

# THE GATT AND RESTRICTIONS ON FOREIGN INVESTMENT: THE UNITED STATES CHALLENGE TO CANADA'S FOREIGN INVESTMENT LAW

Robert K. Paterson\*

## INTRODUCTION

On January 7, 1982 the United States notified<sup>1</sup> the General Agreement on Tariffs and Trade (the GATT)<sup>2</sup> that it had requested consultation with Canada regarding measures taken under Canada's Foreign Investment Review Act (the Law).<sup>3</sup> The United States stated that it was particularly concerned with legally binding agreements between Canada's Foreign Investment Review Agency (FIRA) and foreign investors. The agreements aim to ensure the purchase of Canadian goods over imports.<sup>4</sup> The United States claimed that those agreements violate Canada's obligations under Article III of the GATT, which sets a non-discrimination standard for imports.<sup>5</sup>

The formal request for consultation was brought before the contracting parties.<sup>6</sup> Consultations, nonetheless, were fruitless, and on March 31, 1982 the GATT Council agreed to the United States' request to establish a panel<sup>7</sup> to examine the agreements.<sup>8</sup>

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\* Associate Professor of Law, University of British Columbia. Research for this paper was supported by a grant from the Donner Canadian Foundation.

1. The notification was pursuant to Art. XXII(1) of the General Agreement which provides for individual consultation between Contracting Parties on any matter affecting the operation of the Agreement. For a discussion of the GATT dispute settlement procedures under Art. XXII, see J.H. JACKSON, *WORLD TRADE AND THE LAW OF GATT*, 177-78 (1969) [hereinafter cited as Jackson].

2. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. (5), (6), T.I.A.S. No. 1700, 55 U.N.T.S. 194 (1948).

3. CAN. REV. STAT. c-46 (1973).

4. Some of the following information was obtained from confidential sources at the GATT in Geneva and at the Canadian Dept. of External Affairs.

5. See JACKSON, *supra* note 1, at 272-303, and K.W. DAM, *THE GATT, LAW AND INTERNATIONAL ECONOMIC ORGANIZATION* 115-31 (1970).

6. See JACKSON, *supra* note 1, at 175.

7. Art. XXIII of the Law provides for the establishment of a panel.

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In its request to the GATT, the United States suggested that the panel examine both Canadian content and export requirements. Canada agreed to the establishment of an examining panel, subject to the finalization of its terms of review. These terms are now finalized, though not disclosed, and the panel has begun hearings in Geneva.

Resort to the GATT manifests growing United States concern over Canadian foreign direct investment regulation. United States uneasiness has led to a low point in relations between the two countries.<sup>9</sup> This Comment will explore resolution of the dispute under GATT auspices. The dispute context should be interesting to students of international economic law. It is a rare but necessary attempt to explore the relationship of the General Agreement on Tariffs and Trade to restrictions on foreign investment. This Comment will also show how the dispute highlights weaknesses in the procedural mechanisms available to solve a dispute.<sup>10</sup>

## I. THE FOREIGN INVESTMENT REVIEW ACT

Although the foundation of the Law has been explored elsewhere, it remains necessary to provide some background information.<sup>11</sup> The Law establishes FIRA as an arm of the Canadian

8. JACKSON, *supra* note 1, at 176. See also Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance, 26 GATT, Basic Instruments and Selected Documents 210 (1980) (B.I.S.D.). Neither the constitution of the panel nor its membership has as yet been announced.

9. There has been one prior instance of the establishment of a GATT panel at the request of the U.S. in an attempt to resolve a trade dispute between Canada and the United States (though there have been several actions initiated by Canada). See Exports of potatoes to Canada, GATT Doc. L/1927, Basic Instruments and Selected Documents 88, 11th Supp. (1963).

10. See Goldberg & Kindleberger, *Toward a GATT for Investment: A Proposal for Supervision of the International Cooperation*, 2 LAW & POL. INT'L BUS. 295 (1970). See also D. WALLACE JR., INTERNATIONAL REGULATION OF MULTINATIONAL CORPORATIONS (1976) and INTERNATIONAL CONTROL OF INVESTMENT (1974).

11. For background of the law, see Cranston, *Foreign Investment Restrictions: Defending Economic Sovereignty in Canada and Australia*, 14 HARV. INT'L L.J. 345 (1973); Franck & Gudgeon, *Canada's Foreign Investment Control Experiment: The Law, the Context and the Practice*, 50 N.Y.U. L. REV. 74 (1975); McMillan, *After the Gray Report: The Tortuous Evolution of Foreign Investment Policy*, 20 McGill L.J. 213 (1974); Freeman, *Canada's changing posture toward multinational corporations: an attempt to harmonize nationalism with continued industrial growth*, 7 N.Y.U. J. INT'L L. & POL. 271 (1974); Espinosa, *The Canadian Foreign Investment Review Act: Red, White and Gray*, 5 LAW & POL. INT'L BUS. 1018 (1973); Lamont, *Emerging Neo-Mercantilism in Canadian Policy Toward State Enterprises and Foreign Direct Investment*, 8 VAND. J. TRANSNAT'L L. 121 (1974); Grover, *Canada's Foreign Investment Review Act*, 29 BUS. LAW. 805 (1974); Gualtieri, *Canada's Foreign Investment Policy*, 10 TEX. INT'L L.J. 46 (1975); Spence, *The Foreign Investment Review Act of Canada*, 4 SYRACUSE J. INT'L L. COMM. 303 (1976-77). For the most recent comprehensive discussion, see R.A. DONALDSON, FOREIGN INVESTMENT REVIEW AND CANADIANIZATION,

government with the authority to screen foreign investors' proposals to acquire an interest in or establish businesses in Canada.<sup>12</sup> The primary FIRA responsibilities are administrative. The agency gathers information concerning foreign investment, assesses investment proposals, and counsels investors on which proposals are most likely to be approved. Approval rests with the federal Cabinet.<sup>13</sup> American investors often criticize this division of responsibilities between the FIRA and the Cabinet claiming, with some justification, that it leads to uncertainty and, in practice, insulates decisions from judicial review.<sup>14</sup> The cabinet's tendency not to disclose reasons for rejection reinforces their claim.

The Law<sup>15</sup> answers the Canadian concern of the late 1960s and early 1970s that focused on the high level of foreign ownership and control of the Canadian economy and the lack of a comprehensive regulatory mechanism.<sup>16</sup> The same concern arose in other countries,<sup>17</sup> but was heightened in Canada because of physical proximity to the United States and a related sense of cultural asphyxiation.

The Law establishes the standards that a proposed investment must meet before the Cabinet will grant approval. These

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CORPORATE LAW IN THE 80's, SPECIAL LECTURES OF THE LAW SOCIETY OF UPPER CANADA 461 (1982).

12. *The Law*, *supra* note 3, §§ 5, 6 and 7.

13. *The Law*, *supra* note 3, § 12.

14. See Molot, *Administrative Discretion and Current Judicial Activism*, 11 OTTAWA L. REV. 337; Re Gloucester Properties Ltd. and the Queen in Right of British Columbia 123 D.L.R.3d 33 (1981) (B.C.C.A.).

15. The Law resulted from a series of reports received by the Canadian government during the 1950's and 1960's. The final report, the Gray Report, provided policy foundation for the present legislation. See Final Report of the Royal Commission on Canada's Economic Prospects (1958) (the Gordon Commission); Report on Foreign Ownership and the Structure of Canadian Industry (1968) (the Watkins Report); Report of the House of Commons' Standing Committee on External Affairs and National Defense (1970) (the Wahn Report); Foreign Direct Investment in Canada (1972) (the Gray Report); see also Rugman, *The Foreign Ownership Debate in Canada* 10 J. WORLD TRADE L. 171 (1976); Espinosa, *The Canadian Foreign Investment Review Act: Red, White and Gray*, 5 LAW & POL'Y INT'L BUS. 1018 (1973).

The author of the Gray report, Herb Gray, became the Minister of Industry, Trade and Commerce with logical responsibility for the administration of the Law. (The Federal Cabinet (the Governor in Council) designated the Minister in accordance with *the Law*, *supra* note 3, § 3(1).)

Last year Mr. Gray succeeded Edward Lumley, a less staunch economic nationalist than Mr. Gray and more likely to appeal to United States' business and governmental leaders.

16. See Hudec, *Possible Trade Policy Consequences of the Canadian Foreign Investment Policy*, 6 CASE W. RES. J. INT'L L. 74 (1973); A.F. LOWENFELD, INTERNATIONAL PRIVATE INVESTMENT, 13-19 (2d ed. 1982) [hereinafter cited as LOWENFELD].

17. The concern arose in countries such as France and Australia. The aims of regulation in these high investment countries should be clearly distinguished from those of a country such as Japan whose regulatory aims are to minimize the expansion of an already low and highly controlled base of foreign investment.

standards are encapsulated in the requirement that the investment must be of "significant benefit to Canada".<sup>18</sup> Applicants have the onus of establishing "significant benefit," though the Law does not explain how this can or should be done.<sup>19</sup> Investors may engage in undertakings that involve any of the following five criteria: (1) the production of export goods, (2) the location of research and development in Canada, (3) the processing of raw materials in Canada, (4) the hiring of Canadian managers and directors, and (5) the purchasing of Canadian goods and services. Regulations passed under the Law require applicants to file background information concerning proposed investments.<sup>20</sup> In addition, the Law requires that the minister assess all information provided by applicants, co-venturers, and provinces materially affected by an investment.<sup>21</sup> Although the information the applicant provides is important, the minister, in making a recommendation to the Cabinet, must consider the proposal in light of all five criteria.<sup>22</sup> Applicants are free to make public all or part of their proposals at any time. However, because all Cabinet discussions are confidential, the Cabinet does not disclose reasons for rejection.<sup>23</sup> This

18. The criteria follows:

*Factors to be taken into account in assessment.* In assessing for purposes of this act, whether any acquisition of control of a Canadian business enterprise or the establishment of any new business in Canada is or is likely to be of significant benefit to Canada, the factors to be taken into account are as follows:

- (a) The effect of the acquisition or establishment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada, and on exports from Canada;
- (b) the degree and significance of participation by Canadians in the business enterprise or new business and in any industry or industries in Canada of which the business enterprise or new business forms or would form a part;
- (c) the effect of the acquisition or establishment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- (d) The effect of the acquisition or establishment on competition within any industry or industries in Canada; and
- (e) the compatibility of the acquisition or establishment with national industrial and economic policies, taking into consideration industrial and economic policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the acquisition or establishment.

*The Law*, supra note 3, § 2(2). See also LOWENFELD, supra note 16, at 57-60.

19. See *the Law*, supra note 3, § 9; Franck & Gudgeon, supra note 11, at 125.

20. Foreign Investment Review Regulations, Can. Gaz. ch. 892 (1978) (as amended). Larger and more complex cases than small business proposals require larger and more detailed information.

21. *The Law*, supra note 3, § 9. In the case of parties to an investment proposal any written undertakings that are provided must also be reviewed by the minister.

22. See supra note 16.

23. Sometimes, after discussions between the FIRA and the applicant, an invest-

practice has attracted criticism from United States investors who claim that the process is vague, unpredictable, and secretive.<sup>24</sup> In particular, the review process does not provide a clear basis for legal challenge of a disallowed proposal, and this was a source of much frustration to American lawyers.<sup>25</sup>

Not all "significant benefit" criteria are equally important to each investment class.<sup>26</sup> Some Canadian industrial sectors appear more likely to meet requirements than others. The likelihood of meeting requirements in turn changes as government policy changes. For example, while investments in Canada's energy resource industry have had favorable treatment in the past, this trend may be modified in the light of the new National Energy Policy.<sup>27</sup> In most cases, however, the significance of specific criteria will accord with the nature of the investment. For instance, while employment opportunities for Canadians will usually be a significant factor for a construction investment, employment opportunities will be less important in financial and real estate investments. Moreover, those investments in already highly regulated industrial sectors, such as transportation, communications, utilities, and finance, appear to require less "benefit to Canada" than those in less regulated fields like manufacturing, primary resources, and real estate.

Pursuant to section 2(2)(e) of the Law, the Cabinet must consider the compatibility of the proposed investment with provincial industrial and economic policy. The provinces hold varying degrees of enthusiasm for the Law. British Columbia, for example,

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ment proposal may undergo modification, which in turn, increases its chances of success.

24. For references to examples of this criticism, see HAYDEN, BURNS & FOX, *FOREIGN INVESTMENT IN CANADA*, ¶¶ 75:1-92:1 (1974) [hereinafter cited as HAYDEN BURNS].

25. See R. SCHULTZ, G. SWEDLOVE & K. SWINTON, *THE CABINET AS A REGULATORY BODY: THE CASE OF THE FOREIGN INVESTMENT REVIEW ACT*, WORKING PAPER NO. 6, ECONOMIC COUNCIL OF CANADA 147-159 (1980). An applicant can, of course, submit a second revised proposal.

26. As the FIRA's 1977-78 annual report explains:

. . . the mix of benefits offered varies from case to case depending on the circumstances and capabilities of the investor, and the particular characteristics of the sector in which the proposal is made. Every application cannot be expected to provide benefits under each of the criteria.

See ANNUAL REPORT, *FOREIGN INVESTMENT REVIEW ACT 12 1977-78*. In addition, other considerations besides those listed in the Law are sometimes taken into account. For a discussion of these other factors, see Donaldson, *supra* note 11, at 501.

27. See Olson, *Foreign Investment Restrictions on Canadian Energy Resources* 14 INT'L LAW. 579, 596 (1980). See also Scarfe, *The Federal Budget and Energy Program, Oct. 28, 1980: A Review*, 7 CAN. PUB. POL'Y 2 (1981); Getman, *Canada's National Energy Program: An Analysis*, 3 HOUS. J. INT'L L. 155 (1980). In a speech to the American Mining Congress on Oct. 11, 1982, the Minister of State for Mines, the Hon. Judy Erola, stated that NEP type measures would not be applied to the non-energy resource sector.

appears to have an ambivalent attitude toward foreign investment.<sup>28</sup> Canada's entangled constitutional relationships complicate the "significant benefit" requirement.<sup>29</sup> Aside from the Foreign Investment Review Act, there are also a number of federal and provincial laws which regulate foreign investment in certain sectors of the economy.<sup>30</sup>

A final aspect of the "significant benefit" test is that it represents in substance a bias toward macro-economic concerns.<sup>31</sup> Some of the Law's criteria appear to prejudice consumers and exporters to the benefit of business, both Canadian and foreign. Investors often agree to "Buy Canadian" provisions but few FIRA approvals list secured benefits in the form of increased competition or enhanced product variety. It is also hard to grasp how productivity gains to foreign investors can enhance Canadian control of the economy.

## II. FIRA UNDERTAKINGS

Applicants to the FIRA may submit written undertakings in giving notice of their investment proposals under the Law.<sup>32</sup> In some instances, however, approvals are based upon the undertakings as a way of ensuring that the requirement of "significant benefit" will be satisfied. A good example is the 1981 proposal of Nippon Kokan Kabushiki Kaisha et al. of Tokyo to establish a new business in Canada. The investment consisted of a joint venture with a Canadian firm to develop and mine a coal property in Alberta. The Minister approved the proposal but stated that the applicants had to undertake certain capital investments, provide

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28. See FOREIGN INVESTMENT REVIEW IN BRITISH COLUMBIA, PROVINCE OF B.C., MINISTRY OF INDUSTRY AND SMALL BUSINESS DEVELOPMENT (1981). On the one hand, Premier William Bennett reacted unfavorably to the prospect of a takeover of British Columbia's largest forestry corporation, MacMillan Bloedel Ltd.; on the other hand, he recently visited Japan to encourage Japanese investment in British Columbia's resource industry.

29. See Beck, *Law and Policy in the Operation of Canada's Foreign Investment Review Agency*, 45 SASK. L. REV. 183, 195-96 (1981); Frank & Gudgeon, *supra* note 11, at 136-40. See also MacNab, *Constitutionality of Federal Control of Foreign Investment*, 23 U. TORONTO FAC. L. REV. 95 (1965).

30. See generally Feltham & Ravenbusch, *Economic Nationalism*, CANADIAN PERSPECTIVES ON INTERNATIONAL LAW AND ORGANIZATION, (MacDonald, Morris & Johnston eds. 1974).

31. One is tempted to contrast Canada's long history of anti-dumping regulation with FIRA's regulation of foreign investment. See R. GREY, *THE DEVELOPMENT OF THE CANADIAN ANTI-DUMPING SYSTEM* (Canadian Economic Policy Committee) (1973); R. DALE, *ANTI-DUMPING LAW IN A LIBERAL TRADE ORDER* (1980). Anti-dumping regulation benefits some Canadian manufacturers at the expense of consumers. The economics of foreign investment are more complex.

32. Applicants are not legally obligated to submit written undertakings. For published samples of the actual text of such undertakings, see DONALDSON, *supra* note 11, at 566-76.

for certain levels of Canadian ownership and employment opportunities, and purchase materials and supplies of Canadian manufacture or origin.<sup>33</sup>

The authority to secure undertakings gives FIRA considerable bargaining strength in negotiating with investors. Applicants are not obligated to provide undertakings but in some cases inclusion may increase the likelihood of approval. FIRA now requires that undertakings be formally executed under seal and addressed to the Crown.<sup>34</sup> Undertakings are then monitored by the Enforcement Division of the Compliance Branch of FIRA.<sup>35</sup> It appears that undertakings constitute ordinary contractual obligations between an investor and Canada, and as such are capable of enforcement. The Law, however, provides for a specific judicial compliance order for undertakings. Section 21 of the Law states that the Minister of Industry, Trade, and Commerce may apply to a superior court for such an order if a successful applicant fails to comply with a written undertaking. This relief may increase the remedies available at common law, such as specific performance.<sup>36</sup> In view of the presumption that statutes in derogation of the common law should be strictly construed, the FIRA may seek relief pursuant to section 21 and at common law. However, it has never resorted to these measures.

The Law contains a series of provisions meant to ensure compliance. Where the Minister has not allowed an investment or where there is material variation from the terms and conditions on which the Minister allowed an investment to proceed, the Minister may investigate.<sup>37</sup> The Minister has extensive powers to collect evidence.<sup>38</sup> He can require the parties to produce contracts and agreements related to the investment, and can ask the court to compel the production of documents and the examination of witnesses. If the Minister has not allowed an investment or the investment is made in a way that materially differs from the terms the Minister allows, the Minister may obtain an injunction preventing the investment or an order rendering the investment nugatory.<sup>39</sup>

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33. News Release F-163 (6,25,81) located in HAYDEN BURNS, *supra* note 24, ¶ 1162.

34. See J. LANGFORD, CANADIAN FOREIGN INVESTMENT CONTROLS, 55-56 (2d ed. 1979).

35. See SCHULTZ, *supra* note 25, at 81-83.

36. A host of issues present themselves surrounding the difficulties inherent in the granting of such relief both at common law and pursuant to § 21. Canadian courts would likely resist an invitation to supervise the performance of a series of acts. See B.J. REITER & J. SWAN, STUDIES IN CONTRACT LAW 124, 144 (1980).

37. *The Law*, *supra* note 3, § 15.

38. *The Law*, *supra* note 3, § 16.

39. *The Law*, *supra* note 3, §§ 19 and 20. Such orders will not be given extra-

So far, the possibility of legal action by FIRA has been enough to ensure that applicants fulfill their undertakings. In addition, in many instances where undertakings are given to purchase a certain percentage of goods in Canada or to employ specified number of people in Canada, it is difficult to see how a credible case could be made if the failure was due to extraneous economic factors or mismanagement. The practice of discussion and negotiation which goes on between applicants and FIRA avoids the necessity of exploring these types of questions in legal proceedings. In certain instances, where an investor, for good reason, has not been able to comply fully with a particular undertaking, the practice of FIRA is to renegotiate a new undertaking in place of the original. Often such renegotiation is unnecessary because the investors write caveats into their undertakings that suffice to protect investors in changed circumstances.

### III. THE BACKGROUND OF THE UNITED STATES GATT CHALLENGE

In 1980 the Canadian government proposed significant FIRA changes. These changes included periodic performance reviews of large foreign firm operations, publication of prospective large-scale foreign takeovers,<sup>40</sup> and financial government assistance to local bidders.<sup>41</sup> The proposals met with widespread opposition from the United States, Japan, and the European Economic Community.<sup>42</sup> In February 1981 the United States Trade Representative, William Brock, announced that the United States government would consider revisions of the Automotive Products Agreement only if Canada would respond to United States complaints about the Act.<sup>43</sup> United States firms levelled charges of

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territorial effect. See *Attorney General of Canada v. Fallbridge Holdings Ltd.*, 7 BUS. L. REP. 275, 281 (1979) (Federal Ct. of Can.). See also G.C. HUGHES, A COMMENTARY ON THE FOREIGN INVESTMENT REVIEW ACT 73-7 (1975).

Such an order may involve:

- (a) the revocation or suspension, for any period specified in the order, of any voting rights attached to any shares of a corporation or of any right to control any such voting rights,
- (b) the disposition by any person of any shares of a corporation acquired by him, or
- (c) the disposition by any person of any property acquired by him that is or was used in carrying of a business.

It appears that orders include any undertakings provided by the investor because of the words "terms and conditions on which [the] investment has been made."

See also HAYDEN BURNS, *supra* note 24, ¶ 41,033.

40. Foreign takeovers are published in order to give Canadian investors the opportunity to make competing bids.

41. Speech from the Throne, April 14, 1980.

42. See HAYDEN BURNS, *supra* note 24, Report Bulletin No. 81, ¶¶ 81-2, 81-4 (July 31, 1981).

43. *Id.* at Report Bulletin No. 76, ¶ 76-9 (February 27, 1981).

discriminatory treatment and alleged that United States businesses would face disadvantages in Canada that would not hinder Canadian businesses in the United States. An attempt by Seagrams Company of Montreal to gain control of St. Joe Minerals Corporation of New York led the House of Representatives to consider a six-month moratorium on mining company takeovers, as well as a ban on foreign investment in more than twenty-five per cent of United States mining company voting stock.<sup>44</sup> Subcommittees in the House of Representatives passed draft bills to restrict Canadian acquisition of United States' firms.<sup>45</sup>

Early in 1981 the House of Representatives' Committee on Energy and Commerce Sub-committee on Oversight and Investigations announced hearings on Canadian foreign investment policy. In April, the Secretary of Commerce, Malcolm Baldrige, and Trade Representative Brock, wrote to Herb Gray, the Minister responsible for FIRA, and expressed concern over the increasing number of complaints involving the Canadian foreign investment review process.<sup>46</sup> In July 1981, Mr. Gray replied that foreign-controlled firms operating in Canada tend to rely on their parent companies' traditional suppliers, regardless of the availability of competitive goods and services in Canada.<sup>47</sup>

Despite those statements, in October 1981, the Canadian Minister of Finance announced that the strictness of FIRA's review procedures would be eased in a dramatic reversal apparently aimed at meeting international criticism. The November 1981 federal budget confirmed the Minister's position and announced that legislation extending the law<sup>48</sup> would not be introduced. Instead, the Minister proposed changes in administrative procedures in order to increase the speed and efficiency with which FIRA processes applications.<sup>49</sup>

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44. *Id.* at Report Bulletin No. 80, ¶ 80-7 (June 30, 1981).

45. *Id.* at Report Bulletin No. 81, ¶ 81-1 (July 31, 1981).

46. Baldrige and Brock stated, "We are particularly concerned about commitments which are secured from firms which do not increase foreign presence in Canada (e.g. takeovers of foreign firms by other firms), or situations in which commitments are secured which are unrelated to the foreign investment." *Id.* at Report Bulletin No. 82, ¶ 82-13 (August 13, 1981).

47. Gray further stated, "It does not appear to me that where investors choose to make local sourcing commitments to the Canadian Government regarding their sourcing intentions, as a means of demonstrating that their investments will be of significant benefit to Canada, this practice represents any impairment of Canadian concessions under the GATT." *Id.*

48. Legislation to extend the Law was outlined in 1980.

49. *See* FIRA Release F-26 (1982).

#### IV. THE UNITED STATES CHALLENGE AND THE GATT

The United States, in its request to establish a GATT panel pursuant to the provisions of Article XXIII, referred to various practices in the implementation of the Canadian foreign investment law that it considered hindrances to trade and contrary to the aims and provisions of the General Agreement. Among the practices noted were undertakings to purchase Canadian products and to export a percentage or quantity of production. In preliminary bilateral consultations the provisions of Articles III, XI, XVII, and XXIII of the General Agreement were discussed.

##### A. National Treatment and Article III

The only General Agreement Article mentioned in the United States' request for consultation is Article III, which has never been considered by a GATT panel considering foreign investment restrictions. Unlike Article I, which establishes a general principle of most-favored-nation treatment, Article III sets a principle recognizing the need to avoid internal measures that discriminate against imported goods. A series of specific obligations to avoid certain internal measures protecting local industry follows the text stating the principle. Paragraph 2 of Article III deals with discriminatory internal taxes or other internal charges; paragraph 5 deals with mixing requirements, and Article IV contains a special exemption for domestic cinematograph film quotas. The specialized treatment of discriminatory domestic measures discourages discussion of the general principle of national treatment in the General Agreement and makes it difficult to predict how a GATT panel might approach the United States' complaint under Article III.

Despite little precedent, Article III is a promising legal basis for the argument that Canada's actions violate the Agreement.<sup>50</sup> The fact that Article III applies equally to products subject and not subject to GATT tariff bindings adds to its attractiveness.<sup>51</sup>

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50. National treatment clauses originated in bilateral treaties and are characteristically found in treaties of Friendship, Commerce and Navigation. For a history of Art. III see Jackson, *supra* note 1, 276-279. See also Walker, *Modern Treaties of Friendship, Commerce and Navigation*, 42 MINN. L. REV. 805 (1958).

51. JACKSON, *supra* note 1, 277 and 280.

The most relevant language of Art. III in para. 4:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect to all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on

FIRA approvals are subject to legally enforceable undertakings regarding local purchasing.<sup>52</sup> One might contend that those undertakings treat imported goods less favorably than domestic products and therefore violate Article III:4.

A recent Article III discussion appeared in a GATT panel report concerning a United States complaint involving European Economic Community (EEC)<sup>53</sup> measures on animal feed proteins.<sup>54</sup> The EEC Council had adopted regulations obliging EEC producers or importers of certain animal feeds to buy quantities of surplus domestic skimmed milk powder. The United States specifically noted imported corn gluten, unlike domestic gluten, was subject to skimmed milk purchase requirements and other administrative measures. The EEC argued that United States exports to the EEC of vegetable proteins had not declined as a result of the measures. The GATT panel decided that the EEC regulations accorded imported gluten less favorable treatment than the same product of national origin and that, therefore, the measures violated Article III:4.<sup>55</sup> The panel made the finding despite arguments that a certification requirement was administrative without legal or economic value. The decision suggests that the language of Article III:4 will be interpreted liberally in the spirit of the GATT's free trade objectives.

One way to distinguish *Animal Feeds* from FIRA undertakings is to suggest that the FIRA requirements do not affect the sale of American products in Canada because they do not require that the exporters perform a specific act. A GATT panel has rejected the argument that Article III is limited to "laws, regulations, and requirements" concerning the actual conditions for sale and transportation of commodities.<sup>56</sup> Furthermore, paragraph 4 refers to

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the economic operation of the means of transport and not on the nationality of the product.

52. See *id.* & text accompanying note 28.

53. The European Economic Community (EEC) is an international federation of European States, with both economic and social purposes. It includes a common market, with zero tariffs between its members and a common external tariff as to the rest of the world, as well as a council of ministers, commission, court, assembly, and an extensive technical staff.

54. GATT Doc. L/4599, Basic Instruments and Selected Documents, 25th Supp. at 49 (1979) [hereinafter cited as *Animal Feeds*].

55. The panel also found that the Regulation "afforded protection to domestic production" within the meaning of Article III:1 because they ensured the sale of a given quantity of skimmed milk powder. *Id.* at 65.

56. GATT Doc. L/833, Basic Instruments and Selected Documents, 7th Supp. at 60 (1959) [hereinafter cited as *Italian Machinery*].

When the United Kingdom complained regarding special credit terms made available by the Italian government to purchasers of certain machinery, the panel stated:

It was clear from the English text that any favourable treatment granted to domestic products would have to be granted to like imported prod-

laws, regulations, and requirements *affecting* conditions of sale and purchase and not to requirements *governing* such conditions. In *Italian Machinery*,<sup>57</sup> the panel concluded that the draftsmen intended paragraph 4 to apply not only to laws directly governing conditions of sale and purchase, but also to those conditions that might adversely modify the conditions of competition between domestic and imported products in the internal market. The United States could argue that undertakings regarding the purchase of Canadian goods unfavorably affect the sale of American imports. There is little legal or economic distinction between granting special credit for domestic product purchases and requiring that investors purchase the same goods in legal undertakings. In both instances imported goods are accorded less favorable treatment than domestic products. As the *Animal Feeds* panel concluded, the motives behind a law or regulation are irrelevant if the effect is to afford illegitimate protection.<sup>58</sup>

Little attention has focused on the words "laws, regulations, and requirements" in Article III:4. On the one hand, it may be suggested that undertakings given to FIRA do not fall within Article III:4 because investors voluntarily offer undertakings.<sup>59</sup> On the other hand, FIRA makes it abundantly clear to an applicant that failure to provide certain undertakings will result in an unfavorable FIRA recommendation for an investment proposal. Thus the *effect* of FIRA procedures is to make undertakings a "requirement" for approvals in many cases. It would seem to be an unnecessarily restrictive reading of Article III:4, especially in light of its interpretation in *Animal Feeds*, to say that because the statute does not require applicants to provide undertakings that there are no "requirements" to provide them.<sup>60</sup>

There have been instances in the United States where "Buy American" laws have been successfully challenged in the courts on the basis of Article III. In one case, the City and County of San Francisco rejected a bid to supply equipment for a municipally-owned power station because the bid was conditioned on furnishing certain parts manufactured outside the United States.<sup>61</sup>

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ucts and the fact that the particular law in question did not specifically prescribe conditions of sale or purchase appeared irrelevant in the light of the English text.

*Id.* at 63-64.

57. *Id.*

58. *Animal Feeds*, *supra* note 54, at 65. This section may now be questionable in light of the DISC case. See Jackson, *The Jurisprudence of International Trade: The DISC case in GATT*, 72 AM. J. INT'L L. 747, 768 (1978).

59. Undertakings are not required by law or policy guideline.

60. A similar approach is taken in U.S. constitutional case law; see L. TRIBE, AMERICAN CONSTITUTIONAL LAW 1025-1028 (1978).

61. *Baldwin-Lima-Hamilton Corp. v. Superior Court*, 208 CAL. APP. 2d 803, 25

The city based its rejection on a California statute requiring that municipalities contract only with those parties who agree to use United States produced materials. A California court held that the bid's requirement conflicted with Article III because it treated imported goods less favorably than domestic goods and expressed its view that the California statute violated Article III. Similarly, the Canadian Law contains no express requirement that investment approvals be subject to legally enforceable undertakings concerning local content. However, the Law does refer to Canadian content in its statement of criteria of "significant benefit".<sup>62</sup> FIRA requests for investors to provide such undertakings parallel the requirement of domestic content made by the City and County of San Francisco.<sup>63</sup>

A claim that the undertakings violate Article III could lead to further action under Article XXIII, such as the suspension of trade concessions. In the history of the GATT, such a suspension has been authorized once. In answer to such a claim, it could be suggested that the requirements of Canada's investment laws are exempt from Article III as subsidies.<sup>64</sup> This exemption is designed to protect production subsidies granted for the benefit of domestic producers.<sup>65</sup> Unfortunately, a good deal of uncertainty surrounds the meaning of a subsidy under the GATT.<sup>66</sup> There are no instances where courts have held that "Buy American" or similar laws constitute subsidies. Most subsidies have involved direct assistance in the form of payments or financing on favorable terms. A clue to the meaning of "subsidy" is found in Article XVI:1, which requires that notification be made of any subsidy, that operates "directly or indirectly to increase exports . . . or re-

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CAL. RPTR. 798 (1962). See Comments, 52 CALIF. L. REV. 335 (1964) and 17 STAN. L. REV. 119 (1964).

62. *The Law, supra* note 3, § 2(2)(a).

63. The court also held that the exemption in Art. III, para. 8(a), in respect of government procurement, was inapplicable since the equipment which was the subject matter of the bid was to be used to produce goods for sale. On this exemption see JACKSON, *supra* note 1, at 270-293 and Agreement on Government Procurement, B.I.S.D. 26th Supp. 33 (1980), esp. Art. II, (National Treatment and Non-Discrimination).

64. Art. III, para. 8(b) provides: "The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article."

65. Unlike Art. III, which states a prohibition, Art. XVI, which governs subsidies, merely requires notification and consultation. There appear to have been no instances of a GATT member limiting a subsidy following Art. XVI consultations; see Rivers & Greenwald, *The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences*, 11 LAW & POL'Y INT'L BUS. 1447, 1459 (1979).

66. See JACKSON, *supra* note 1, at 365-377, and J. JACKSON, LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 756-757 (1977).

duce imports of any products." A GATT panel discussed those words in 1960 in a manner that suggests that the concept of subsidy is broad.<sup>67</sup> It is beyond the scope of this article to discuss the issue fully but one can at least assume that Canadian purchasing requirements would lead to reduced imports.<sup>68</sup>

### B. Foreign Investment Controls and Article III

The novelty of the United States claim makes it difficult to predict how a GATT panel might apply Article III. The foregoing discussion has focused on the wording of Article III in light of its application to particular cases. One can argue that FIRA purchasing and export investments are outside the scope and purpose of Article III as investment costs to which investors willingly consent. The United States concedes the fact that Canada has the right to regulate the entry of foreign investment. At issue is whether local purchasing requirements are legitimate as essential parts of such regulation. It is well known that multinational branch operations in Canada tend to restrict their Canadian purchasing.<sup>69</sup> Moreover, such corporations often arrange for other arms of their enterprises to serve their export markets. Canada might suggest that the legal undertakings decried by the United States are an essential element in modifying such behavior and do not properly fall within the scope of Article III. The fact that purchasing requirements and other measures reduce import levels could be an incidental result of the pursuit of legitimate investment controls.

Traditionally, GATT panel members have been selected on the basis of their expertise concerning the General Agreement. Consequently, GATT panel members have been unwilling to discuss or apply principles beyond the Agreement. In the FIRA case, however, the subject of the dispute is an investment requirement rather than a trade control. This subject necessitates a consideration of the purpose of Article III in relation to such measures.

The legal basis of the agreement between Canada and the

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67. See Review Pursuant to Article XVI, para. 5, GATT Doc. L/1160 Supp. 9 B.I.S.D. 188 (1961), and JACKSON, *supra* note 1, at 382-386.

68. Any discussion of subsidies must now include the new GATT Code on Subsidies and Countervailing measures. Canada and the U.S. have both signed the new agreement. A strong case may be made that the Canadian Petroleum Incentive Payments, which distinguish between Canadian and foreign-owned corporations, are subsidies under Art. XVI. It would appear possible to calculate the degree to which incentive payments would prejudice investors from other countries and reduce imports.

69. See Hudec, *Possible Trade Policy Consequences of the Canadian Foreign Policy*, 6 CASE W. RES. J. INT'L L. 74 (1973), and MacDonald, *Canadian Industrial Policy Objectives and Article III of GATT: National Ambitions and International Obligations*, 6 CAN. BUS. L.J. 385, 403-404 (1982).

United States on the validity of certain national foreign direct investment restrictions lies in state practice. Many states restrict foreign investment in a variety of ways and both countries, as OECD members,<sup>70</sup> have signed the 1976 Declaration on International Investment and Multinational Enterprises (the Declaration).<sup>71</sup> That Declaration, though hardly a weighty international legal precedent, recognizes the right of states to prescribe conditions under which multinational enterprises may operate in host countries. It is a big step, however, for Canada to argue that it is established state practice for foreign investment review agencies to obtain binding commitments from investors regarding exports or local purchasing in exchange for permission to invest freely.<sup>72</sup>

All OECD members<sup>73</sup> adopted the Declaration on International Investment on June 21, 1976.<sup>74</sup> Its main elements are the Guidelines for Multinational Enterprises, the Decision on National Treatment, and the Decision on International Investment Incentives and Disincentives. Regarding national treatment, the Declaration provides that members should, consistent with security interests, accord to foreign-controlled enterprises operating in their territories, treatment under their laws, regulations, and administrative practices that is no less favorable than the treatment accorded in like situations to domestic enterprises. The treatment must also be consistent with international law. Regulation of the entry of foreign investment or the conditions for establishment of foreign enterprises is specifically exempted. The exempting provision clearly protects most of FIRA's activities. Canada filed exceptions and qualifications to the national treatment provisions when it signed the Declaration. Those exceptions, *inter alia*, refer to FIRA approval of take-overs of Canadian business enterprises and the establishment of new businesses by foreign investors.<sup>75</sup>

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70. The Organization for Economic Cooperation and Development, 12 U.S.T. 1728, Dec. 14, 1960, [1961] T.I.A.S. No. 4891.

71. See 15 I.L.M. 967 (1976) [hereinafter referred to as Declaration].

72. Many developed countries like Australia, France, and Japan have foreign investment screening procedures which typically vest considerable discretion in government officials to impose conditions on investors. See, e.g., Sexton, *Regulation of Direct Foreign Investment: A Case of Delayed Reaction in Australia and Canada*, 2 AUSTL. BUS. L. REV. 241 (1974), Torem & Craig, *Developments in the Control of Foreign Investment in France*, 70 MICH. L. REV. 285 (1971), and *Exchange and Foreign Trade Control Law*, 1 JAPAN BUS. L.J. 8 (1980).

Requirements that investors utilize domestically produced goods do not seem commonly imposed in the form of binding undertakings, but the same result may be achieved by other means such as exchange controls. See Paterson, *Legal Restrictions on Foreign Investment in New Zealand*, 9 J. WORLD TRADE L. 177, 186 (1975).

73. Turkey is the exception.

74. OECD Declaration on International Investment and Multinational Enterprises, OECD Press Release A(76)20, June 21, 1976, reprinted in 15 I.L.M. 961 (1976).

75. See National Treatment for Foreign Controlled Enterprises Established in OECD Countries, OECD 49-52 (1978), and MacDonald, *supra* note 69, at 398.

Moreover, the Declaration provides that national treatment should accord with the protection of "essential security interests". In view of the high level of foreign ownership of its domestic industries, Canada may argue that foreign investment concerns national essential security and justifies exceptional measures.

The Declaration also requires members to give "due weight to the interests of Member countries affected by specific laws, regulations and administrative practices . . . providing official incentives and disincentives to international direct investment."<sup>76</sup> Generously interpreted, this structure would largely undermine the principle of national treatment. However, the force of OECD Codes in international law is fragile given the limited and specialized nature of membership in the organization.<sup>77</sup>

In addition to OECD arguments, Canada might also argue that the United States has acquiesced in the validity of Canada's investment restrictions.<sup>78</sup> Furthermore, under international law, the continued existence of many "Buy American" laws in the United States might undermine the equity of the American claim.<sup>79</sup> If the United States' claim as to the inconsistency of FIRA undertakings with Article III is upheld, then it follows that many "Buy American" and other laws must also be at variance with Article III. Of course, the panel could avoid this controversial result by deciding that Article III was not intended to invalidate measures properly related to legitimate foreign investment controls.<sup>80</sup> Whatever its findings, the panel decision will be important for the international standing not only of Canadian investment laws, but also of similar laws in other developed countries. In particular, any findings on the application of Article

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76. Declaration, *surpa* note 70, at 968 (Art. III:2).

77. See Schwartz, *Are the OECD and UNCTAD Codes Legally Binding?* 11 INT'L L., 529 (1977).

78. See *Case concerning the Temple of Preah Vihear* 1962 I.C.J. 6, at 135 (per Vice-President Alfaro.)

79. See *Diversion of Water from the River Meuse* 1937 P.C.I.J. ser. A/B, No. 70, at 73 (per Judge Hudson.)

80. Numerous countries have a wide variety of domestic programs and legislation designed to promote health and safety, and various open-ended economic goals. The difficulty is resolving the conflict between the legitimate policy objectives of some of these programs and the equally legitimate rule against discrimination in international trade. Art. XX creates a number of general exceptions designed to provide relief for some of these municipal programs. These exceptions, notably Art. XX(g), may protect Canada's controversial National Energy Policy in some of its manifestations. Art. XX is problematic, however, since the criteria by which justifiable discrimination is to be measured are not clear. In *Hawaii v. Ho* 41 Hawaii 565 (1957), the Supreme Court of Hawaii found that a territorial law requiring imported eggs to be labelled as "foreign eggs" violated Art. III paras. 1 and 4 and was not saved by the exceptions in Art. XX.

III will bear significantly on the relationship of the General Agreement to investment law as well as to trade law.

### C. Quantitative Restrictions and Article XI

A major thrust of American policy in the formulation of the General Agreement has been the elimination of nontariff barriers. This thrust has been part of a strategy to concentrate on the reduction of the most visible trade restraint—the tariff. Article XI:1 provides for a prohibition on quantitative restrictions.<sup>81</sup> Enormous definitional problems arise from that provision.<sup>82</sup> Canada, one could argue, does not maintain restrictions “on the importation of any product” by requiring undertakings from investors.<sup>83</sup> Any such undertakings that are obtained are likely to have a modest effect on import levels. Furthermore, undertakings are given by individual entities and do not place precise ceilings on imports of particular products. Whether or not these arguments are accepted, it would be illogical, given the separate existence of Articles III and XVII, to extend Article XI to cover internal economic measures related to domestic economic development. Article XI is properly applied to border measures relating to imports and exports. Article XI should not be extended to internal requirements as to domestic purchasing.

### D. Privileged Enterprises and Article XVII

Article XVII differs from other General Agreement obligations in that it represents a broad attempt to restrict state involvement in private international trade. While other provisions seek to prohibit or regulate various measures that restrict free trade, Article XVII seeks, instead, to limit the activity of governments in what is perceived to be an activity within the domain of private enterprise.<sup>84</sup> This focus makes the provision more controversial than many others because there is no matching GATT code on

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81. Art. XI:1 provides for a prohibition on quantitative restrictions:

No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

82. See JACKSON, *supra* note 1, at 305ff.

83. *Id.* at 315 & text accompanying note 6.

84. See I. BERNIER, STATE TRADING AND THE GATT, STATE TRADING IN INTERNATIONAL MARKETS 245 (M.H. Kostecki ed. 1969). The author questions the premise of Art. XVII that state-trading enterprises should be expected to act as if they were private bodies, when their *raison d'être* is to fulfil roles not usually performed by private enterprises.

restrictive business practices.<sup>85</sup> The meaning of "special privileges" is not clear.<sup>86</sup> No court or administrative agency has found that investment concessions fall within the meaning of Article XVII(1)(a). A "noneligible person" whose investment receives Canadian government approval gets no privileges or concessions that are not available to other businesses in Canada. On the contrary, the successful applicant may be subject to additional obligations that do not encumber domestic entrepreneurs. A GATT panel may be reluctant to fully discuss this point because a discussion might point the way to a general policy determination of the legitimacy of restrictions on foreign direct investment. A finding that FIRA undertakings on local content violated Article XVII would be tantamount to prohibiting foreign investment screening agencies from extracting performance requirements.<sup>87</sup>

Article XVII:1(c) obligates Contracting Parties not to prevent enterprises under their jurisdiction from acting in accordance with paragraphs (a) and (b) of Article XVII:1.<sup>88</sup> The nature of the obligations imposed on the Contracting Parties by Article XVII:1 is far from clear.<sup>89</sup> Professor Jackson suggests that neither paragraph 1(a) nor 1(b) was intended to imply "national treatment" but instead to establish a modified form of most-favored-nation

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85. Art. XVII(1)(a) states that:

Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

See JACKSON, *supra* note 1, at 330. But See *OECD Recommendation Governing Action Against Restrictive Business Practices*, 17 I.L.M. 1527 (1978).

86. See *Notifications of State Trading Enterprises*, GATT Doc. L/1146, Basic Instruments and Selected Documents, 9th Supp. (1961); see also JACKSON, *supra* note 1, at 340-43.

87. *Contra* C.G.B. Fontheim & R.M. Gadbow, *Trade Related Performance Requirements under GATT—MTM System and U.S. Law*, 14 LAW & POL'Y INT'L BUS. 129, 153-56 (1982), and THE LABOR INDUSTRY COALITION FOR INTERNATIONAL TRADE, *PERFORMANCE REQUIREMENTS: A STUDY OF THE INCIDENCE AND IMPACT OF TRADE-RELATED PERFORMANCE REQUIREMENTS AND AN ANALYSIS OF INTERNATIONAL TRADE* 21 (Washington 1981).

88. See *supra* note 75 for text of Art. XVII(1)(a). Art. XVII(1)(b) provides that:

The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

89. See JACKSON, *supra* note 1, at 339-45.

treatment.<sup>90</sup> If his view is correct, Article XVII cannot be relied on to restrain Canada from prohibiting enterprises from purchasing lower-priced imported goods. Nor can Article XVII be relied on to suggest that Canada must ensure that its enterprises do not discriminate against foreign goods in favor of domestic goods. The words "purchases or sales involving either imports or exports" in paragraph 1(a) support the view that Article XVII:1 was not intended to include domestic purchasing requirements or export performance requirements. In any event, the GATT has received few complaints concerning Article XVII.

### E. Dispute Settlement and Article XXIII.

The FIRA case constitutes an important exercise in GATT dispute settlement methodology. Under Article XXIII, in certain circumstances, Contracting Parties can suspend concessions made under the General Agreement when benefits accruing under the Agreement are being "nullified or impaired."<sup>91</sup> In addition to the language of Article XXIII, one must look at the complex law and practice surrounding Article XXIII. One must also take into account the Tokyo Round Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance<sup>92</sup> as well as important precedents, such as the history of the DISC case.<sup>93</sup> The controversial DISC decision arose from an E.E.C. complaint against the United States Domestic International Sales Corporation legislation (DISC) which allows certain United States corporations to defer income tax on export profits. The United States counterclaimed that if DISC infringed on the General Agreement so did certain tax laws of Belgium, France, and the Netherlands. The panel<sup>94</sup> found that both the DISC legislation and the European laws were invalid export subsidies under Article XVI.

The FIRA case has characteristics similar to those that caused difficulty in the DISC case. The legality of the Law could

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90. *Id.* at 345-47. *But see* K.W. DAM, *THE GATT, LAW AND INTERNATIONAL ECONOMIC ORGANIZATION* 322 (1970). If this view is correct then Art. XVII could constitute a significant loophole. *See* Bernier, *Le GATT et le probleme du commerce d'etat dans les pays a economie de marche: Les cas des monopoles provinciaux dex alcools au Canada*, 13 CAN. Y. INT'L L. 98 (1975).

91. *See* JACKSON, *supra* note 1, at 163, and DAM, *supra* note 90, at 351.

92. GATT Doc. L/4907, Basic Instruments and Selected Documents, 26th Supp., at 210 (1980). *See also* GATT Doc. L/4422, Basic Instruments and Selected Documents, 23rd Supp., at 98 (1977).

93. *United States Tax Legislation (DISC)*, Basic Instruments and Selected Documents, 23rd Supp. 127 (1977), B.I.S.C. 23rd Supp. 114 (1977) and Jackson, *The Jurisprudence of International Trade*, *supra* note 58.

94. The panel included two experts. The "outside experts" were European tax professors. They were not employed by the disputants' governments or any associated governments. *See United States Tax Legislation (DISC)*, Basic Instruments and Selected Documents, 23rd Supp. 127, at 763 (1977).

be an inappropriate issue for settlement through GATT dispute resolution procedures because the issue suggests the need for new international rules governing foreign investment controls, rather than the need for the application of existing GATT law. This point may even lead Canada to counter with a formal complaint under Article XXIII:2, as did the United States in the DISC case. Furthermore, the novelty of the American claim may provoke a panel, as in the DISC case, to return findings without recommending action. The modern tendency of panels to encourage voluntary settlement may also be the chosen alternative.

One significant aspect of proceeding under Article XXIII is that the panel can rely on the Article whether or not the detriment results from a violation of the General Agreement. Article XXIII may justify action by the United States even if FIRA undertakings are found not to violate any provisions of the General Agreement. If Canada is ruled in breach of Article III then according to GATT practice, as described in the Code on Dispute Settlement, the United States can assert a *prima facie* case of nullification or impairment.<sup>95</sup> The onus would then rest on Canada to show that no such nullification or impairment had occurred. If Canada did not present any such evidence, a GATT panel could recommend the withdrawal of the measures as contravening Article III.<sup>96</sup>

A dispute between Chile and Australia over the latter's suspension of a fertilizer subsidy led to the first discussion of Article XXIII in a case not involving a violation of the General Agreement.<sup>97</sup> Chile alleged that the termination of the subsidy effectively negated an earlier tariff concession Australia had made to Chile. The Working Party explained that nullification or impairment would only arise if Chile could not have reasonably anticipated the Australian action at the time it negotiated the duty-free binding.<sup>98</sup> This requirement of "reasonable anticipation" reflects the need not to limit "every element of national policy against trade distorting effects."<sup>99</sup> The past conduct of Australia toward Chile seems to have been significant. Australia had impliedly represented to Chile that it intended to provide subsidies in a certain manner and Chile was seen as being entitled to rely on that representation in negotiating the tariff reduction.

Has Canada done anything to justify a United States claim

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95. See JACKSON, *supra* note 1, at 216 n.5.

96. See JACKSON, *Governmental Disputes in International Trade Relations: A Proposal in the Context of GATT*, J. WORLD TRADE L. 1 (1979).

97. See JACKSON, *supra* note 1, at 172-73, and R.E. HUDEC, *THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY* 144-53 (1975).

98. HUDEC, *supra* note 97, at 314.

99. R.E. HUDEC, *ADJUDICATION OF INTERNATIONAL TRADE DISPUTES*, 61 n.113 (1978).

that it could not reasonably expect FIRA undertakings as to local purchasing? If this question turns on circumstances existing at the time tariff bindings were negotiated then the answer may well be a negative one. A more workable approach, and one that recognizes the need for the General Agreement to respond to changing circumstances, is to ask the same question in the light of surrounding circumstances at the time the alleged nullification or impairment occurred. Certainly Canada had done nothing prior to 1974 to suggest that it would not impose performance requirements. Article XXIII will usually be narrowly interpreted so as not to interfere unduly with ordinary measures not otherwise in violation of the General Agreement.<sup>100</sup> This policy suggests that unless the Canadian requirements are seen as contrary to international law or unreasonable in the circumstance, it is unlikely that the Panel would find them to constitute nullification or impairment.

## V. PROPOSED INVESTMENT TREATY

The novelty of the United States' claim adds uncertainty to an already vague quasi-legal exercise in the administration of the General Agreement. Though a GATT panel will limit its observations to the express terms of the General Agreement, it is not likely to ignore the surrounding circumstances. Historically, Canada and the United States have shown an ability to resolve economic issues through bilateral negotiation. The GATT Ministerial Conference in November 1982 may serve to expedite the settlement of the American concerns. This background may influence the GATT panel not to make any "recommendations" pursuant to Article XXIII:2, as occurred in the DISC case, even if it were to find a breach of a provision of the General Agreement.<sup>101</sup> That would be a disappointing result in view of the Code on Dispute Settlement, which has as its main objective the expedition of dispute resolution pursuant to Articles XXII and XXIII of the General Agreement.

Though the Canadian Law is aimed at regulating foreign investment in Canada, the United States chose the GATT—the primary international trade organization—as the forum in which to press its complaint. The apparent anomaly of airing an investment complaint in a trade forum is explicable in terms of the deficiency of avenues for redress of foreign investment restrictions. There is no multilateral agreement on investment which has the stature of the General Agreement. The OECD Declaration on International Investment and Multinational Enterprises tends to sanction, rather than proscribe, restrictions on foreign direct in-

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100. HUDEC, *supra* note 97, at 149.

101. See Jackson, *supra* note 58, at 773.

vestment.<sup>102</sup> Another problem is the lack of a formal dispute resolution process in the Declaration.

Canada could gain a tactical advantage from the lack of multilateral or bilateral avenues for the redress of investment disputes between itself and the United States. It may offer to negotiate a bilateral commercial treaty. The traditional form of "Friendship, Commerce and Navigation" treaty might not solve the problems of developed country investment regulation because such treaties focus on trade rather than investment. A more imaginative solution might be to adopt the recent treaty form entered into by Germany, Switzerland, the United Kingdom and other countries to promote as well as protect capital investment in developing countries.<sup>103</sup> Such an agreement may encourage an increase in the level of American investment in Canada. Specifically, it may provide a basis for channelling future concerns over each country's investment laws.

### CONCLUSION

The United States' proceedings in the GATT represent one facet of the concern over Canadian investment policy. Even if Canada is obligated to discontinue negotiating purchasing requirements from prospective investors, its foreign investment machinery will remain intact. Canada may resolve United States concern about the FIRA system through bilateral negotiation.<sup>104</sup> Even now, United States pressure on Canada has had some constructive effect. It has exposed weaknesses in Canada's foreign investment review system. In August 1982, FIRA published a set of "Interpretation Notes" concerning the Law's provisions and an "Information Circular concerning Agency opinions" which describes how applicants can obtain formal opinion from FIRA as to whether they are subject to the Law.<sup>105</sup> FIRA also plans to establish an advisory committee composed of representatives from the private sector. These FIRA actions are direct responses to criticism about the vagueness and uncertainty of Canada's foreign investment review process. Unfortunately they may not go far enough. The problem of defining the standards used in the application of the "significant benefit" criteria remains unaddressed.

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102. Declaration, *supra* note 71, at 968.

103. See Z.A. KRONFOL, PROTECTION OF FOREIGN INVESTMENT, 35-6 (1972). For an example of such a treaty, see *Sri Lanka—Switzerland: Agreement for the Reciprocal Promotion and Protection of Investments*, 21 I.L.M. 399 (1982), especially Art. 10 (Dispute Settlement).

104. See HAYDEN BURNS, *supra* note 24, (Report Bulletin No. 84, para. 84-6) for reference to recent statement by the Canadian-American Committee.

105. Information circular concerning Agency opinions, Foreign Investment Review Agency, Aug. 1982.

FIRA would do much to stem the tide of criticism if it were to clarify its own policies.

THE GATT AND RESTRICTIONS ON FOREIGN INVESTMENT:  
THE U.S. CHALLENGE TO CANADA'S FOREIGN INVESTMENT LAW

*R.K. Paterson*

A SEQUEL

In July of this year a GATT Panel of three members reported its decision on the U.S. complaint regarding certain Canadian practices under the Foreign Investment Review Act.

The Panel Report (which has not been made public) concluded that the practice of permitting foreign investments in Canada subject to undertakings as to the purchase of goods of Canadian source or origin was inconsistent with Article III: 4 of the General Agreement. In reaching this conclusion, the GATT Panel found that existing purchasing undertakings could be seen as "requirements" within the meaning of Article III: 4. The Panel went on to find the undertakings were not inconsistent with Canada's obligations under Article XI: 1 of the General Agreement. In view of these findings, the Panel thought it unnecessary to determine the legitimacy of the undertakings under Article XVII: 1(c). The validity of undertakings by foreign investors in Canada to export specific quantities or proportions of their production were also within the terms of reference of the Panel. On this question the Panel found no provision in the General Agreement forbidding such practices.

The findings of the Panel are consistent with the spirit of the national treatment obligation in Article III. The Panel's findings do not bring into question Canada's foreign investment controls but are limited to a narrow consideration of the validity of certain types of purchasing and export requirements under GATT law.

The Panel's findings relate solely to existing purchasing requirements and do not affect future Canadian practice. It is anticipated that, consistent with its earlier view that it would abide by the Panel decision, Canada will bring its practice regarding purchasing undertakings into conformity with the Panel's opinion.

The decision comes at a time when the Canadian Foreign Investment Review Agency has implemented measures to streamline the administration of the Foreign Investment Review Act. The 1983 Annual Report of the Agency announced substantial elimination of delays in processing applications despite an increase in investment proposals, the raising of eligibility ceilings for abbreviated review procedures and a 94 per cent approval rate for the 984 applications decided during the past year. In the first quarter of the current fiscal year 99 per cent of all applications were approved.