THE FOREIGN INVESTMENT REVIEW AGENCY (FIRA) AND THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT): INCOMPATIBLE?

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I. INTRODUCTION

Are the practices of Canada’s Foreign Investment Review Agency, which regulates foreign investment, contrary to Canada’s obligations to the United States under the General Agreement on Tariffs and Trade? As a leading recipient of investment capital from the United States and as a major trading partner of the United States, Canada has always maintained a friendly, if somewhat defensive, economic relationship with the United States. The two countries have a history of amicable trading. Only rarely in the past has a trade dispute between Canada and the United States entered the international arena. Recently, Canada’s commitment to welcoming only that foreign investment which could bring significant benefit to Canada has led to a new international trade dispute between the United States and Canada. The issue in this dis-

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1 The Foreign Investment Review Agency (FIRA) was created under the Foreign Investment Review Act (the Act), 1973-1974 Can. Rev. Stat. ch. 46.


3 See, e.g., Canadian Import Quota on Eggs, GATT, Basic Instruments and Selected Documents (BISD) 91, 92, appendix, case 78 (23rd Supp. 1977); Exports of Potatoes to Canada, GATT, BISD 88, 89 (11th Supp. 1963).

4 Neither the FIRA nor United States officials has been willing to divulge the exact content of the United States complaint. The following two excerpts are, however, helpful: What we are challenging are commitments extracted by FIRA from companies seeking to invest in Canada that legally bind those companies to source locally or to export.
pute is whether Canada, in its attempt to encourage beneficial foreign direct investment, has acted contrary to its obligations to the United States and to the international community.

The United States contention that some of the side effects of Canada's regulation of its foreign direct investment have led to a violation of free trade principles may have serious implications for the political and economic relationship between the two countries. This Article will present the possible areas of conflict, analyze the United States allegations, and discuss a possible outcome of the dispute as well as possible future approaches to the issues.

II. BACKGROUND TO THE FIRA/GATT CONFLICT

A. Foreign Investment in Canada and FIRA

Canada's history, its vast natural resources, and its relatively small population have led Canadians to need and to encourage capital inflow as a means of developing the country's economy. The level of foreign direct investment increased dramatically after World War II. By 1970, 36% of all assets in non-financial corporations in Canada were controlled by foreigners, including 69% in the mining sector and 58% in the manufacturing sector. The United States controlled over 75% of all foreign investment in Ca-

Letter from Nicholas Burakow, United States Department of Commerce, to Dr. Emily Carasco (March 3, 1983) (discussing the United States complaint against FIRA).

As you may be aware, our complaint addresses certain trade-related aspects of FIRA's operations, not FIRA itself. Specifically, we are maintaining that the practice by which FIRA exacts undertakings from prospective foreign investors to source locally and/or to export certain percentages or volumes of production is contrary to certain GATT principles.

Letter from W.S. Merkin, Office of the United States Trade Representative, to Dr. Emily Carasco (February 24, 1983) (discussing the United States complaint against FIRA).

Canada has had a long history of encouraging the flow of capital into the country. Sir John A. MacDonald's National Party was directed to encourage capital inflow. High tariffs have also provided a strong motive for direct investment, especially by United States investors. The United States is Canada's major supplier of external capital. See generally G. Hughes, A COMMENTARY ON THE FOREIGN INVESTMENT ACT (1975); TASK FORCE ON THE STRUCTURE OF CANADIAN INDUSTRY, PRIVY COUNCIL OFFICE; FOREIGN OWNERSHIP AND THE STRUCTURE OF CANADIAN INDUSTRY (1968); J. Young, CANADIAN COMMERCIAL POLICY, ROYAL COMMISSION ON CANADA'S ECONOMIC PROSPECTS (1975).

Between 1945 and 1967 the book value of United States long term investment in Canada increased from just under $5 billion to $28 billion (about 81% of total foreign investment), while direct investments increased from around $2 billion to $17 billion. GOVERNMENT OF CANADA, FOREIGN DIRECT INVESTMENT IN CANADA 13-14 (1972) [hereinafter cited as The Gray Report].

A study commissioned by the Canadian government in 1972 concluded that although foreign direct investment had been necessary for economic development, it had side effects which were not always to Canada's long term benefit. The study, known as the Gray Report, led to the passage of the Foreign Investment Review Act in 1974. The Act created the Foreign Investment Review Agency.

FIRA was intended as an instrument not for restricting foreign investment but for reviewing potential foreign direct investment with the intention of approving all foreign direct investment likely to be of "significant benefit to Canada." The Act regulates foreign investments in the Canadian economy by subjecting to federal government review the acquisition of control of existing Canadian business enterprises by a foreign individual, government or corporation (referred to as "non-eligible persons") and the establishment of new business enterprises in Canada by non-eligible persons, including investments by existing foreign-owned Canadian businesses in new areas of business. Non-eligible persons seeking to enter either of these two categories of investment in Canada must apply to the FIRA for approval of the proposed investment. Approval of an acquisition of control or establishment of new business will be given by the federal Cabinet if the applicant demonstrates that the acquisition or establishment will be of "significant benefit to Canada" under criteria listed in the Act. Included in this list of criteria is the "effect on the level and nature of economic activity in Canada, including employment, resource processing, utilization of parts, components and services produced in Canada, and exports from Canada." To satisfy this criterion foreign inves-

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* See *The Gray Report*, supra note 6, at 430.
* See supra note 1.
* Id. §§ 3-4.
* Id. § 2(2):
  (a) the effect of the acquisition or establishment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada, and on exports from Canada;
  (b) the degree and significance of participation by Canadians in the business and in any industry or industries in Canada of which the business enterprise or new business forms or would form a part;
  (c) the effect of the acquisition or establishment on productivity, industrial
tors sometimes undertake to carry out trade-related performance requirements. Examples frequently cited include undertakings by foreign companies to purchase parts and materials in Canada, to export a portion of their production, and to establish an exclusive distribution network for their products within the country.

In 1982, FIRA approved 86% of the applications it received. Despite FIRA approval of the vast majority of applications by potential foreign investors, successive United States administrations have complained about FIRA's procedures. The criticism was particularly harsh when in 1981 Canada outlined nationalist energy policies that the United States believed openly discriminated against United States dominated multinational oil operations in Canada. One allegation against Canada was heard above the rest: FIRA's procedures were claimed to be in violation of Canada's obligations under the GATT.

B. The GATT Connection

The GATT, which is the most important international agreement regulating trade among most of the market economy industrialized nations, has an overall goal of reducing nationalist practices that inhibit free trade. The 1947 General Agreement, to

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efficiency, technological development, product innovation and product variety in Canada;
(d) the effect of the acquisition or establishment on competition within any industry or industries in Canada; and
(e) the compatibility of the acquisition or establishment with national industrial and economic policies, taking into consideration industrial and economic policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the acquisition or establishment.

15 See supra note 4. The United States has not been alone in its criticism of FIRA. For a different perspective, see Twalfhoven, Foreign Investment Review Act: Comments by a Concerned Dutch Party, in INTERNATIONAL BUSINESS: A CANADIAN PERSPECTIVE 466 (K. Dhawan ed. 1980).
17 See, e.g., infra note 24 and accompanying text.
which both the United States and Canada are contracting parties, embodies the results of tariff negotiations and contains general protective articles which seek to prevent evasion of tariff commitments. These articles, now numbering thirty-eight, contain detailed rules and obligations designed generally to prevent nations from pursuing "beggar-thy-neighbour" trade policies19 which would be self-defeating if emulated by other nations. Recognizing the role that international economic affairs had played in causing World War II, GATT contracting parties concentrated on lowering post World War II tariff levels in the belief that this would prevent a repetition of pre-World War II economic instability. In recent years, starting with the Tokyo Round of Multilateral Trade Negotiations, increasing attention has been focused on non-tariff barriers that distort trade.20

Some trade-related performance requirements may arguably be regarded as non-tariff barriers because they result in a direct transfer of investment, jobs, and production to the country which imposes them — and away from other countries. An argument has been made that the international shifts in investment, employment, production, and trade which are caused by trade-related performance requirements are not a response to market forces, but are imposed by government fiat.21 Although their purpose is to increase the economic welfare of the country imposing such measures, these requirements may be regarded as a new form of "beggar-thy-neighbour" policy. However, trade-related performance requirements were not discussed at the Tokyo Round, and there are currently no international norms regarding their legitimacy.

One United States company whose undertakings to FIRA have received considerable attention is Apple Computer, Inc.22 After nearly a year of talks with FIRA, the company was given permis-

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20 At the Tokyo Round of Multilateral Trade Negotiations, agreement was reached on a number of matters including trade-distorting government subsidies and countervailing duties imposed to offset the effects of such subsidies. Graham, Results of the Tokyo Round, 9 GA. J. INT'L & COMP. L. 153 (1979).
sion to set up Canadian operations. Among the many undertakings given by the company were agreements to purchase Canadian-made parts, to ensure a certain level of Canadian value-added, and to recommend Canadian-made peripheral equipment to its dealers around the world.\textsuperscript{23} Apple Computer, Inc.'s application led to the question of whether undertakings exacted under pressure (and with the prospect of review three to five years after a major investment has been made) to achieve percentage levels in repair, maintenance, and Canadian value-added or to use specific videotex system are not, in effect, more demanding than higher tariff levels or as demanding as quantitative restrictions, both of which are proscribed by the GATT.\textsuperscript{24}

The trade-related performance requirements which the United States alleges have been imposed by FIRA may be illustrated by the following examples:

Company H was required to promise only to bank with Canadian banks and utilize exclusively Canadian advertising agencies and public accountants.

Company I was required to affirm that it would purchase a specific percentage of its requirements in Canada.

Company J was requested to reduce its equity share not only in the firm being acquired in Canada but in other unrelated operations in Canada.

Company K was required to pledge that it would cease to import specified products.

Company L was pressured to move certain manufacturing operations from the United States to Canada.

Company M was required to agree to export specific products.

Company N, and numerous others, were required to furnish technology, trademarks etc. free of charge to its Canadian subsidiary.

Company O was requested to make "financial contributions" to a Canadian project in which it had no interest.\textsuperscript{25}

Based on the imposition by FIRA of such trade-related performance requirements which are non-tariff barriers to international trade and which therefore impede the attainment of GATT objec-

\textsuperscript{23} Id.

\textsuperscript{24} MacDonald, supra note 16, at 396.

tives and violate explicit GATT provisions, the United States formally requested in March 1982 that the Council of the GATT create a panel to examine FIRA and rule on whether Canada is in violation of its obligations under the GATT. The United States decision to take its grievances to the GATT Council followed two months of inconclusive consultations with Canada conducted under article XXII of the GATT.

In the event that a dispute between governments such as the FIRA-Canada/GATT-United States dispute cannot be resolved by the consultative procedures of article XXII, the GATT provides a procedure for third party adjudication of legal claims which is known as the "panel procedure." Article XXII provides that if any contracting party believes that any benefit accruing to it under the GATT is being "nullified or impaired or that the attainment of any objective of the agreement is being impeded" by the actions or inactions of other contracting parties or by "the existence of any other situation," the aggrieved contracting party may make written representations or proposals to the other contracting party or parties which it considers to be concerned. If no satisfactory adjustment is made, the matter may be referred to the contracting parties who may then set up an investigative panel. The panel usually consists of three or five respected diplomats from the GATT delegation of countries not involved in the dispute. This panel reports to the contracting parties or the GATT Council, which makes the final decision.

The outcome of the United States claim that FIRA's trade-related requirements as part of its foreign investment regulation violate GATT principles will be of significance to more than the two countries immediately involved in the dispute. Nearly all of the major trading partners of the United States impose some form of performance requirements on at least some local affiliates of foreign corporations. Performance requirements relating to the level of exports are imposed in varying degrees of severity on foreign

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**Footnotes:**

86 See infra notes 36, 37, 61, and 70 and accompanying text.
88 Article XXII provides generally for consultation either between disputing contracting parties or between the contracting parties and one or more disputing contracting parties as a preliminary step in dispute resolution. GATT, supra note 2, art. XXII.
89 Id. art. XXIII(1), (2).
90 See J. Jackson, supra note 18, at 176.
91 LICIT, supra note 21, at 4.
investments in at least seventeen countries. For example, Brazilian regulations differentiate between automobile manufacturers with a Brazilian approved export program and those without such a program. Companies with an export program are favoured and allowed a lower level of local content by value. Israel offers incentives linked to 20% to 50% production for export and some of its grants and loans are tied to export performance.

Although perhaps the most assertive advocate of foreign investment review, Canada is not alone among the economically developed nations in its campaign to review foreign direct investment. Australia, France, Japan, and even the United States are among the group of economically advanced nations that monitors or in some way restricts foreign direct investment. There is no customary international law prohibiting such restriction or monitoring since investment is considered an internal matter. Hence, the United States claim against FIRA is directed not at the existence of FIRA, unhappy as the United States may be about its presence, but at the FIRA practice of obtaining trade-related performance undertakings which are allegedly contrary to Canada's GATT obligations.

III. THE FIRA/GATT COMPLAINT

The types of trade-related performance requirements which the United States alleges that FIRA imposes may be challenged as being proscribed by a number of GATT provisions, specifically, those

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82 These countries are Belgium, Brazil, Canada, Greece, India, Israel, Italy, Korea, Malaysia, Mexico, New Zealand, Philippines, Portugal, Singapore, Spain, Taiwan, and Turkey. See id. Table 3, at 7.
83 Id. at 8.
84 Id. (b) at 4.
85 Foreign investment regulation is usually associated with the less developed nations. Brazil, Mexico, Singapore, Malaysia, Indonesia, Algeria, Nigeria and Peru, which are major recipients of foreign investment among the less developed countries, have some form of investment regulations. See id. at 16.
86 In recent years, a number of developed countries have enacted some form of foreign investment regulation. See generally Note, Foreign Direct Investment in the United States: Possible Restrictions at Home and a New Climate for American Investment Abroad, 26 Am. U.L. Rev. 109 (1976).
88 See supra note 4.
governing national treatment, elimination of quantitative restrictions, and subsidies. Further, in cases where a performance requirement restricts trade in an item covered by a tariff concession, it may be considered an impairment of that concession.  

A. GATT Article III: National Treatment

Article III of the GATT, entitled "National Treatment on Internal Taxation and Regulation," seeks to ensure that imported products are treated no less favourably than domestic products. Like the most-favoured-nation rule, another keystone GATT rule, national treatment is a rule of non-discrimination. It means that imported goods should be accorded the same treatment as goods of local origin with respect to matters under government control, such as taxation and regulation. Paragraph 1 of this article provides that domestic production is not to receive protection with respect to taxation. The article further elaborates the principle of national treatment as it applies to particular areas: internal taxes and charges, internal laws or requirements, quantitative restrictions, and price controls.

A number of the official disputes that have arisen through the dispute settlement procedure in the GATT has dealt with the national treatment clause of the GATT. These disputes usually involve tax, particularly border tax adjustments in relation to the first sentence of article III(1). The tax provisions may not be relevant to the FIRA/GATT dispute, but the prohibition of quantitative regulation "so as to afford protection to domestic production" may be highly relevant. It may be argued that value-added requirements, by definition, involve quantitative regulation of for-

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For instance, a performance requirement may relate to one or more of the sectors covered by tariff concessions made by Canada to the United States. For examples of Canada's tariff concessions, see General Agreement on Tariffs and Trade, Protocol, Volume I, Geneva (June 30, 1979).

GATT, supra note 2, art. III.

J. JACKSON, supra note 18, at 273.

Paragraph 1 sets out the basic principle in broad terms:

The contracting parties recognize that internal taxes and other internal changes, and laws, regulations and requirements affecting the internal sale, offering for sale, or purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

GATT, supra note 2, art. III.

Id.

J. JACKSON, supra note 18, at 284-86 nn.21-27.
foreign investment operations within the country with the goal of facilitating and protecting domestic production. Value-added requirements force an enterprise to use local materials or components even if it would have otherwise preferred to import such materials or components. In effect, a quantitative regulation is imposed on certain items.

Paragraphs 4 and 5 of article III, which are relevant to the issue of local sourcing, allow for further arguments alleging FIRA/GATT incompatibility. Paragraph 4 deals with national treatment for imported products with respect to all laws, regulations, and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution, or use. Paragraph 5 prohibits the establishment of any regulations relating to the mixture, processing, or use of products in specified amount or proportion which requires that any specified amount or proportion of any product be supplied from domestic sources. Undertakings made to FIRA by the United States companies, such as Apple Computers, Inc.'s undertaking to ensure 30% Canadian value-added of the cost goods sold in Canada, arguably may be treatment that is contrary to the national treatment requirement of paragraph 4. Apple Computer, Inc.'s undertaking to purchase Canadian-made parts arguably may be a local sourcing requirement imposed by the Canadian Government. As such, it would be contrary to paragraphs 4 and 5 of article III.

The Canadian Government and FIRA officials repeatedly have pointed out that value-added undertakings or local sourcing undertakings such as those given by Apple Computer, Inc. and by other

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46 LICIT, supra note 21, at 20.
44 GATT, supra note 2, art. III, § 2:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchases, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product. Section 5 provides that no contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.
applicants to FIRA are undertakings freely entered into and not requirements imposed by FIRA. There is nothing in the Act that requires applicants to make any undertakings in order to obtain approval for the proposed foreign investment. Nevertheless, some undertakings are almost always made, and FIRA has admitted that undertakings make assessment of an application easier. Undertakings once made are binding on the applicant if the investment is allowed, and there are provisions in the Act whereby in case of non-compliance, the Minister may apply to the courts for remedial orders. Although no legal action has yet been taken on any undertakings made by successful applicants, the potential for legal action does exist. The Minister in charge of FIRA has stated that renegotiation is a preferred alternative. The effect of these “undertakings,” however, at least as far as the foreign investor is concerned, is the same as that of a requirement, i.e. the investor is legally bound by the undertaking.

FIRA and the Canadian government could question whether the drafters of the GATT intended article III to apply to FIRA-type regulations which are foreign investment regulations and not trade restrictive regulations. The goal of FIRA regulations was the promotion of beneficial foreign investment to develop and strengthen the Canadian economy. At least one attempt has already been made to confine article III(4) interpretation to trade regulations. In a 1958 dispute between Italy and the United Kingdom, the latter alleged that an Italian law which provided special credit facilities to the purchasers of agricultural machinery was inconsistent with Italy’s article III(4) obligation to provide national treatment to imports. Italy argued that the GATT was a trade agreement and that its scope was limited to measures governing trade. Moreover, the Italian delegation considered that the text of article III(4) could not be construed in such a way as to prevent the Italian government from taking the necessary measures to assist economic de-

48 How FIRA Works, supra note 47, at 8.
49 Dewhirst, supra note 8, at 459.
50 See e.g., Grover, Foreign Investment Review in Canada, in NEW DEVELOPMENTS IN FOREIGN TRADE AND INVESTMENT: AUSTRALIA, UNITED STATES, CANADA 42 (Presented jointly by the International Law Institute of Georgetown University, the Law Institute of the Pacific Rim, and the Law Institute of Australia and North America, August 12, 1982).
development in Italy. In the view of the Italian delegation, it would be inappropriate for the contracting parties to construe the provisions of article III in a broad way since this would limit their rights to formulate their domestic policies in a manner which was not contemplated when they accepted the terms of the GATT. The GATT panel, however, rejected a narrow view of article III(4) by stating that in their opinion:

the drafters of the Article intended to cover in paragraph 4 not only the laws and regulations which directly governed the conditions of sale or purchase but also any law or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market (emphasis added).

Nevertheless, it remains to be seen whether practices such as undertakings which are only related to foreign investment regulations and are not directly connected with trade will be deemed contrary to article III. After all, the same panel that rejected a very restrictive interpretation of article III(4) said that the intent of the article III drafters “was to provide equal conditions of competition once goods had been cleared through customs.” Neither the local sourcing undertakings nor value-added undertakings affect goods that have already been imported into Canada.

Article III(5), which deals with local sourcing, was the subject of considerable discussion by the GATT drafters. According to one authority on the GATT, “[m]ixing (local content) requirements received extensive consideration by the draftsmen. For example, a requirement might be imposed that margarine contain at least 20% domestically produced margarine or butter. This would violate the GATT obligation.” However, even at the time article III(5) was drafted, many countries felt that mixing regulations should be permissible because, even if they did inhibit trade to some degree, they were the only effective means of protecting infant industries. FIRA’s acceptance of an undertaking by Apple Computer, Inc. to purchase Canadian material was an attempt to create a competitive market for Canadian goods and to move away from the tendency of foreign enterprises to favour their own suppliers over domestic goods. Given Canada’s desire to build upon its

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68 Id. at 64.
69 Id.
70 J. Jackson, supra note 18, at 289.
71 U.N. Doc. EPCT/c.II/40 (1946); EPCT/A/PV 9, at 52 (1947).
secondary manufacturing sector, the Apple Computer, Inc. type of undertaking does not seem unreasonable. Further, it can be argued that article III(5) only prohibits regulations on products by the contracting parties. This article does not affect discrimination freely undertaken by private firms.66

The complainant in the FIRA/GATT dispute, the United States, is familiar with local sourcing regulations as well as with other legislation regulating foreign investment.67 "Buy-American" legislation exists at both federal and state levels in the United States.68 "Buy-American" policies range from outright prohibitions on foreign purchases by governmental agencies and from embargoes on communist goods to discriminatory licensing, labeling, and inspection requirements. These policies may be embodied in state constitutions, statutes, city ordinances, or informal purchasing policies.69

The relationship of local protection to United States international commitments has given rise to considerable litigation in the United States.60 One California court has found that, on its face, the California "buy-American" and "buy-Californian" statutes are in conflict with the GATT since foreign products are not being accorded the national treatment required by article III(4) of the GATT.61 Canada will undoubtedly bring to the attention of the GATT panel that the United States is not without its own share of protectionist legislation. The California "buy-American" act, enacted almost simultaneously with the federal "buy-American" law, was a depression measure designed to ensure that "American tax money should sustain American Labor in a moment of American crisis and American emergency."62 Canada’s motivation in creating FIRA was not significantly different.

The federal Buy-American Act63 does provide an example of how

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66 J. JACKSON, supra note 18, at 289-90.
70 Id. See generally Hobin, GATT, the California Buy-American Act, and the Continuing Struggle Between Free Trade and Protectionism, 52 CALIF. L. REV. 335 (1964).
72 76 CONG. REC. 3254 (1933) (remarks of Sen. Vandenburg).
local sourcing legislation can avoid contravening the letter and the spirit of article III(4) of the GATT. Unlike some of the state "buy-American" laws, the federal law provides at least two escape routes from the preference for American goods or services: (1) the cost differential must not be "unreasonable" and (2) the preference must not be "inconsistent with the public interest."\(^\text{64}\) Undertakings given to FIRA in relation to local sourcing could be couched in such terms as to be non-discriminatory in relation to imports. This is already being done in some instances. Apple Computer, Inc.'s undertaking to FIRA to "actively seek to develop Canadian sources for power supply units and semi-conductor memories" was conditional. "In the event that power supply units or any other components can be sourced in Canada at competitive prices, quality, reliability, and in quantities sufficiently large to meet the needs of the applicant and of the new business, the applicant will purchase such products and components . . ."\(^\text{65}\) (emphasis added).

Article III presents a host of difficult interpretative problems and involves major policy issues. A nation may be entitled in some circumstances to impose conditions on foreign investors which effectively curtail imports and afford a "protection" that may be worse than a tariff. It may be relevant that the imposed conditions were not directed toward "protectionism." A nation may have a wide variety of programs and legislation, such as Canada's FIRA or National Energy Program, designed to protect the well-being of its people and its economy. Few would advocate an international economic system of rules which would prevent nations from exercising their sovereignty to provide for domestic policy goals in various ways.

B. **GATT Article XI: Quantitative Restrictions**

Value-added requirements and local sourcing requirements also may be considered violative of article XI(1), which prohibits quantitative restrictions.\(^\text{66}\) As stated in paragraph 1 of that article:

> No prohibition or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any Contracting Party on the importation of any product of the territory of any other Contracting Party

\(^{64}\) Usher, *supra* note 59, at 224-25.


\(^{66}\) GATT, *supra* note 2, art. XI.
While local sourcing requirements cause firms to purchase goods locally which they would perhaps prefer to import, value-added requirements curtail imports of components which a manufacturer may have preferred to import but is forced to produce locally. The result is a quantitative regulation which is set by a complicated formula.\(^6^7\) Thus, although a quota is not directly imposed, the result that would have been achieved by a quota is brought about by the value-added or local sourcing requirement. Foreign investors could argue that the value-added undertakings which they give to FIRA may be considered "measures" maintained by Canada to restrict the importation of the products involved in the undertakings.

Quantitative restrictions such as quotas have always been frowned upon by the United States on the ground that they make all international commerce a matter of political negotiation: "goods move, not on the basis of quality, service and trade, but on the basis of deals . . . ."\(^6^8\) Value-added requirements imposed on foreign investors make import levels subject to deals between firms and host countries rather than to the forces of the open market. The local market is sealed off from competition. Furthermore, unlike tariffs, which can be surmounted in some circumstances, quotas cannot be overcome either through increased efficiency by the exporter or through decreased efficiency by the importer; imports are still limited.

The prohibitive quantitative restriction provisions of GATT have three major exceptions. Quantitative restrictions may be maintained for balance-of-payments purposes, to support certain domestic agricultural programs, and by the less-developed countries to further their economic programs in certain circumstances.\(^6^9\) Most of the major trading nations, including the United States, have some quantitative restrictions concerning agricultural and food products.\(^7^0\) Because of the history of exceptions that have always riddled article XI(1), Canada could present strong economic reasons, either within the balance-of-payments category or gener-

\(^6^7\) LICIT, supra note 21, at 21. For examples of various types of value-added requirements, see id. at 4-8.


\(^6^9\) K. DAm, supra note 18, at 20-21.

\(^7^0\) Id. at 165.
ally as a necessary economic protection, to justify the need for value-added requirements in foreign investment within Canada. At the 1946-47 GATT preparatory conferences, India, one of the nations not yet industrialized, commented concerning restrictions:

Our approach to this program is very different, and . . . on many points the disagreement between our experts and the American experts is fundamental. . . . The kind of cooperation to which India attaches importance is a relationship based on respect for the principle of equal rights and self-determination of peoples.

From every point of view, we consider that it is essential that the nation's economic development should not be left wholly to the operations of private enterprise and unchecked competition, whether internal or external, as seems to be implied by some of these proposals.\(^7\)

Canada has expressed similar sentiments on various occasions.\(^7\)

Although the United States itself has enjoyed a waiver from article XI obligations and other governments have widely ignored the criteria of article XI for years, the United States was not prevented from claiming in 1976 that certain agricultural restrictions imposed by Canada were not justified by article XI.\(^7\) There is no reason to believe that continued enjoyment of the article XI waiver will prevent the United States from raising article XI objections in the FIRA/GATT conflict. However, Canada can argue that the history of article XI shows that the article is not always strictly complied with, that there is an economic need for the development of industry, that undertakings given by private enterprises do not constitute measures instituted by the Canadian government, and that the United States does not come before the GATT with "clean hands" in matters of quantitative restrictions.

C. GATT Article XVI: Subsidies

Article XVI(1) of the GATT seeks to restrain contracting parties from granting or maintaining "any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports" of any product into, their

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\(^7\) See supra note 3.
Subsidies were regarded by the GATT drafters as undesirable interferences with the free flow of trade. Both value-added requirements, which may be said to reduce imports, and export performance requirements, which may be said to increase exports, could be regarded as subsidies. The language of article XVI(1) indicates, however, that the drafters of that article clearly envisaged the classical form of subsidy, i.e. payment of money to someone to do something or refrain from doing something. Government actions such as currency retention practices, value-added requirements, or export performance requirements may have the effect of subsidies, but they are not at this point clearly prohibited by the GATT. If the FIRA undertakings which in effect constitute non-monetary subsidies were challenged under article XVI(1) of the GATT, Canada would probably strongly oppose such an attempt to read into the provision prohibition of actions not contemplated at the time of drafting. Any other approach would result in the elimination of a number of positive practices and programs designed by governments to deal with specific problems not directly related to trade.

IV. THE FUTURE OF THE FIRA

Canada appears determined that FIRA will continue to exist in its present form. The United States appears equally adamant

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74 GATT, supra note 2, art. XVI, para. (1):
If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization.

75 See generally, K. DAM, supra note 18, at 132.

76 Currency retention consists of permitting exporters to retain a portion of scarce foreign exchange proceeds. Depending upon the details of the system, these proceeds may be sold in a free market, where, under scarcity conditions, they will command a price higher than that obtainable under the official exchange rate, or they may be used to import foreign goods for which foreign exchange would otherwise be unavailable under the applicable exchange control regulations.

Id. at 137.

77 Canada’s Minister of Industry and Trade, Ed Lumley, informed reporters in February
about its opposition to FIRA practices and its determination to challenge the legality of these practices. The United States is, in fact, committed to an intensive use of the GATT dispute settlement procedures by virtue of provisions in the Trade Act of 1979 requiring the administration to pursue these procedures in response to meritorious complaints by private citizens.78

Any discussion of the possible outcome of the FIRA-Canada/GATT-United States deadlock must take place in the light of the history of dispute resolution within the GATT, the limitations on possible legal action within the GATT, as well as the economic realities of the day which are an inevitable component of any trade dispute. Even though the original GATT is a fairly legalistic document, pragmatism has always played a major role in its interpretation and administration by the GATT Secretariat and by some of its most influential contracting parties.79

Neither the dispute resolution provisions of the GATT nor the history of their use provides any encouragement to contracting parties to bring their differences before the other GATT contracting parties in the form of a legal dispute.80 Article XXIII documents clearly emphasize a preference for voluntary settlement of disputes between contracting parties.81 Article XXIII itself does not give a contracting party a "right" to the establishment of a panel upon request. Legislative history indicates that it was intended that the GATT contracting parties treat the panel procedure as a last resort to be used with great caution.82 A preference for consultation and conciliation was indicated then and has prevailed since. Even where a dispute reaches the panel procedure stage, as has the FIRA/GATT dispute, attempts to achieve concili-

1983 that he doubts that legislative changes for FIRA are a current government priority. The Windsor Star, Feb. 22, 1983, at 1, col. 3.


80 Id.


82 Hudec, supra note 79, at 159.
ation between the disputants continue.\textsuperscript{83}

Economic protectionism is widely prevalent today. The protectionist activities have become so serious in sectors such as steel, automobiles, chemicals, textiles, footwear, and farm products that trade ministers and officials at the GATT have drawn parallels with the Depression of the 1930’s.\textsuperscript{84} Given the existing economic realities and the fact that the trade-related performance requirements which the United States alleges as contrary to Canada’s GATT obligations are not uncommon among the practices of other GATT contracting parties, the panel investigating the FIRA/GATT dispute has a difficult task ahead. It cannot be unaware that the effectiveness of the GATT’s legal rules has always rested upon the consensus among contracting parties, a consensus not necessarily articulated, of what constitutes acceptable government action.

It is not the first time that a GATT panel has been faced with a complex case which presents issues that exceed those of common trade disputes. A 1961 complaint by Uruguay listed over 600 major restrictions imposed by fifteen developed countries and asked the panel, without further participation by Uruguay, to rule on the legality and/or “nullification and impairment” consequences of the various restrictions.\textsuperscript{85} In spite of doubts by many GATT observers as to the appropriateness of the panel for such a “high profile” case, the panel in question presented a respectable outcome.\textsuperscript{86} The FIRA/GATT panel will be touching upon the highly sensitive issue of a nation’s sovereign right to regulate domestic matters such as foreign investment and economic development.

The possibilities for the investigating panel are legion. It is possible, although highly unlikely, that the panel will refuse to make a finding because of the sensitive and complex nature of the dispute. Such a refusal would not be in the best interests of GATT as an international institution. The panel may delay making a formal legal finding by asking for more information or by urging the parties to continue to seek a negotiated settlement.\textsuperscript{87} As trade-related

\textsuperscript{83} H.R. Doc. No. 153, supra note 81, at 639.
\textsuperscript{84} The Globe and Mail, Nov. 20, 1982, at B1.
\textsuperscript{86} Uruguayan Recourse to Article XXIII, GATT, BISD 95 (11th Supp. 1963); GATT, BISD 35 (13th Supp. 1965); GATT Doc. L/1647, appendix, case 55 (1961) at U5.
\textsuperscript{87} This technique was employed by the panel which investigated a 1972 charge by the United States in which the United Kingdom was violating GATT articles XI and XIII by maintaining quantitative restrictions that discriminated against United States exports in
performance requirements are not directly prohibited by the GATT, the panel probably will not make a finding of guilt or non-guilt regarding violation of the GATT. However, as article XXIII can be invoked even in the absence of any breach of GATT obligations, there is still the possibility of a finding of nullification or impairment of any benefit accruing to the United States under the GATT by the actions of Canada or by "the existence of any other situation."88

The terms "nullification or impairment" have not been precisely defined. It is unclear whether the concept of "nullification or impairment" can be interpreted as being related to the balance of benefits derived from the GATT. Since the balance of benefits received under the GATT can be described in very broad and general terms, such an interpretation is fraught with danger. New obligations could be read into the GATT. If the panel were to regard some of the undertakings given by foreign investors to FIRA as trade-related performance requirements imposed upon foreign investors by the Canadian Government, these requirements (even though not directly prohibited by the GATT) could be regarded as nullifying or impairing benefits accruing to the United States under the GATT. This possibility is strengthened if the concept of nullification or impairment is related to the expectations of the complaining contracting party — in this case, the United States.89 Such an approach would greatly diminish any Canadian arguments regarding Canadian motives in accepting trade-related performance undertakings given by foreign investors.

There is evidence to indicate that the concept of "nullification or impairment" does not in fact render the use of article XXIII unlimited. There is a statement contained in the GATT preparatory work that article XXIII should not be used to "change the obligations" of the agreement.90 In other words, new obligations should not be read into the GATT via article XXIII. Furthermore, at least one attempt to broadly interpret "nullification or impairment" has

favour of exports from certain Caribbean developing countries. The reaction of developing countries to the United States complaint led the panel to note the legal issues and to request the parties to continue searching for a negotiated settlement that would protect the interests of the developing countries involved. United Kingdom-Dollar Area Quotas, GATT, BISD 236 (20th Supp. 1974).

88 GATT, supra note 2, art. XXIII, para. 1.
89 Chile's expectations played a significant role in a 1949 dispute with Australia. GATT, II BISD 188 (1952).
failed. In 1960, the majority of a group of experts studying the question of whether or not article XXIII should be legally invo-
cable in situations where restrictive business practices cause “nulli-
faction or impairment” felt that it was dangerous to use article
XXIII in these circumstances.91 Trade-related performance re-
quirements in relation to “nullification or impairment” may meet a
similar fate at the hands of the FIRA/GATT panel.

GATT panel reports to the contracting parties usually are ac-
cepted without major amendments. Upon receiving the report of
the FIRA/GATT panel, should the contracting parties decide that
“nullification or impairment” has occurred, they may authorize the
United States to suspend the application to Canada of such con-
cessions or other obligations under the GATT that the United
States determines to be appropriate in the circumstances.92 Thus
far in the history of the GATT, only one dispute has resulted in
suspension of concessions.93 Even if there is a finding of “nullifica-
tion or impairment” in the FIRA/GATT dispute, it is highly ques-
tionable whether the suspension of United States concessions to
Canada would do anything to resolve the actual issues involved in
the dispute. Suspension of concessions would probably be a back-
ward step which could lead to a spiralling of retaliatory actions by
both sides.

There are some positive possibilities open to the panel. Rather
than finding that the benefits of the GATT enjoyed by the United
States are being nullified or impaired by FIRA and thereby risk
alienating not only Canada but all of the other countries that regu-
late foreign investment, the panel could attempt to give recogni-
tion to the substance of the dispute, while at the same time sug-
gest ing a way out for both disputants that enables them to exercise
their sovereign rights. The panel could note that Canada is well
within its rights in regulating foreign investment, that the FIRA
does not require or impose trade-related performance require-
ments, and furthermore that trade-related performance require-
ments are not directly in contravention of the GATT obligations
undertaken by Canada. It could also note that, although Canada’s
FIRA does not directly contravene Canada’s GATT obligations, a
situation does exist in which the United States believes that its

92 GATT, supra note 2, art. XXIII(2).
93 See Netherlands complaint against United States, GATT, BISD 32 (1st
Supp. 1953).
level of trade is being affected by the undertakings given to FIRA by United States investors and that the United States is within its rights in attempting to ensure that the flow of trade in and out of the United States is not interfered with by the actions of another GATT contracting party. In order to enable Canada to carry out its objective of permitting only foreign investment that is of benefit to it, FIRA should not be denied the right to accept trade-related undertakings such as value-added or local sourcing undertakings. United States interests, on the other hand, could be protected if these undertakings were couched in competitive terms so that the foreign investors undertake to give Canadian products and materials a first option that is required to be competitive with what the investors could obtain abroad. This compromise may not take care of Canada's need to protect, so as to strengthen, certain sectors of the Canadian economy. FIRA practice indicates that certain sectors of the Canadian economy are regarded as "sensitive," but the identity of these sectors has not always been clear to potential foreign investors. It may be possible for Canada to negotiate with the United States, in the GATT tradition, a list of limited "sensitive" sectors in which it will be free to accept trade-related performance undertakings in whatever terms the foreign investors choose to give the undertakings. Such a Canadian request would not be unreasonable considering that the United States already protects a number of sectors of its own economy. The panel's recommendation to the contracting parties of the FIRA/GATT dispute could be that undertakings made to FIRA be couched in competitive terms in relation to all but those sectors of the Canadian economy as agreed upon by the United States and Canada.

V. Conclusion

Both parties to an international trade dispute typically seek to further the best interests of their own citizens. In the FIRA/GATT dispute, Canada wants to develop its own economy and promote the interests of its own producers and manufacturers; the United States wants to ensure that Canada's actions do not interfere with its own citizens' trading activities. Fortunately, the GATT is an international institution that provides the flexibility which allows

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* The unpredictable application of §2(2) of FIRA to various sectors was one concern expressed in the Canadian Bar Association Brief to Herb Gray, Minister of Industry, Trade and Commerce (Sept. 24, 1981).

** See generally Note, supra note 36.
the disputing contracting parties to achieve their respective goals if a pragmatic and realistic approach is adopted in relation to the GATT provisions.