleron, 1997.

- No. 19 **Analysis of International Trade Dispute Settlement Mechanisms and Implications for Canada's Agreement on Internal Trade**, E. Wayne Clendenning and Robert J. Clendenning, E. Wayne Clendenning & Associates Inc., under contract with Industry Canada, 1997.

JOINT PUBLICATIONS

Capital Budgeting in the Public Sector, in collaboration with the John Deutsch Institute, Jack Mintz and Ross S. Preston eds., 1994.

Infrastructure and Competitiveness, in collaboration with the John Deutsch Institute, Jack Mintz and Ross S. Preston eds., 1994.

Getting the Green Light: Environmental Regulation and Investment in Canada, in collaboration with the C.D. Howe Institute, Jamie Benidickson, G. Bruce Doern and Nancy Olewiler, 1994.

To obtain copies of documents published under the *RESEARCH PUBLICATIONS PROGRAM*, please contact:

Publications Officer
Micro-Economic Policy Analysis
Industry Canada
5th Floor, West Tower
235 Queen Street
Ottawa, Ontario, K1A 0H5
Telephone: (613) 952-5704
Fax: (613) 991-1261
E-Mail : fumerton.cheryl@ic.gc.ca