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CanadaWatch

PRACTICAL AND AUTHORITATIVE ANALYSIS OF KEY NATIONAL ISSUES

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"AND THE LION SHALL LIE DOWN WITH THE LAMB": UNITED STATES-CANADA CULTURAL RELATIONS IN A FREE TRADE ENVIRONMENT

BY JOYCE ZEMANS

At the heart of the discussion of Canada-United States relations in the cultural field is the fundamental difference in the two countries' views concerning the position of culture in a free-trade environment. Canada views culture and the cultural industries as the United States views national security — as a social good essential to its sovereignty and its capacity to preserve national values and its unique identity. In contrast, the United States, as the dominant world force in cultural trade, views the sector primarily on an economic basis and is committed to ending trade restrictions which infringe or are likely to limit its trading capacity. This is not surprising. Entertainment is the second-largest American export and the Americans know that their ability to export their culture is closely tied to their dominance in other domains.

THE CULTURAL INDUSTRIES "EXEMPTION"

In Canada, as in Europe and China, the United States is standing firm in its claim to unrestricted access to foreign markets and the profits associated with that access. The situation is particularly problematic in light of the Free Trade Agreement (FTA) and the North American Free Trade Agreement (NAFTA). Although Canadians have been assured that Article 2005, "the Canadian cultural industries exemption" (negotiated in the FTA and retained in the NAFTA) removed culture from the agreement, Article 2005(2), the "notwithstanding" clause, suggests that the cultural exemption may be less of an achievement than the Canadian government claimed when its negotiators rose from the bargaining table. In *Trade Liberalization and the Political Economy of Culture: An International Perspective on the FTA*, Graham Carr suggests that 2005(2) is particularly troubling since "it has long been a cardinal rule of Canadian diplomacy to avoid any linkage of issues in bilateral

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THE SOFTWOOD LUMBER DISPUTE

BY GERRY SHANNON

Clearly, it is time to seek a permanent solution to the recurring, damaging problem we have with the United States over softwood lumber exports. For well over ten years, we have found ourselves caught in the cross hairs of American lumber protectionists and of their very skilled trade lawyers in Washington — a coalition well able to pull all the political triggers necessary to do us in.

They failed in 1983 because their own quasi-judicial system found Canada innocent of subsidization of our industry — in other words, the

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dealings with the United States on the ground that the advantages in such arrangements would automatically redound to the Americans by virtue of their greater scope for retaliation." By consenting to the retaliation clause, Canada permitted the linking of the treatment of culture to other areas of the Agreement, thus establishing an enormously problematic precedent which goes far beyond the limits of the Agreement.

An American summary of the clause highlights its ambiguity and concludes, on the one hand, that "Canada faces no constraints on its ability to promote the development of Canadian culture through economic measures." It adds, on the other, that "[t]he United States can take measures of equivalent economic effect to respond to actions taken by Canada in the cultural area. The U.S. recognizes the importance to Canada of maintaining its cultural identity. At the same time, however, the U.S. wants to ensure that Canadian cultural policies do not constitute an unnecessary barrier to U.S. trade."

RELEVANT PROVISIONS OF THE FREE TRADE AGREEMENTS

FTA, ARTICLE 2005

1. Cultural industries are exempt from the provisions of this Agreement, except as specifically provided in Article 401 (Tariff Elimination), paragraph 4 of Article 1607 (divestiture of an indirect acquisition) and Articles 2006 and 2007 of this Chapter.
2. Notwithstanding any other provision of this Agreement, a Party may take measures of equivalent commercial effect in response to actions that would have been inconsistent with this Agreement but for paragraph 1.

NAFTA, ANNEX 2106 - CULTURAL INDUSTRIES

Notwithstanding any other provision of this Agreement, as between Canada and the United States, any measure adopted or maintained with respect to cultural industries, except as specifically provided in Article 302 (Market Access - Tariff Elimination), and any measure of equivalent commercial effect taken in response, shall be governed under this Agreement exclusively in accordance with the provisions of the *Canada - United States Free Trade Agreement*. The rights and obligations between Canada and any other Party with respect to such measures shall be identical to those applying between Canada and the United States.

The fact that subsequent to the signing of the FTA the Conservative government backtracked or stalled on every cultural policy initiative on its agenda which could have been seen to threaten American interests, while at the same time capitulating to the American demand to reduce postal subsidies, strongly suggests that the government was afraid to challenge American interests or to open the Pandora's box of Article 2005. That the Mulroney period saw limited friction in this area had more to do with the Conservatives' acquiescence to the United States in cultural matters than with any real meeting of the minds on this subject. Acknowledging the problem during the 1993 election campaign, the Liberals stated that "[a] Liberal government would put the notwithstanding clause as an issue for discussion during the renegotiation process." At the same time, recognizing culture as a cornerstone of nation-building, they pledged to take action in the cultural domain both nationally and internationally. Their record, however, reveals a less-than-consistent approach, shifting between capitulation on the Ginn and Viacom deals to a stand-firm position on *Sports Illustrated* and split-run editions.

What is at stake in this discussion is Canadian cultural sovereignty and Canada's ability to create, produce, and disseminate its arts and cultural products.

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Music Television decisions, Mickey Kantor described Canada's actions as "concrete evidence of an increasing and disturbing trend in Canada toward the implementation of policies which are intended to protect Canadian industry by discriminating again legitimate U.S. broadcasting, publishing and copyright [interests]." Yet, as Donald Macdonald, Chair of the Royal Commission on Canada's Economic Future acknowledged: "[I]f it were left to market forces, there would be almost no room for Canadian production, however attractive those programs would be to Canadians. The harsh economics of the cultural business would dictate buying foreign which is generally to say American production at the very much lower cost." [Canadian Culture/Communications Industries Committee, *Free Trade and Cultural Identity: Will We Have Access to Our Own Markets?*, 1986, at 14.]

NAFTA exposes Canada's cultural industries, indeed its cultural policy as a whole, to the increasingly relentless challenge of American interests.

What is at stake in this discussion is Canadian cultural sovereignty and Canada's ability to create, produce, and disseminate its arts and cultural products. From the beginning, Canadian public policy has focussed on cultural development in Canada in the context of market forces which work against that development, and the recognition that public policy decisions, and not technological innovations alone, must determine the future of Canada's cultural identity. Given the current American climate, particularly in this pre-election period, there is little doubt that we are heading for continued confrontations. NAFTA exposes Canada's cultural industries, indeed its cultural policy as a whole, to the increasingly relentless challenge of American interests.

Joyce Zemans is Co-Director of the Program in Arts and Media Administration, Schulich School of Business, and Robarts Chair in Canadian Studies, York University. This article was adapted from "'And the Lion Shall Lie Down With the Lamb': U.S.-Canada Cultural Relations in a Free Trade Environment," *The American Review of Canadian Studies (Winter 1994 at 509).*

THE SOFTWOOD LUMBER DISPUTE *from page 69*

system of stumpage whereby our provincial governments, as owners of the resource, charge forest companies a fee to cut down trees for lumber, was found not to be subsidized. The question of whether it was injurious to American commerce, therefore, did not arise.

They succeeded the second time in the American trade system in 1986 when the Commerce Department reversed itself, finding that domestic subsidies did in fact exist, and the International Trade Commission found them to be injurious. The decision was derided in Canada, and rightly so, as an artificial and contrived one, designed to meet the needs of the American lumber states and companies. A "solution to the lumber problem" was thought to be the price of approval on the part of some key United States senators to grant the American administration the famous Fast Track authority to launch the Canada-U.S. Free Trade negotiations. And we were right.

The objective of the architects of their strategy, the late Commerce Secretary Mac Baldridge, and the former United States Trade Representative Clayton Yeutter, was to get us to agree not to pursue either our GATT case — which was well advanced — or an appeal process, but rather to go for an out-of-court settlement.

And we did, when Canada agreed to impose a 15-percent tax on lumber exports — a move which was highly divisive in Canada. To speak to its merits:

1. It preserved a considerable amount of revenue in Canada (about $600 million a year, which otherwise would have gone to American coffers;
2. It averted an appeal process against the decision in American courts which would have taken about five years to resolve with no assurance of eventual victory;
3. It met the requirements of the two most important provincial softwood suppliers: British Columbia, by the far the largest, and Quebec; and
4. It was degressive and was to be reduced directly in relation to stumpage increases.

In 1992, Canada terminated the settlement on the grounds that stumpage fees had vastly increased in the key exporting provinces and, therefore, there was no basis for an export tax. The United States retaliated by imposing a 6.2-percent countervailing duty, an action which Canada argued before a binational panel was inconsistent with the United States' NAFTA obligations, and won the case. The United States was required to pay back some $800 million in duties which they had amassed. Even with a binding panel decision, this was not easily extracted from them.

[A]fter more than seven years into a free trade deal with the United States, the Americans are not really prepared to accept any serious pain.

Finally, in 1995, the American lumber coalition returned to the charge and once again coerced the Canadian

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government into levying an export tax, this time more convoluted and, in my view, fragile. Fragile because it puts the Canadian federal government into the export allocation game, and because it relies on the ability of the United States government to deliver on a promise that no new cases would be launched against Canadian lumber exports for five years. I, for one, do not know how this or a successor United States government can deliver on such a promise if an American company exercises its rights under United States law and, in good company, files a case against Canada one more time.

[W]e clearly do not have a national consensus or a national policy to deal with our softwood problem vis-à-vis the United States.

ESSENCE OF THE PROBLEM

What are the essential ingredients of the problem?

First, it must be apparent by now that, after more than seven years into a free trade deal with the United States, the Americans are not really prepared to accept any serious pain. The adjustment has been largely on Canada's side. When pain is felt in the United States, as it seems to be when Canadian lumber exports exceed around 30 percent of the American lumber market, they mobilize their vast political, legal, and financial resources and ensure that we are rolled back. The question of alleged and injurious subsidy on our side recurs and, even though they have been unable to establish it before the binational panels, they trumpet it and use our own internal split jurisdictions to ensure that somehow we ease their pain.

Second, there probably is no solution to be found in further bilateral talks. We always get roughed up in dealing alone with the Americans on issues which they deem to be critical to them. They simply have too many guns and they will persevere until they win.

Third, we clearly do not have a national consensus or a national policy to deal with our softwood problem vis-à-vis the United States. The trade and commerce powers of the federal government are there, but they were almost left in shreds during the 1996 skirmish, when at least two of the provinces rushed to Washington to make their own deals. We need to reassert the federal powers and federal leadership, but do so in a way that takes fully into account the needs and views of the provinces and industry as well as the overall Canadian requirements.

Fourth, we did attempt in the Uruguay Round of multilateral trade negotiations to deal with the issue of resource pricing in the context of the multilateral subsidy agreement, but did not succeed. Again, the underlying issue for both the Americans and ourselves was lumber and, unfortunately, we were not able at that time to mobilize sufficient support from other countries to get the Americans to agree on subsidy definitions on resource pricing which would have met our needs on softwood.

OPTIONS

The options then seem to be as follows:

First, continue to proceed on an *ad hoc* basis, knowing that when prices rise, or American suppliers of softwood lumber produce less than expected for environmental or other reasons, we will face new trade harassment. No one can say that, when that occurs, the next Canadian government will do better in presenting its case than its two predecessors.

A second option is to give in — to change our fee-for-tree system to emulate that of the United States — an auction system where the wood goes to the highest bidder. It must be remembered, of course, that stumpage is squarely in provincial jurisdiction, so provinces' acquiescence would be required.

Perhaps there is a way of pricing our timber resources which stops short of an auction, but which would better shield us from the American lumber protectionists.

A third option, which I think should be explored, is to launch two initiatives to resolve the issue. The first would be to discuss the issue at the national level in a federal government-led forum involving the provinces, industry, and labour. Perhaps there is a way of pricing our timber resources which stops short of an auction, but which would better shield us from the American lumber protectionists. One of the immediate issues to focus on would be our log export controls — which was the principal, if not the only, element of subsidy found by Commerce in 1992. It's worth a try.

The second initiative would be to propose to negotiate the broader issue of resource pricing in the next round of multilateral trade negotiations in the World Trade Organization. The agenda for the next round will be discussed at the Singapore December 1996 World Trade Organization Review Conference, where Trade Ministers will meet to discuss mutual priorities. This is an occasion where, if we carefully explored the ground in advance with important allies, we could launch a negotiating initiative designed to do what we were unable to achieve in the Uruguay Round — i.e., find a global solution to the resource-pricing issue which would meet our domestic and bilateral needs.

In this regard, it may be salutary to recall that our major trade policy objective in the Canada-United States Free Trade negotiations ten years ago was to establish definitions and rules that would clarify what was an unfair subsidy and what was a non-actionable one — that is, not subject to countervail. We could not do it because the Americans refused, although we did get Chapter 19 dispute settlement which has proven advantageous to us. On resource pricing, in particular, the United States insisted on including a provision that nothing in the Agreement could be a basis for undoing the Softwood Lumber Memorandum of Understanding.

In the Uruguay Round,

however, we did achieve a number of our key objectives on subsidies — rules satisfactory to Canada on subsidy definitions, which protected from attack subsidies in support of reducing regional disparity, in support of research and development, and in support of efforts to make industries environmentally sound. We won these gains because our interests and those of key allies, such as the European Union, converged.

Resolving these issues takes time. While we could not deal with resource pricing in our bilateral negotiations or in the Uruguay Round, we may well be able to do it next time if we can get our act together domestically and if we can conceive a workable strategy to develop a coalition of like-minded countries, as we did on the questions of regional disparity, research and development, and the environment.

No doubt, work is under way on such a strategy somewhere in the federal government.

Gerry Shannon is a Senior Associate with International Trade Policy Consultants, Ottawa. He was formerly Deputy Minister of International Trade and Canada's Chief Negotiator for the GATT Uruguay Round to Trade Negotiations in Geneva.

CULTURE AND LUMBER: FREE TRADE THE AMERICAN WAY

BY MAUDE BARLOW

The central argument put forward by the Mulroney Tories, when they entered negotiations for the Canada-United States Free Trade Agreement (FTA), was the need to come up with a common and binding set of rules to settle trade disputes between Canada and the United States. These would allow Canadian exporters to escape the arbitrary use of American trade-remedy laws governing anti-dumping and countervailing cases, and end years of trade skirmishes that had limited the access of Canadian goods to the American market.

It was agreed that, within seven years, a clear subsidies code would be completed, a promise Prime Minister Jean Chrétien repeated when he signed the North American Free Trade Agreement (NAFTA) in 1993. In fact, he said that Canada's continued support for free trade was conditional on developing these rules within the two years remaining of the original understanding.

HOLLOW PROMISES

The seven years have now come and gone and there is no sight of the promised rules, nor any prospect for them. It has become clear that, just as many of us feared, there never was any real intention of completing a binding code. All we have, and are ever likely to have, are dispute resolution panels that judge whether American laws have been correctly applied; the United States is free to change its laws when a panel does not rule in its favour.

In fact, International Trade Minister Art Eggleton recently admitted as much, saying that the current saw-off is the best we can hope for. Unfortunately for Canada, we continue to be on the losing end of most disputes which, if anything, have intensified since we first entered a free trade arrangement with the United States. Two cases in particular demonstrate the hollow nature of the promise to establish a more equitable system.

The stakes in the softwood lumber dispute are very high for Canada for it is our third-largest export, worth about $8 billion a year.

Our government recently agreed to significantly reduce exports or place an export tax on softwood lumber shipments to the United States, in spite of winning several consecutive trade panels. We gave in because each time it lost a dispute with Canada, the United States simply changed its law to favour its own industry, as it is allowed to do under the terms of the NAFTA.

The stakes in the softwood lumber dispute are very high for Canada for it is our third-largest export, worth about $8 billion a year. In fact, one of the reasons that the Canadian government wanted free trade in the first place was that it wished to avoid a repeat of the 1986 export tax Washington forced it to place on all softwood lumber exports to the United States. However, the deal has not been worth the paper it is written on to Canadian lumber producers.

In 1991, American trade authorities imposed a tariff on Canadian exports; Canada appealed before a binational trade panel and won, and the tariffs were removed. But the industry fought on, forcing the United States government to change the rules and making it more difficult for binational panels to overturn American tariff decisions. Canada entered negotiations knowing it now had less chance of winning another panel under the new rules. British Columbia decided to impose a provincial export quota instead of increasing stumpage fees and Ottawa made the export tax national.

The "deal" has not satisfied the American lumber industry. A former Canadian Ambassador to the World Trade Organization says that the deal will never last the five years of its term. Under the NAFTA rules, the industry can, and likely will, launch another challenge in the American courts.

CULTURAL EXEMPTION "VICTORY"

Another area of ostensible argument was culture. The Mulroney government claimed it had scored a great victory when it gained an "exemption" for Canadian culture in the FTA, and the Chrétien government pointed to the same "win" when it signed the NAFTA. But claims of victory on this front are hollow.

The terms on culture set out in the FTA were adopted by the NAFTA Annex 2106. While one article (FTA 2005.1) exempts the cultural industry from the agreement with the exception of tariff elimination, divesture of an indirect

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HELMS-BURTON: AN OVERSTATED THREAT

BY SUSAN KAUFMAN PURCELL

Canadian officials have strongly criticized the new Helms-Burton law [the *Cuban Liberty and Democratic Solidarity (Libertad) Act of 1996*], which tightens the American embargo against Cuba for allegedly violating Canadian sovereignty by attempting to limit Canada's trade with Cuba. They have also charged that the law violates the NAFTA and the rules of the World Trade Organization (WTO), and have threatened to take up the issue with both bodies. The objections give the impression that Helms-Burton targets all Canadian companies or individuals doing business with Cuba, which is not the case.

The scope of Helms-Burton is considerably more limited. One of its most criticized — and admittedly broad — provisions bars entry into the United States to corporate officers, principals of partnerships, or controlling shareholders of foreign companies who traffic in expropriated American property. This provision, however, will probably be extremely difficult to enforce, except in certain very clear-cut cases, the number of which is small.

The other provision of the law that most concerns Canadian and other foreign investors gives United States nationals the right to bring suits in American courts against foreign governments, companies, and individuals who knowingly and intentionally traffic in property expropriated from American citizens. Plaintiffs can sue only the American subsidiary of the company operating in Cuba. The law is mainly relevant to claims against commercial property in Cuba worth US$50,000 or more at the time of expropriation. The president of the United States can suspend application of this provision for six months at a time if he believes that suspension is in the American national interest and is necessary for encouraging democracy in Cuba.

Not only is the scope of Helms-Burton more limited than most Canadians believe, but charges of the law's illegality under the NAFTA and the WTO are questionable as well.

The fact that the embargo will not be lifted any time soon because of the Helms-Burton law is, therefore, a big economic blow to most foreign investors on the island.

Both Canada and Mexico agreed that nothing in the NAFTA would operate to override the Cuban sanctions program of the United States. Furthermore, Article 1110 of the NAFTA forbids nationalization or expropriation without just and adequate compensation. Although Cuba is not a party to the NAFTA, this provision could be seen as an implicit endorsement of the American position regarding the illegality of Cuba's expropriation of American property without due compensation.

With regard to the compatibility of Helms-Burton and the *World Trade Agreement*, American officials argue that Article 21 allows WTO members to take unilateral actions involving trade in order to protect their "essential security interests." A trade dispute panel asked to render a judgement on Helms-Burton would probably not consider itself competent to make a judgment concerning American security needs. If it were to accept the case and rule that Washington's definition of its national security interests was misguided or wrong, WTO opponents in both the United States and other countries would immediately press for their country's withdrawal from the organization, thereby calling into question the future of the WTO.

CUBAN EMBARGO TO STAY

Although much of the criticism of Helms-Burton has focused on the visa and claims provisions of the law, they are of less importance to Canadian and other foreign economic interests than the provision which takes the power to lift the embargo from the president of the United States and gives it instead to the United States Congress. As a result of this change, it is now highly improbable that the embargo will be lifted any time soon.

Most of the foreign investment that has entered Cuba during the past few years has done so in the expectation that President Clinton would be re-elected in November 1996 and would shortly thereafter lift the American embargo. Foreign investors based their assumption on the fact that key people in the Clinton administration were known or assumed to favour such a policy change. Foreigners were not alone in this assumption. Many United States Congressmen and Senators shared this belief, which accounts, in part, for their support of Helms-Burton.

Top priority should be given to holding free and fair elections in the presence of international observers.

Before Helms-Burton, the existence of the American embargo gave Canadians and other foreigners a triple incentive to invest in Cuba. First, they could do so without having to concern themselves with competition from American companies. Second, the Castro Government was desperate for hard currency in the aftermath of the disappearance of the Soviet subsidy to Cuba, which equaled US$3-6 billion annually. Knowing this, investors could drive a hard bargain with the Cuban Government and invest on very favourable terms. Third, once the embargo were lifted, the value of their Cuban investments would skyrocket. They could then either sell out to American investors, or take advantage of Cuba's sudden access to the lucrative American market.

The fact that the embargo will not be lifted any time soon because of the Helms-Burton law is, therefore, a big economic blow to most foreign investors on the island. What happens next partially depends on what they decide to do.

Fidel Castro has no choice now but to implement additional economic reforms in order to increase the productivity of the Cuban economy and attract additional foreign

capital to Cuba. He correctly views such reforms as potentially threatening to his continued control over the Cuban people: Cubans with increased access to property and money will be less dependent on the state and more able to resist state control. This explains the recent increase in political repression in Cuba. The Cuban Government is attempting to reinforce its control over the Cuban people prior to embarking on the next wave of needed, and politically threatening, economic reforms.

If Canadians and other foreigners truly favour a peaceful transition to a democratic regime in Cuba that respects human rights, they should begin pressing the Castro Government to reform not only economically, but politically as well. Canada, which has had close relations with the Castro regime for several decades, is ideally positioned to take the lead in this regard. Top priority should be given to holding free and fair elections in the presence of international observers.

An elected civilian regime in Cuba would produce both popular and congressional support in the United States for lifting the embargo. It would also restore the value of the investments that Canadians and others have made on the island. Most important, it would finally allow the Cuban people to speak for themselves regarding how and by whom they wish to be governed.

Susan Kaufman Purcell is Vice President, Americas Society, and Managing Director, Council of the Americas.

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acquisition, and transmission rights, another (FTA 2005.2) puts culture right back in by giving the Americans the right to retaliate against Canada for "actions" the United States deems "inconsistent" with it. Yet another provision (FTA 2011.2) permits the United States to circumvent the dispute settlement procedure when it retaliates. Other sections of the agreement, particularly those dealing with Investment, Competition Policy, and Monopolies also infringe on the right of Canadians to protect their cultural policy.

This means that the United States has the legal right to unilaterally decide if a Canadian cultural measure is "inconsistent" with NAFTA, to retaliate against Canada, and to select the nature and severity of the retaliation. The United States is the accuser, the umpire, and the enforcer. The late Peter Murphy, chief American FTA negotiator, explained to journalist Marci McDonald how Canadians just did not "get it": "Because [of] the way the agreement is written, if there's a problem, the US will take action — and it doesn't have to show any injury. The retaliatory possibilities are huge."

Canada has no legal rights whatsoever. It cannot even request a panel to judge whether American accusations are justified and, if so, to ensure American retaliation is commensurate with the offence. Further, in signing the NAFTA, Canada surrendered important GATT cultural protections which included the freedom to act to sustain its cultural industry by virtually any measure that did not impair tariff concessions, the establishment of screen quotas that "require the exhibition of cinematographic film by national origin," and the right to a panel to judge American complaints on the basis of GATT law and not in accordance with the vested interests of the American broadcasting, publishing, film, and recording industries.

It is time to admit that Canada is never going to get the fair trade rules we were promised and to understand that we do not have "free trade" even in theory.

Both the Mulroney Conservatives and the Chrétien Liberals have continued to assert the claim that NAFTA protects Canadian culture while giving in, time and again, to American demands on key Canadian cultural issues such as film distribution and book publishing. Complying with American demands has the advantage of avoiding retaliation and enabling politicians to continue to sell the illusion that the agreement protects Canadian culture.

TARGETTING CANADA

The Chrétien government has finally taken several mild measures to protect Canadian culture — one on split-run editions of *Sports Illustrated* and the other on the big-six book retailer Borders. But the American industry has threatened retaliation and the Secretary of Commerce has stated that the tax on *Sports Illustrated* directly conflicts with NAFTA.

United States Trade Representative Mickey Kantor had Canadian cultural disputes specifically in mind when he recently announced the creation of a "hit squad" to apply American trade law to "unfair" trade practices around the world, and named Canada as one of the targets. The smoke-and-mirrors "cultural exemption" will not protect Canadian culture against these threats any more than the non-existent disputes code protected Canadian lumber.

It is time to admit that Canada is never going to get the fair trade rules we were promised and to understand that we do not have "free trade" even in theory. Stelco's President, Frederick Telmer, says that American trade laws are sacrosanct and their preservation was a precondition for the United States to sign the NAFTA: "We do not have free trade with the United States. Anybody who thinks otherwise is living in a dream world."

Therefore, it is also time to admit what these arguments were really about — to impose an American-style free market model on Canada complete with weakened government, low corporate tax rates, privatized social programs, a deregulated environmental regime, a contingency work force, and class warfare. It is time to reopen this debate.

Maude Barlow is the Chairperson of the Council of Canadians, a national citizens' social advocacy group with over 55,000 members.

SOFTWOOD LUMBER, NAFTA, AND THE NEED FOR REFORM

BY JEAN-G. CASTEL & C.M. GASTLE

The recent Canada-United States agreement settling the Softwood Lumber dispute highlights the weaknesses of the NAFTA Chapter 19 dispute settlement mechanism in anti-dumping and subsidization cases. The need to reform the mechanism is confirmed when the agreement is reviewed in the context of Canada's "win" in *Softwood Lumber III* [h *re Certain Softwood Lumber Products from Canada*, No ECC-94-1904-01USA, 1994, FTAPD Lexis II (August 3rd, 1994)]. The agreement imposes a $50.00 charge on exports per thousand beyond 14.7 billion board feet and $100.00 per thousand beyond 15.35 billion board feet. Shipments in 1995 were 16.2 billion board feet, representing approximately $8 billion in export value, and the agreement would result in duties of more than $170 million being paid should future shipments match this annual export volume. The agreement is designed to provide five years of trade peace during which no trade action will be initiated by the United States government against Canadian lumber, and any actions commenced by the United States industry will be dismissed.

THE LUMBER AGREEMENT

The agreement is a relatively good deal for Canada, which was faced with a new complaint to be filed immediately in the United States by a strong interest group, the Coalition for Fair Lumber Imports. United States Trade Representative Mickey Kantor, in a spirit of frontier justice, had already announced that he intended to impose a ten-percent duty on all shipments, which would have resulted in as much as $800 million in duties being collected per year, based on the 1995 export volume. If the duration of the new dispute matched that of *Softwood Lumber III* (October 4, 1991 to August 3rd, 1994), the interim duty of ten percent would remain until January 1999 and amount to as much as $2.4 billion, even if Canada ultimately won the dispute at which time the interim duties would be returned. The Canadian government expected that final duties would be imposed, as International Trade Minister Art Eggleton surprisingly conceded in early April, 1996 that Canada could not win a new dispute because of changes to American trade laws made subsequent to the termination of *Softwood Lumber III*. Canada also could not be certain to have the benefit of a Canadian majority on both the binational panel and the Extraordinary Challenge Committee, which appears to have been a factor in Canada's success in *Softwood Lumber III*. One of the central issues in that dispute was the proper measure of deference to be accorded by the binational panels to the American administrative agencies, and this issue clearly divided panelists and committee members along national lines, with American members requiring that almost absolute deference be shown.

Even though the agreement is the best solution in the circumstances, it is perverse in the light of free trade objectives. *The Financial Post* reported that the settlement will encourage a quota system for exports to the United States ["Softwood Deal Affords Trade in US Export Quotas", *The Financial Post*, April 3rd, 1996], which is one of the most inimical trade practices that the GATT has attempted to eliminate since its inception in 1947. If such a quota system is necessary, it may place the federal government in the delicate position of allocating the quota among the provinces. It also reflects the tendency of the United States to manage trade in certain sectors, made evident in the pattern of use of the American trade laws.

Softwood Lumber III may well become a "high water mark" for the Chapter 19 mechanism from a Canadian standpoint, as it will be a brave American panelist who does not pay heed to the directions given by Congress and Judge Wilkey.

The greatest casualty is the NAFTA Chapter 19 mechanism, which has been largely discredited by the agreement so close upon the heels of Canada's "win" in *Softwood Lumber III*, as well as by Eggleton's concession that Canada could not win a new dispute. Chapter 19 is designed to replace the domestic channels of administrative review. One of its major limitations is that only final anti-dumping and countervailing duty determinations are subject to review. Mickey Kantor's threat of a ten-percent preliminary duty represents pre-judgment relief which prompted the signature of the agreement, as it did in 1986 when a Memorandum of Understanding was signed after a preliminary duty of 14.5 percent had been announced. Not much has changed in ten years regarding the United States' ability to reach a "voluntary" understanding with Canada in one of our most sensitive trade sectors.

A more important problem in the Chapter 19 mechanism is that it blindly accepts American domestic trade laws and any changes thereto. This gives rise to a classic "Catch-22": if Canada wins an important trade dispute, Congress simply changes the trade laws, the industry interest group launches a new complaint, and the result likely will be reversed.

From a Canadian standpoint, the *Softwood Lumber III* determination also challenges the fundamental justification for the Chapter 19 mechanism. Its effectiveness is dependent upon the degree to which it can yield results different from the determinations that would have been made by the United States Court of International Trade (CIT) and United States Federal Court of Appeals (USFCA). Canadian trade officials justified the mechanism by arguing that the CIT and USFCA had been too deferential and that the American standard of judicial review ("supported by substantial evidence on the record") would allow the binational panels to be less deferential. The record of performance of the binational panels would tend to support the view that they have been less deferential, but the question arises whether this trend

will continue. Judge Wilkey, the American representative on the *Softwood Lumber III* Extraordinary Challenge Committee, argued strongly in dissent that the binational panel mechanism must show the same deference as the CIT/USFCA. We have argued elsewhere that Judge Wilkey descended into the forum and became an advocate with respect to the central requirement that the binational panel result "threatened the integrity of the binational panel review process" and, therefore, his dissent must be taken with a healthy degree of scepticism. It does appear clear from the Congressional reports that, in his dissent, Judge Wilkey relied upon the United States' intention to monitor more closely the exercise of discretion through such mechanisms as the selection of panelists, or by "correcting aberrant results" through regulatory or statutory changes, if the convenient evolution of administrative practices does not suffice. The agreement in the softwood lumber dispute certainly will give encouragement to members of Congress opposed to NAFTA Chapter 19 in this regard. *Softwood Lumber III* may well become a "high water mark" for the Chapter 19 mechanism from a Canadian standpoint, as it will be a brave American panelist who does not pay heed to the directions given by Congress and Judge Wilkey.

PROSPECTS FOR REFORM

It is questionable whether any effective reform is now possible in the light of Congressional hostility and the prominence which may be given to NAFTA during the presidential election. Nevertheless, effective reform would place greater restrictions upon the ability of a Party to impose preliminary duties, and would allow a review of preliminary determinations. Pre-judgment remedies are allowed sparingly in domestic civil litigation proceedings because of their potentially determinative effect, and they are only provided after onerous thresholds have been met by those seeking the relief and after appropriate undertakings as to damages have been given. Placing substantive restrictions upon the granting of preliminary duties is probably impossible due to the entrenchment of current preliminary duty practices in the World Trade Organization (WTO) Agreements. Effective reform would also free the panels from the tradition in the United States of deference to the administrative agencies.

If receptiveness by the United States is to be the litmus test of any potential reform, there is no point in suggesting any reform at all.

We believe that one potential route of reform is the elimination of the Chapter 19 mechanism in favour of binding and enforceable WTO Dispute Settlement Body (DSB) decisions in anti-dumping and countervailing duty disputes involving NAFTA Parties. [The WTO DSB determinations are not directly enforceable in the courts of the WTO Parties which, as a result, are not required to implement the recommendations of the DSB panels. While removal of the offending measure or provision is the primary objective of the WTO DSB, the only remedy provided if met with a refusal by the defaulting Party to comply, is that the complaining Party may suspend the application of benefits of equivalent effect until a resolution has occurred.] Since the WTO DSB can review preliminary determinations, the underlying trade legislation and any amendments thereto, it is better placed to impede unprincipled amendments to domestic trade laws designed specifically to overturn earlier determinations. The United States would have to comply immediately with WTO DSB directions that the preliminary determinations or trade law amendments were not WTO-consistent. It would also be more difficult for the United States to mount a campaign to overturn a favourable WTO DSB result, because the world trade community is now looking to the United States to support the GATT/WTO and abandon its policy of aggressive unilateralism. The WTO DSB panel determinations would also likely be more credible than Chapter 19 panel determinations, due to the advantages in due process provided by the WTO's innovative appellate procedures.

The potential reform has been criticized on the basis that it would be impossible to negotiate it with the United States or to achieve the necessary amendments to the WTO Agreements. If receptiveness by the United States is to be the litmus test of any potential reform, there is no point in suggesting any reform at all. We do note, however, that Judge Wilkey is in favour of eliminating Chapter 19 in favour of the WTO DSB, and has made a submission to that effect in Congressional hearings (although he has not commented on our proposal that the mechanism be made enforceable as a *quid pro quo*). As a result, there is a basis upon which to advance this potential reform. An amendment to NAFTA could provide that NAFTA Parties will make enforceable WTO DSB determinations in anti-dumping or countervailing duty disputes, and thus no amendment to the WTO Agreements should be necessary. If an amendment to the WTO Agreements is required, the WTO Parties would likely be receptive because the channelling of Chapter 19 disputes through the WTO DSB would be an important boost to the development of the multilateral mechanism and a body of international trade law. More importantly, making the WTO DSB determinations not only binding but *directly enforceable* upon the United States and other NAFTA members would represent an important precedent for the future development of the multilateral mechanism.

This method of reform has also been criticized on the basis that the WTO DSB requires governments to commence the proceedings, because private parties do not have direct access to them as in the case of Chapter 19 panel proceedings. An amendment to the Canadian *Special Import Measures Act* and similar American and Mexican legislation could require Canada, the United States, or Mexico to commence WTO complaints when petitioned to do so.

Critics should also remember that a practice has developed of taking aspects of disputes before the binational panels to GATT panels, now WTO DSB panels. *Softwood Lumber III* was taken before GATT with respect to self-initiation of the investigation, along with certain other aspects of the dispute. Had there been a binding GATT mechanism, the duties would have been repaid in October 1993

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THE NEED FOR REFORM

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instead of a year later. If the Chapter 19 panel determination had been made by a binding WTO DSB panel, the world trading community would have had a stake in ensuring that the United States could not simply change the rules as they did.

We believe that a tendency exists to discount the WTO DSB as a potential route of reform because of the experience with the GATT mechanism in the past. It is now time to give the multilateral dispute settlement mechanism a second chance.

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ENDNOTE

1. The authors have provided a detailed analysis of the Softwood Lumber III Extraordinary Challenge decision, as well as potential reforms of the Chapter 19 mechanism in Gastle & Castel, *Should the North American Free Trade Agreement Dispute Settlement Mechanism in Antidumping and Countervailing Duty Cases be Reformed in the Light of Softwood Lumber III?*, Law and Policy in International Business, Vol. 26, Spring 1995, pp. 823-896.

NAFTA AND INVESTMENT: AN ECONOMIC CONSTITUTION?

BY BARRY APPLETON

While generally considered to be strictly a trade agreement, it comes as a surprise to many to find that a large part of the NAFTA's three-thousand-plus pages is devoted to the protection of investment, services, and intellectual property. Indeed, so strong are these protections that the NAFTA can properly be called the most far-reaching international investment agreement in the world.

What makes the NAFTA so remarkable is not just its very broad definition of investment, but also its unique process to protect the "rights" of NAFTA investors. The NAFTA imposes obligations upon its signatories in a number of investment areas. The difference is that if these obligations are not met, individual investors have direct legal rights that can be brought to a tribunal without the agreement of their home government.

The NAFTA's "investor state" dispute settlement process, a central component of the agreement, provides for a fast and effective means of settling disputes between investors and governments by bypassing domestic courts. Designed to provide protection for foreign investors in developing countries, the investor-state dispute process focuses strictly on settling investment disputes between individuals and governments.

The use of arbitration is not new in international law. Countries have relied upon it to settle their disputes for hundreds of years. What is new is that the NAFTA makes this formerly country-only process available to all North American private citizens and their businesses. What is surprising is that these governments have agreed to accept the decisions of these international tribunals to discipline their conduct.

The NAFTA requires that there be some international element involved in an investment dispute. Under the agreement, any individual or business resident in a NAFTA country can launch a claim against the government of another NAFTA country. Thus, Canadian investors are not eligible to bring disputes against the government of Canada, but American or Mexican investors are. A major exception to this rule is that Canadian corporations "owned or controlled directly or indirectly" by a citizen of another NAFTA country can bring a claim against a Canadian government.

The bizarre result is that foreign companies or investors are able to access the NAFTA investor-state process to protect their rights while Canadians are not. This is not just an academic quandary. In

WHAT RIGHTS DOES THE NAFTA PROTECT?

The thousands of pages that make up the NAFTA are divided into twenty-two chapters and supplemented by thousands of pages of annexes. The Agreement contains one chapter dealing with trade in goods but five chapters dealing with investment and services (one chapter each on investment, cross-border services, telecommunications, financial services, and intellectual property).

The NAFTA investment chapter imposes stringent obligations on member governments regarding investments from other NAFTA countries. The NAFTA defines an investor as a NAFTA citizen (private or corporate) that "seeks to make, is investing or has made an investment."

The types of investment rights covered include:

National Treatment: Foreign investors must be treated at least as well as domestic ones. This means that neither formal nor substantive rules can be structured in such a way as to give an advantage to domestic companies.

Most-Favoured Nation Treatment: Any special treatment given to non-NAFTA country investors must also be extended toNAFTA investors.

Minimum Standards of International Treatment: Investors and their investments must be given due process, fairness, and other protections.

Limits on Performance Requirements: Rules that require ll loca local hiring, local sourcing, or a percentage of local content are severely limited or prohibited against all foreign investments (not just NAFTA-based investments).

Full Compensation on Expropriation: Full, swift, and fair compensation must be paid after any expropriation or any act that is similar to expropriation. In some circumstances, excessive government regulation could constitute an act "tantamount to expropriation."

These obligations apply to national and subnational governments as well as to Crown corporations that exercise any authority given to them by governments.

the first NAFTA investor-state case, a Mexican company challenged the Government of Canada over certain federal pharmaceutical approval regulations. The company alleged that the Canadian rules unfairly prohibited its access to courts and ultimately to the Canadian market. These same regulations affect hundreds of Canadian companies, but they are ineligible to bring a NAFTA action because they are Canadian. In essence, foreigners are treated better than Canadians under these rules.

While states and provinces are not themselves members of the the NAFTA, North American "subnational" governments often engage in covert practices designed to help local business.

Claims can be raised regarding the widest possible variety of investments, including businesses (incorporated and non-incorporated), shareholdings, loans made to foreign companies for more than three years, real estate, intellectual property, and goodwill. All of these investments would be protected by the NAFTA.

INVESTORS' RIGHTS

NAFTA investors are entitled to dispute governmental acts that harm their investments. These rights must be respected by governments in their legislation, regulation, policies, and practices. While states and provinces are not themselves members of the the NAFTA, North American "subnational" governments often engage in covert practices designed to help local business. Such actions are covered under the NAFTA and will, no doubt, be a fertile source for future investor-state disputes, as will be areas where the intersection of public and private rights may differ among the NAFTA countries. Such disputes are inevitable when dealing with cultures as different as those of Canada, the United States, and Mexico. Areas that may immediately raise concerns are health care delivery, and public secondary and post-secondary education.

The potential class of trade-related litigants has increased from two under the Canada-U.S. Free Trade Agreement to millions under the NAFTA.

NAFTA investor-state panels consist of three arbitrators and are appointed by the disputing parties. They can award financial compensation to investors who have been harmed by inappropriate governmental action. The panels do not have the power to strike down infringing laws, but they can award damages that can quickly motivate governments to amend their legislation. The awards of these panels are not subject to any appeal.

There is little doubt that this NAFTA dispute system will play a major role in how business is done in North America over the next decade. The potential class of trade-related litigants has increased from two under the Canada-U.S. Free Trade Agreement to millions under the NAFTA. All these newly empowered litigants will be unfettered by the constraints of diplomatic niceties. In conferring rights and remedies, the NAFTA investment provisions have quietly created an economic constitution that protects the elite rights of foreign NAFTA investors investing in each NAFTA country.

The impact of these NAFTA cases will not go unnoticed by governments. Faced with ever-decreasing amounts of discretionary spending, governments will begin to modify their policies so that they can avoid the high damage awards that panels could assess. With an enlarged class of potential litigants free from the shackles of diplomacy, NAFTA investor-state disputes are certain to become part of doing business North American-style.

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EXAMPLES OF POTENTIAL NAFTA INVESTOR-STATE CASES

One highly publicized example of government action presents an excellent illustration of the types of situations that could be the basis of an investor-state claim. A review of Bill C-22, the legislation killing the privatization of Toronto's Pearson International Airport, discloses that it was carefully drafted to avoid constituting an expropriation under Canadian law. The NAFTA defeats this careful wording by extending the definition of the term "expropriation" to include acts "tantamount to expropriation." The NAFTA requires a speedy process for payment whenever there is a measure tantamount to expropriation, which was not followed in the Canadian legislation in this case. American investors in the Pearson consortium could challenge Canada's actions before a NAFTA panel, while the majority of Canadian investors cannot. The Pearson Airport privatization example illustrates that foreign investors operating in Canada enjoy greater rights in challenging domestic measures than do Canadians.

THE LIBERTAD ACT: MUCH ADO ABOUT NOTHING

BY JEAN-G. CASTEL

The downing by the Cuban air force of two unarmed American civilian airplanes near or within Cuban airspace prompted Congress to pass the *Cuban Liberty and Democratic Solidarity (Libertad) Act* of 1996 and the President to sign it.

It is rumoured that the Canadian government is planning to have recourse to the dispute settlement procedures of chapter 20 of the NAFTA on the ground that the legislation is inconsistent with the international obligations of the United States government.

Of particular interest are Titles III and IV. The purpose of Title III is to protect the rights of American nationals whose property was confiscated on or after January 1959 without the payment of compensation by the Cuban government. Any person, including any agency or instrumentality of a foreign state, trafficking in confiscated property worth more than $50,000 is liable for damages to any American national who owns the claim to such property, whether or not the owner was an American national at the time of confiscation. United States District courts are given exclusive jurisdiction over such actions. Enforcement of a judgement would be against the defendant's United States-based assets.

Title IV directs the Secretary of State to exclude from the United States aliens or their spouses and minor children or agents involved in the confiscation of the property or in the trafficking in such property. Waivers of the exclusion are permitted in the national interest of the United States and the right to sue does not take effect until 1 August 1996.

As a major trading partner of both the United States and Cuba, Canada has been very vocal in expressing its opposition to this legislation on the ground that it violates customary international law and several provisions of the GATT/WTO, the GATS, and the NAFTA. The Canadian Government has already invoked the provisions of the *Foreign Extraterritorial Measures Act* [S.C. 1985, c. 20] to issue an order to prohibit compliance with the American legislation. [Foreign Extraterritorial Measures (United States) Order, 1992, amendment, SOR 96-84, 15 January 1996.]

Space does not permit a detailed analysis of all the arguments that can be advanced by those who support or oppose the American legislation. What must be made clear is that the potential impact of this legislation has been grossly exaggerated by the Canadian government. The legislation does not prevent a Canadian corporation or individual from doing business with Cuba. However, there is a price attached to it if confiscated assets belonging to American nationals are involved: the corporation or individual can no longer do business with or enter the United States. This is a legitimate exercise of the territorial principle and not an attempt to regulate the activities abroad of foreign corporations. [For an analysis of the Siberian pipeline controversy, see Castel, *Extraterritoriality in International Trade, Canadian and United States of America Practices Compared* (1988), at 159-68.] A state is free to decide who can enter its territory. In practical terms, the American legislation may affect only a handful of companies or individuals.

In the name of economic self-interest, Canada should support the United States and not Cuba as no customary rules of international law or GATT, GATS, and NAFTA provisions have been infringed by the American legislation.

With respect to foreign expropriations or confiscations of property, Canadian courts have refused to give effect to such expropriations or confiscations in the past unless adequate compensation was paid to the former owners. [See, for instance, *Loane and Baltser* v. *Estonian State Cargo and Passenger Steamship Line*, [1949] S.C.R. 530.]

It is also well established that a state may legitimately impose liability for conduct outside its borders which has effect within its borders. In Canada, a number of federal laws contain provisions intended to have an extraterritorial effect.

It is rumoured that the Canadian government is planning to have recourse to the dispute settlement procedures of chapter 20 of the NAFTA on the ground that the legislation is inconsistent with the international obligations of the United States government. [NAFTA, Art. 2004.] Similar action is contemplated for alleged violation of the GATT/WTO and GATS/WTO obligations. In its defence the United States may wish to rely on the security exceptions found in the NAFTA [Art. 2102.1 b], the GATT/WTO [Art. XXI b], and the GATS/WTO [Art. XIV bis 1 b]. Furthermore, with respect to the exclusion of certain business persons and their families from the United States, Article 1603.1 of the NAFTA, which deals with the grant of temporary entry, makes it clear that these persons must be otherwise qualified for entry *under applicable measures relating to national security.*

In the name of economic self-interest, Canada should support the United States and not Cuba as no customary rules of international law or GATT, GATS, and NAFTA provisions have been infringed by the American legislation. Although this legislation may be considered ill- suited to bring democracy back to Cuba, on a higher moral plane, there is no justification for giving comfort to a totalitarian government that has a long record of serious human rights violations.

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REMAKING CANADA: THE ROLE OF THE PEOPLE

BY DAVID V.J. BELL

As we approach the end of the current millennium, Canadian democracy will face an important challenge: what role (if any) will "ordinary Canadians" have in shaping the future of the country?

Until recently, this question would scarcely have been raised. Canadians' belief in deference was legendary. Students of political culture repeatedly concluded that ordinary Canadians were quite happy to allow tough political decisions to be made by trusted elites. Some celebrated this cultural trait for it permitted "elite accommodation" to function smoothly. Others saw it as a regrettable (but probably permanent) legacy of our non-revolutionary past.

MEECH: THE FIVE-LETTER WORD

Much has changed in the heat of constitutional struggle over Meech Lake and Charlottetown. Meech was a powerful symbol that connoted closed decision making and the absence of consultation. The First Nations made it into a verb — a five-letter political swearword. Native leaders vowed that the spectacle of eleven white men in suits, meeting behind closed doors to decide Canada's constitutional fate, would never be allowed to happen again. Many others agreed.

Indeed, Canadians have catapulted "from deference to defiance," a rite of passage marked dramatically by the defeat of the Charlottetown Agreement, which had been endorsed by all premiers and the federal government. Perhaps for the first time in Canadian history, the elites were soundly rejected, their recommendations deemed unacceptable by a majority of "ordinary Canadians."

If we are to preserve and enhance democracy in the twenty-first century, we will need to pay much more attention to grassroots sentiment and the opinions of ordinary Canadians.

But the result has been a constitutional stalemate. The elites are now reluctant to act. No provincial premier is prepared to undertake a project of constitutional revision. However, "The People" have no mechanism to participate in constitutional review. This despite "The People's Commission" chaired by Keith Spicer and designed to facilitate broad public involvement; despite the Montreal rally which, for many Canadians, symbolized their commitment to renew efforts to transform and thereby rescue Canada; and despite the use of the referendum for constitutional change. The latter mechanism has so limited a focus that it can merely serve as an expression of support or opposition at the end of a much more complex process of constitution drafting which, in the case of Charlottetown, was entirely elite-dominated.

The outcry over the closed nature of the decision-making process has changed nothing. Under the *Constitution Act, 1982*, the provincial premiers still have a hammerlock on constitutional change. They are incapable of acting and are determined not to open up the process.

THE "72 HOURS" PROJECT

The CBC initiative "72 hours to remake Canada" must be evaluated in this context. Under the able chairmanship of Thomas Berger, 24 "Citizens of Canada" were brought together for three days to see if they could reach agreement on principles for a revised constitution for the country.

Three resident expert advisors (Guy Laforest, Kathleen Mahoney, and Peter Russell) and numerous guest politicians and other leaders presented their views to the group of 24. In the end, the group reached a remarkable consensus. They developed a new language to express old but, nonetheless, important principles that define Canada's identity and to articulate the basis for a continued association between Quebec and the rest of Canada.

The CBC project was preceded by an extensive survey that revealed public opinion on the key issues relating to constitutional change. In some respects, the survey findings revealed a mirror image between Quebec and the rest of Canada. There was general agreement that the Federal Government should make "constitutional offers" to Quebec prior to another referendum on sovereignty. Whereas 80 percent of those in Quebec favoured the inclusion of distinct society as part of such an offer, however, this proposal had only 43-percent support in the rest of Canada, and practically no support (9 percent) if it were to involve "special powers" different from those enjoyed by other provinces. Indeed, a plurality of non-Quebecers favour the status quo. But according to the survey, a slight majority (51 percent) of those in the rest of Canada would give Quebec additional powers rather than face the prospect of Quebec independence. Divisions on other matters remained strong and compelling. A plurality of 36 percent of those in Quebec think the present system benefits the other provinces to Quebec's disadvantage. Precisely the reverse view is held by an even larger 45 percent outside of Quebec.

Canada's future will depend as much on our ability to "get it right" with respect to the environment as it will on resolving the Quebec problem, and both issues will require a transformation of Canadian democracy.

One interesting outcome of the 72 hours spent together by these "Ordinary Canadians" is the extent to which they were able to bridge some of these gaps in understanding and perception. Several of them expressed genuine surprise that Quebec's complaints about the federal system were largely shared in other parts of the country, particularly in the West. They eventually concluded that Quebec's concerns were fundamentally focused on identity and recognition as much

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as on demands for substantive or material benefits. And it was on this basis that they were eventually able to reach a consensus about the content of the statement of principles.

Most significant is the personal lesson Thomas Berger drew from his involvement: "They persuaded me that Canada can succeed."

Similarly, they all agreed that the primacy of the First Nations as the original inhabitants of this land must be acknowledged in the opening paragraph of the section on "The Canadian Community." Their statement is not a work of poetry, but it does express in plain and fresh language the possible basis for the reconstruction of our country:

"All Canadians must recognize that Canada has been built on the land of First Nations, that no honourable solution is possible without a commitment to justice for Aboriginal peoples, to the recognition of their inherent right (as political communities pre-dating the coming of the French and English) to govern themselves and to the provision of the means to their economic self-sufficiency.

We believe that Canada is not only a union of provinces and territories, but also a partnership of two founding peoples, two societies, two nations, English-speaking and French-speaking, which have welcomed a multitude of immigrants from every continent who have made Canada their home and we believe Canadians should nurture, indeed celebrate, this diversity.

We believe that Canada should recognize and affirm the fact that Quebecers are predominantly French-speaking people. Quebec is home to a culture unique in North America."

Despite the accomplishment of reaching a consensus on such challenging topics, the entire exercise was trashed by leading members of the "chattering class," including Lysiane Gagnon and Andrew Coyne. Both writers ridiculed the efforts of an inexpert group of "uninformed citizens" who lack any official status. Both defended the unquestioned monopoly of elites on matters of such significance.

If we are to preserve and enhance democracy in the twenty-first century, we will need to pay much more attention to grassroots sentiment and the opinions of ordinary Canadians.

In an eloquent defence of the exercise, Thomas Berger challenged the presumption of superior knowledge (if not omniscience) of journalists like Ms. Gagnon, who had predicted that the sovereigntists were "doomed to defeat in the referendum" in a series of columns written a year before the results were known. He acknowledged that the 24 citizens were not linked to previous positions and commitments. On the other hand, their ability to come to the task "with open minds" was perhaps a precondition to their finding fresh solutions. Most significant is the personal lesson Thomas Berger drew from his involvement: "They persuaded me that Canada can succeed." In this time of gloomy, negative speculation, that alone would be worth the price of admission.

If we are to preserve and enhance democracy in the twenty-first century, we will need to pay much more attention to grassroots sentiment and the opinions of ordinary Canadians. We will need to find ways of drawing on their intelligence, spirit, and commitment to galvanize a sense of mission for our country. We will need to break out of the stranglehold of entrenched political elites who have shrouded constitutional change in past grievances and bitter memories. We will need to find a way for our political elites to become at least as visionary as the general public.

Notably absent from the views of experts or the deliberations of the 25 were environmental issues. Surveys have shown repeatedly that Canadian citizens have an abiding concern for the environment, which they place near the top of their public priorities. Canadian elites continue to ignore this fundamental concern and back away from demonstrating leadership in this vital area. A recent survey shows that environment ranks as the second-highest priority for the general public, but only the twelfth out of 25 priorities identified by the elites. Canada's future will depend as much on our ability to "get it right" with respect to the environment as it will on resolving the Quebec problem, and both issues will require a transformation of Canadian democracy.

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EDITORIAL

WHY OTTAWA WAS RIGHT TO INTERVENE IN THE BERTRAND CASE

BY PATRICK J. MONAHAN

Ottawa's decision to intervene in the constitutional challenge brought by Guy Bertrand aroused a chorus of criticism from both sovereigntists and federalists in Quebec. While Premier Lucien Bouchard's outrage at Ottawa's "provocation" was predictable and almost tiresome, what was surprising was the negative reaction of Quebec federalists such as Daniel Johnson and Jean Charest. Critics of Ottawa's decision argued that any time Ottawa succeeds in uniting Lucien Bouchard, Daniel Johnson, and Jean Charest on the same side of an issue, it must be doing something wrong.

In fact, however, this negative reaction in Quebec to an eminently reasonable decision by the federal government is compelling proof that the intervention was both right and necessary.

THE BERTRAND CASE

To understand why this is so, it is necessary to briefly review precisely what it is that Guy Bertrand is seeking from the Quebec Superior Court.

Bertrand's complaint is that Bill 1 — the Quebec legislation that was the subject of last October's referendum — purported to authorize the Quebec National Assembly to unilaterally proclaim the province's independence from Canada. True, such a unilateral declaration (UDI) could be made only after a "formal offer" of a political and economic partnership had been made to Canada. But there was no requirement that Canada agree to the terms of Quebec's secession from Canada before the UDI could be issued.

Quebec, in short, was claiming that it was not bound by the rules of the Canadian constitution. This prompted Bertrand to seek an injunction prohibiting any future referenda conducted on this footing; Bertrand maintained that any future referendum could be consultative only since secession required a constitutional amendment approved by Parliament and the other provinces.

Quebec's response? In a brief filed in April, Quebec claimed that it was not bound by the Canadian constitution once it obtained majority support for secession in a referendum. Rather, Quebec claimed, principles of international law recognized the province's right to secede unilaterally following a sovereignty referendum.

THE SIGNIFICANCE OF QUEBEC'S POSITION

Had Ottawa chosen to remain silent, it would have been implicitly acknowledging the legitimacy of Quebec's brazen claim. Moreover, it would have been inviting an illegal UDI — and not just from Quebec. Law is not self-executing. Any state that signals that it will not defend its constitution and laws in the face of a UDI can expect to be faced with such illegal declarations before too long. Conversely, the best way to ensure that illegal secessions are never attempted in the first place is to signal clearly and convincingly that a UDI will be steadfastly resisted with all the resources at the state's disposal.

So the Quebec's government's brief in the Bertrand case marked a key turning point in the sovereignty debate. Ottawa had an important choice to make. If, in fact, it is willing to tolerate a province unilaterally seceding contrary to the Canadian constitution, then all it had to do was sit tight and await the inevitable. If, on the other hand, Ottawa believes that the constitution and the rule of law means something and that a UDI should not be tolerated, now was the time to speak up.

The fact that it was Ottawa's reasonable response, rather than the Quebec government's brazen position, that was seen within Quebec circles as the "provocation" confirmed the necessity and importance of Ottawa's intervention. Evidently it was news in Quebec that secession required the prior agreement of the federal government and the provinces. What would have been surprising — not to say irresponsible — would have been if Ottawa had failed to insist on this position. There is no state anywhere in the world today that authorizes sub-national governments to unilaterally secede without first coming to an agreement on terms with the national government.

QUEBEC AS A RENEGADE REGIME?

There was a second significant feature of the Quebec government's argument in the Bertrand case. While Quebec was claiming that it was not bound by the Canadian constitution, it insisted that unilateral secession was authorized by principles of international law.

In short, Quebec insists that a UDI is perfectly legal — just that the applicable rules are international rather than Canadian.

Here is an opening that Ottawa must not fail to exploit. Every international law scholar who has examined this question — including a panel of five international law experts headed by French scholar Alain Pellat that reported to the Quebec National Assembly in 1992 — have concluded that Quebec is wrong. International law does not recognize Quebec's right to secede from Canada.

There is no doubt that a Quebec UDI would be illegal under Canadian law. (Quebec has, in effect, acknowledged as much by arguing that Canadian law is irrelevant and can be ignored.) But what if Ottawa can demonstrate convincingly that international law also stands against Quebec's unilateral secession?

Lucien Bouchard would then be faced with two options: either he would be forced to abide by the rules of international law and acknowledge that Quebec must come to an agreement with Ottawa prior to secession, or he could simply thumb his nose at international law as well and announce that, as Quebec's supreme ruler, he need not abide by any law other than his own.

Bouchard doesn't want to be faced with that choice since, for him, it is a lose-lose proposition — which is precisely why Ottawa should insist that he be put to that choice well in advance of the next referendum. (I will explore the best way to achieve this objective in a forthcoming *CW* column.)

IS LAW IRRELEVANT?

What of those who claim that law and legalities are irrelevant to this debate and that, for this reason, the Bertrand litigation is an amusing but

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irrelevant sideshow?

If Canada were an anarchic society ruled by guns and force of arms, then law and legality would, indeed, be irrelevant to this debate. But Canada is an advanced liberal-democratic state where law and the rule of law matter. The rule of law also matters to the other G7 countries whose decision on whether to recognize a Quebec state following independence would be of critical importance.

This is not to suggest that law will determine political outcomes. But law is far from irrelevant to those outcomes — as the Quebec government's insistence that its position is consistent with international law unwittingly demonstrates. This is why Ottawa did the right thing by intervening in the Bertrand case. Here's hoping that the federal government has the fortitude to stay the course despite the heavy criticism that it will face on this issue from its friends as well as its foes in the months ahead.

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WHY QUEBEC IS AFRAID OF A NAFTA-TYPE ARRANGEMENT WITH CANADA

BY ALAN M. RUGMAN

With the prospect of another Quebec referendum, it is time for a realistic analysis of how a separate Quebec would conduct its economic relationship with Canada. In the October 1995 referendum, the Quebec separatists argued an ambiguous position concerning future trade relationships with Canada.

A separate Quebec would like to continue the current customs union with Canada and also enter the North American Free Trade Agreement (NAFTA). This, indeed, would be the best of both worlds from the separatist perspective, but neither is likely to occur.

The reason lies in the complex institutional fabric of the NAFTA, a free trade treaty between three very different countries of Canada, the United States, and Mexico. If Quebec is to be a separate country, it will have to be treated like Mexico from the viewpoint of the rest of Canada. This will break up the existing customs union and create great economic hardship in Quebec.

FREE TRADE VS. CUSTOMS UNION

To see this requires that we understand the distinction between a free trade agreement (like the NAFTA) and a customs union or common market (like the current Canadian federation). In a free trade area there is tariff-free movement of goods and services, national treatment for foreign investment and little else. In contrast, a customs union provides for much deeper economic integration, especially with the free movement of people and capital.

As a result, a customs union requires some form of political integration, as has occurred in the European Common Market (now the European Union). But as Quebec wants independence from Canada, a sovereign Quebec cannot realistically expect to partake in such a deep customs union or common market with Canada.

An alternative to the customs union demanded by the PQ would be to extend a NAFTA-type arrangement to Quebec. Then Quebec would essentially be like Mexico — a trading partner of Canada but one at a respectable political distance.

Although Quebec wants to use the Canadian dollar and continue with free trade, there is no economic reason for Canada to extend these preferences to an independent Quebec. Instead, Canada should opt for a NAFTA-type arrangement with Quebec.

The potential trade and investment linkages between a sovereign Quebec and the rest of Canada require more careful consideration than was given during the referendum campaign. The Parti Québécois (PQ) position is to request a continuation of the current customs union, with free trade in goods and services, labour mobility, a common currency, and a sharing (with the percentage amount disputed) of the interest on Canada's national debt. Each of these items needs to be considered separately. By unbundling the PQ package of economic demands, Canada can gain considerable negotiating leverage.

An alternative to the customs union demanded by the PQ would be to extend a NAFTA-type arrangement to Quebec. Then Quebec would essentially be like Mexico — a trading partner of Canada but one at a respectable political distance. For example, if Quebec has a NAFTA-type arrangement with the rest of Canada, there would no longer be free trade in goods and services and national treatment for investment. However, as in the NAFTA, there would be many sectoral exceptions from free trade and also many reservations from the national treatment principle. Let us consider these issues in turn.

CONSEQUENCES OF A FREE TRADE ARRANGEMENT WITH QUEBEC

First, a free trade arrangement would not give Quebec full and secure access to either the Canadian or the American market. Canada would be able to use rules of origin (as does the United States against Mexico) to keep out many manufactured goods, including automobiles. Canada would have the legal right to start using countervailing duties (CVD) and anti-dumping (AD) actions against subsidized and dumped Quebec exports to Canada. Given the large role of the state in the Quebec economy, there would be a great deal of business for CVD and AD trade lawyers in Toronto and Vancouver. Quebec could, of course, reciprocate with its own CVD and AD actions against Canada but, be-

ing only one-quarter of the size of Canada, thist would be as feeble a weapon as Canada's use of CVD and AD in a trade war with the much larger United States.

There are many other NAFTA-based trade and investment measures that can be used by Canadian business to deny Quebec competitors full and free access to the Canadian market. This is why the PQ keeps demanding the continuation of the current customs union rather than risk the lower market access accorded by a NAFTA-type arrangement.

Second, while the NAFTA does extend national treatment for investment, and the right of establishment, it only extends this privilege to selected sectors. For example, under the current terms of the NAFTA, the exempted service sectors include culture, health, social services, education, and transportation. In each of these areas, Canada would be legally entitled to introduce discriminatory measures against Quebec in order to deny citizens of Quebec access to these services in Canada and deny them the right to do business in Canada. (Quebec could, of course, deny Canada access to its business area as well, but the one-quarter-the-size deterrent holds again.)

There is, in fact, more of a rationale for creating two parallel systems in these same areas, since the Province of Quebec has already assumed jurisdiction over the delivery of health, social services, and education, and there is no reason for Canada to carry on any obligation in financing these sectors. However, in transportation, there will be major adjustment costs as airlines, railways, most truck firms, and related entities all relocate to Canada as the larger home market base. Quebec would then have to build its own systems.

In the same way, beer is exempted from the national treatment provisions of the NAFTA, and the two major brewers would have to treat Quebec as a foreign market and separate their production across the two jurisdictions. Here, also, AD actions could be used by Canada to keep out Quebec beer and other alcoholic beverages, as can the United States under the NAFTA.

Obviously, the PQ has fudged the fact that all Quebec citizens would be foreigners in the rest of Canada, and that Canada would literally have to pass new laws to even permit immigration of such foreigners, who have limited rights of entry under the NAFTA.

Third, Quebec agriculture would be largely excluded from the free access to the rest of Canada it currently enjoys in the existing customs union. Under the terms of the NAFTA, Quebec would not only lose subsidies from Ottawa (calculated at about one-million dollars for the Quebec dairy sector) but, if the new government of Quebec replaces such subsidies with its own, the exports of such subsidized products to the rest of Canada could be met with CVD actions. This would serve to deny Quebec's agricultural sector the open access to the Canadian market it currently enjoys. (In turn, any potential Quebec CVDS against Canadian exports would have a minor effect since the American market is much more important to Canada.)

Fourth, while a NAFTA-type arrangement would allow a limited number of Quebec business professionals to secure "temporary entry" to do business in the rest of Canada (in return for access of Canadian professionals to Quebec), there would be no labour mobility as currently exists in the Canadian customs union. Therefore, people wishing to leave Montreal and work elsewhere in Canada would need the equivalent of the American "green card" to be able to do so. The rest of Canada would probably have to introduce a range of classifications (or quotas) for different groups, for example, giving the highest preference to native peoples who would retain rights of entry under previous treaties, but therefore a lower quota for Montreal anglophones.

This would be a very difficult arrangement, but it is how the NAFTA operates. Obviously, the PQ has fudged the fact that all Quebec citizens would be foreigners in the rest of Canada, and that Canada would literally have to pass new laws to even permit immigration of such foreigners, who have limited rights of entry under the NAFTA.

COSTS OF SEPARATION

The conclusion of this very simple investigation of how an independent Quebec and the rest of Canada would conduct a NAFTA-type arrangement is that there would be immense economic costs to Quebec's separation. The P.Q. wish to disguise these costs by assuming that the rest of Canada can be blackmailed into a continuation of the current customs union. But a NAFTA-type arrangement would not be a customs union. It would involve much less market access for Quebec to Canada. Such an arrangement would introduce many new trade and investment weapons to be used by Canadians against a foreign country.

It is obvious from this analysis that both Quebec and Canada are far better-off continuing as one country than as two. But if Quebec does separate, then Canadians should begin to think of it as another Mexico. Under the NAFTA, Canada does business with Mexicans, but Mexicans are not Canadians. Quebec can be an independent political entity like Mexico if it votes that way, but don't expect the rest of Canada to treat a new Quebec nation any differently than it treats Mexico.

A new focus on what the NAFTA actually means for Quebec would be a refreshing change to the P.Q. propaganda about continuing the customs union. We need to replace the long silence in Ottawa about the true economic costs of Quebec's separation from Canada with some level-headed analysis of what the NAFTA really means for Quebec.

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DE-FUNDING THE WELFARE STATE

BY NEIL BROOKS

Over the past fifteen years, business interests and conservative governments around the world have launched intense and sustained ideological and political assaults on big government. Yet modern welfare states have proved surprisingly resilient to such attacks. Although there are other explanations for the durability of social programs, one significant barrier to retrenchment has been the apparent fact that many citizens value the economic security, social equality, and community cohesion that government programs provide.

Perhaps frustrated by efforts to convince citizens of the evils of big government, the Ontario Conservative Government has now launched an unprecedented effort at systemic retrenchment. It plans to simply de-fund the welfare state. Even though billions of dollars of spending cuts will be required just to balance the provincial budget, and another $2.2 billion to offset reduced federal government transfers, the Ontario Government has promised a $5-billion tax cut.

The arguments the government has made in support of tax cuts are patent nonsense.

The Dominion Bond Rating Service has estimated that, with the provincial tax cut, the Ontario Government will have to reduce spending by almost $10 billion in order to achieve a balanced budget in 2000-01. If health care costs are excluded (and the Government has committed to maintain health care costs at their present levels), this is equivalent to a cut of about one-third across all other spending areas. This reduction in government-provided services is unprecedented.

Instead of debating the merits of the additional reduction in government services — and the moral, social, and economic consequences of a dramatic shift from the public to the private ordering processes for allocating services essential to human development — the Conservatives have proceeded with their effort to de-fund the welfare state by preaching the virtues of a tax cut. The arguments the government has made in support of tax cuts are patent nonsense. Nevertheless, since they were put forward — it would appear with a straight face — by a couple of commentators in the last issue of *Canada Watch*, it seems worthwhile reviewing briefly why they are either misleading, conceptually incoherent, without empirical support, or morally reprehensible.

MISLEADING ARGUMENTS

Ontarians are overtaxed.

The claim in support of the tax cuts is frequently phrased in terms of Ontarians having hit the tax wall. Taxes are the price that citizens pay for public goods and services. Therefore, as with prices for private goods and services, the only sensible question to ask about taxes is whether people are getting good value for their money. Nevertheless, in determining whether taxes are "too high," comparisons are commonly made with other jurisdictions. By this standard, in spite of the misleading impression given in the popular press, Canada is a low-tax country. In 1993, total revenues collected in Canada amounted to 35.6% of gross domestic product (GDP). This was more than 2 percent below the average for industrialized countries (38.7%), and almost 5 percent less than that for the European Community countries (40.5%). Indeed, if Canadian governments had only been collecting the same amount of tax revenue as the average European country from 1975 to 1993, all levels of government in Canada would have large surpluses, instead of a debt.

Taxes have been increasing faster in Ontario than in other jurisdictions.

The Ontario Government made this assertion in its 1995 Fiscal and Economic Statement. However, whether taxes in Ontario or Canada have been increasing faster than in other jurisdictions depends upon over what period the increase is measured. For example, between 1979 and 1993 taxes in Canada as a percentage of the GDP increased almost 5 percent, while in the average industrialized country the increase was only 4.4 percent. However, what makes this comparison misleading is that, because of the large tax reductions in the late 1970s by the federal liberal government (which started the debt ball rolling), taxes were lower in Canada in 1979 than at any time over the previous 25 years.

If another baseline is chosen, say 1974, then taxes in Canada increased by only 2.3 percent to 1993, almost the smallest increase among industrialized countries (in the average industrialized country they increased by 6.8 percent over this period). Moreover, the OECD has estimated that taxes in Canada in 1994 were only 32.1% of GDP, 1.2 percent less than they were in 1974; no evidence here that Ontarians are overtaxed.

In 1993, taxes paid in Ontario, as a percentage of the provincial GDP, were 0.7 percent above the average of all provinces and territories. Taxes paid in Ontario have always been slightly higher than the national average as a percentage of the provincial GDP, but this was the narrowest margin in the previous 30 years. Moreover, taxes collected by provincial governments alone as a percentage of provincial GDP have always been below the national average in Ontario. Indeed, in 1993, taxes levied by the provincial government in Ontario were 1.5 percent below the national average, lower in relative terms than they had been in 35 years.

By comparison to the United States, taxes are high in Ontario and Canada.

By international standards, the United States is a low-tax country. In most years, taxes collected by governments there amount to only about 30% of the GDP. But this comparison is misleading because a much larger percentage of health and education costs are paid for in the form of prices in the United States than in Canada. If the additional amounts that Americans pay for these services in the form of prices are added to their taxes, then Americans actually pay more than Canadians for what might be described as public goods. And the fact that Americans pay about 4 percent more of their GDP for health care than do Canadians suggests not only that they cannot distribute these services more equitably through the private sector, but that they cannot do it nearly as efficiently as the Canadian public sector.

INCOHERENT ARGUMENTS

The present level of taxes cannot be afforded.

This common refrain used to justify tax cuts is conceptually incoherent. Most public goods provided by government and financed by taxes, such as health and education services, are necessities. Therefore, reducing the government supply

of these services will not mean that people are no longer paying for them; it will simply mean that instead of paying for them through taxes and having them provided by the public sector, they will be paying for them in the form of prices and have them provided through the private sector.

Similarly, when the government says that we cannot afford public child and elderly care services, presumably they are not saying that we can no longer afford to look after our children or the elderly. What they must mean is that, instead of spreading the cost of these services equitably through the tax system across the entire population, we should leave them to be borne by women who, by and large, provide these services unpaid in their own homes. Thus this misconceptualization of the reasons for not providing these services through the public sector obscures a rather vicious moral judgement.

Reducing taxes will increase personal choice.

The Conservatives frequently justify their proposed tax cut by arguing that allowing people to keep more of their earned income will increase their personal choice and freedom. The most fundamental flaw underlying this argument is that it assumes people only have preferences as individual consumers of private goods and services. But people have preferences not only as consumers but also as citizens — preferences about the kind of society they want to live in. Many people do not want to live in cities, for example, that force vulnerable people to sleep on the streets and beg, or that are polluted and congested with cars, devoid of libraries and other public facilities, or in which they are unable to walk the streets at night because of the fear of crime. As citizens, people also have preferences about engaging in democratic deliberation, reducing their dependency on the marketplace, families, and charity, and enriching the density and quality of the network of human relations in society. The only way they can pursue these preferences is collectively through governments by paying taxes. The Conservatives' notion about what choices are important to people reflects an utterly impoverished view of what it means to be a human being.

Moreover, in another obvious way, taxes in fact greatly increase the amount of freedom in a society. In a market economy, to have money is to have freedom. Canadian governments transfer over 60 percent of the taxes they receive to families in need in the form of pensions, child credits, social assistance, compensation for work-related injuries, and so on. Thus, while it might be said that taxes restrict the freedom of those who pay them, they greatly enlarge the freedom of those who receive the consequent transfer payment — undoubtedly with a huge net overall increase in liberty.

Taxes are an unjustified interference with private property.

Conservatives sometimes talk about tax cuts as if their effect would be to allow citizens to keep more of the earnings to which they have a moral claim, since they earned them in the marketplace. They seem to suggest that the distribution of income that results from the application of the rules of contract and property law should be treated as presumptively just. Yet the rules which regulate the marketplace are every bit as politically and socially constructed as tax rules. Therefore, it is difficult to discern why their distributive consequences should be treated as entitlements.

FACTUALLY INCORRECT ARGUMENTS

Tax cuts are necessary to create jobs.

Whenever questioned about their tax cut, the Conservatives routinely repeat their mantra about it being necessary in order to create jobs. They have even claimed that by the fifth year, the cut will have created 780,000 jobs, although no one knows the origin of this number and they admit there are no studies to support it.

Tax cuts of almost any size are dwarfed by the economy's massive and continually changing face-lifts.

The argument that tax cuts will create jobs is straightforward Keynesian economics. If taxes are cut, people will have more disposable income. With more disposable income, people will buy more and that, in turn, will put people to work producing, distributing, and selling goods and services. And since more people will be at work and earning more, there will be a multiplier effect as they, in turn, use their own income to purchase even more goods and services.

Even in their traditional Keynesian form, most tax cuts have been found wanting as policy instruments to create jobs. First, the amount of stimulus required to give a large economy like Ontario's a boost is enormous. Even if the government cuts taxes by $4 to $5 billion, by 1998 personal income in Ontario is likely to be $300 billion. The tax cut would thus increase disposable income by only about 1.5%. While not insignificant, this increase is substantially less than the normal rate of increase in personal income due simply to economic growth. Moreover, the stock market can rise or fall by this amount within a day and, over longer periods of time, the real estate market can affects people's wealth even more dramatically. Tax cuts of almost any size are dwarfed by the economy's massive and continually changing face-lifts.

Second, particularly in these relatively insecure economic times, it is not clear that most of the tax cut would in fact be spent. Much is likely to be saved or used to pay down debts. To the extent that the tax cut is saved, it cannot have the effect of creating demand for goods and services and, therefore, jobs.

Third, most economists are sceptical of the ability of provincial governments to pursue macroeconomic policy to create consumer demand in their economies. There are two reasons for this scepticism. One is that provincial economies are so open to trade and investment that much of the increased disposable income will be spent on goods and services produced outside the province. That is, in economic terms, there are too many leakages making it unlikely that increased disposable income will increase demand in the province. The second reason for scepticism is that provinces have no control over monetary policy. Thus, to the extent that the tax cut works to stimulate the economy, the federal government might simply negate it through tight monetary policy.

Fourth, if the government truly believed a tax cut could increase disposable income and therefore jobs, the income tax would be the last tax to cut. Most economists agree that, if you want to increase spending activity, you should cut taxes that fall on low- and middle-income families (whc

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consume most of their income), and preferably taxes that are tied to people's actual spending behaviour. Thus reductions in sales taxes would be much more effective at stimulating the provincial economy than cuts in income taxes.

No one believes [the trickle-down] argument, and the only people who assert it are the rich and their political allies.

But all of this standard economic analysis is irrelevant to the Ontario tax cut because it is not, nor was it intended to be, a countercyclical stimulus. This is because the government is cutting taxes at the same time as it is cutting expenditures. Thus, while the tax cut might result in the creation of some jobs, the reduction in government expenditures will result in a loss of jobs. If tax cuts had the same impact on employment in the economy as expenditure cuts, the net effect would be a wash. Disposable income would go up because of the tax cuts, but would go down because of the expenditure cuts. However, it will not be a wash. The evidence is that, for example, a $1 billion tax cut would create considerably fewer jobs than would be lost by a $1 billion government expenditure cut. This only makes sense since expenditure cuts result directly in the loss of jobs. Some economists even predict that equivalent expenditure cuts would result in the loss of 3 to 4 times as many jobs as tax cuts would create.

Tax cuts are necessary to encourage economic growth.

The other distinct economic argument the government has made for the tax cut is that it is necessary in order to ensure long-term economic growth. They have suggested that high taxes, particularly those on the rich, have dangerously diminished their desire to work, fatally discouraged their incentive to save, and impaired new sources of investment. This is the familiar trickle-down or supply-side theory of economics.

No one believes this argument, and the only people who assert it are the rich and their political allies. Countless studies have been done on the effect of taxes on labour supply and saving behaviour but, in spite of economists' desire to find such an effect, no significant effect has been found.

In its 1995 Fiscal and Economic Statement, the Conservative Government stated, "When tax levels are high, a tax reduction can permanently increase the growth rate of GDP by changing investment incentives" (at 88). They "proved" this claim with the aid of a graph on which they had plotted taxation and economic growth rates in a number of industrialized countries, and which purported to show that lower taxes lead to higher rates of economic growth. This graph was at first a bit of a mystery to me because most studies find just the opposite, namely, that countries with high taxes have tended to have higher rates of economic growth. Two aspects of the graph are misleading. One is that it included Japan, which indeed is a low-tax country with a high rate of economic growth. Most analysts, however, exclude Japan when they do such cross-national studies, since it is not only an outlier on the graph, but its economy is also very different than that of most other countries. In particular, many of the elements of economic security — such as a degree of employment security — that are provided in other countries by governments, have been provided in Japan by large corporations. In fact, when you take Japan off the government's graph, the opposite result — showing a correlation between higher taxes and higher rates of economic growth — is reached.

A second misleading aspect of the graph is that the drafters used the average rate of taxation from 1960 to 1990 and compared that to the average rate of economic growth in the listed countries. Yet over that 30-year period taxes and growth rates varied dramatically in many countries. It would make more sense to examine the increase in taxes over, say, a ten-year period, and compare that with economic growth over the next ten-year period. When you do that, for almost any period, you discover a correlation between high taxes and economic growth.

If the Conservatives were really interested in long-term economic growth, they would be investing in exactly what they are tearing down, infrastructure and human capital, poor children in particular.

MORALLY REPREHENSIBLE ARGUMENTS

Tax cuts are necessary to revitalize civil society.

The Conservatives have suggested that cutting back taxes and reducing government services would revitalize family life and the voluntary sector, and that these institutions would provide the services now provided for by government and paid for by taxes. This is a morally reprehensible argument. Suggesting that the vulnerable should rely more upon their family members for assistance even appears inconsistent with the most basic premise of traditional conservative philosophy, namely, that people ought to be responsible for their own actions. It is one thing to say that parents should assume more responsibility for their children, but surely the moral case for victimizing their children if they do not is less clear.

The voluntary sector is equally inadequate to provide for those who have been harmed by the dynamism of the market economy: it invariably satisfies only particularized impulses, it is unaccountable to its beneficiaries, it is unprofessional, and it is woefully incapable of filling the gaps left by government programs.

We all benefit from the operation of a free market economy. Since we all benefit from the system, we have a moral obligation to compensate those who necessarily sustain losses, such as those who lose their jobs and are unable to find work because of the inevitable workings of a dynamic market economy. This moral obligation cannot be satisfied by insisting that vulnerable citizens should have to rely upon their families or other people's altruism.

The arguments that the Conservatives have made to justify their 30-percent tax cut are so patently absurd that their real agenda must be apparent to everyone: to shift power from ordinary Ontarians, where it can been exercised through democratically controlled public institutions, to wealthy business people where it will be exercised exclusively through private markets.

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