

FINANCIAL POST

With world trade on brink of ‘vigilante justice,’ Canada gains new clout

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In the same week it unilaterally disabled a key World Trade Organization body for settling trade disputes, the United States agreed to significantly strengthen Canada’s ability to pursue such cases under an amended North American free trade deal.

The nearly simultaneous developments came amid a raucous week for international trade that also saw the U.S. sign a “phase one” trade deal with China, and the United Kingdom take another leap toward Brexit with a resounding victory by the Conservative Party under Prime Minister Boris Johnson.

Yet amid the flurry of trade news, the importance of the tandem, highly technical changes to how trade spats are resolved wasn’t missed — by analysts or Deputy Prime Minister Chrystia Freeland.

NAFTA’s flawed system for settling disputes between countries is something “Canadian trade negotiators have yearned for decades to improve and now we have finally done it,” Freeland told reporters in Mexico City last Tuesday after the three partners signed the amended United States Mexico Canada Agreement. “It’s really a big deal, especially now, with WTO dispute settlement cast into some doubt.”

For two years, U.S. President Donald Trump’s administration has blocked the appointment of new members to the WTO’s appellate body, a crucial seven-member panel that acts as the final word in international trade disputes. The slow moving crisis finally came to a head last week, when two of the remaining three members retired, leaving the panel without the minimum of three members needed to hear cases.

For Canada, the move weakened a key forum for resolving trade gripes — including with the United States, its largest trading partner and destination for 75 per cent of Canadian exports.

“For Canada, the system is especially important because it might keep the U.S. in check,” said Nicolas Lamp, a former dispute settlement lawyer with the WTO in Geneva and now a law professor at Queen’s University. “By the same token, when Canada is complaining against the U.S. and wants to retaliate, the WTO legitimizes Canada’s retaliation and makes the U.S. more likely to comply with the rules.”

Canada is currently defending itself against U.S. appeals on cases concerning softwood lumber and supercalendared paper. While the latter case is among three of the remaining 14 outstanding appeals slated to be concluded before the appellate body ceases to function, the softwood lumber case will remain in limbo.

Yet, just as the U.S. was paralyzing WTO dispute settlement, it gave Canada a better tool for settling trade gripes in the new NAFTA. The “protocol of amendment” to the revised North American free trade pact includes the removal of a loophole in the pact’s state-to-state dispute settlement mechanism that had enabled the U.S. to block the resolution of trade fights by refusing to appoint new members to arbitration panels.

Canada had long sought to end the practice of “panel blocking” under NAFTA, only to consistently run into U.S. resistance — until last week, when the issue emerged as equally crucial for the Democrats now controlling the U.S. House of Representatives. The Democrats fought to close the loophole in the mechanism — viewed as essential to ensuring Mexican labour reforms are fully implemented — and won.

“What’s striking for me is the irony,” said Lamp. “At the same time the U.S. killed WTO dispute settlement or at least the appellate body, it opened up the possibility that we might have a functioning system under (NAFTA).”

Some procedural rules for how the NAFTA mechanism will work have yet to be completed, cautioned Simon Lester, a trade policy analyst and associate director at Washington’s CATO Institute. And it’s unlikely the mechanism will provide a perfect replacement for the WTO’s. Indeed, the scope of disputes covered by the trilateral trade deal differs from the sort handled by the multilateral WTO, Lester said.

“But having binding dispute settlement in (NAFTA) is pretty valuable for Canada,” he added.

Even so, given its heavy reliance on trade, Canada maintains keen interest in helping sort out the WTO’s problems. Indeed, the crisis in the appellate body has sparked fears of an end to the world’s central organ for rules based trade and a subsequent surge in tit for tat trade wars and bilateral deals.

Of particular concern is whether countries will choose to act in bad faith, exercising their right to file appeals even as the forum for hearing them grinds to a halt. This practice of “appealing into the void” would throw cases into limbo so they never reach the point where a country is authorized by the WTO to retaliate.

“The question then is whether countries will wait to be authorized by the WTO, which keeps retaliation in check, or will they go ahead and be their own judge and jury,” said Lamp. “It’s about having vigilante justice, which is what we had before and which is what the U.S. is returning to or wants to return to.”

Without a body to enforce the rules of global trade, “we’d have the law of the jungle,” European trade commissioner Phil Hogan warned earlier this year.

“The WTO is facing its deepest crisis since its creation.”

Others are less concerned that the current impasse will lead to catastrophe. The appellate body isn't the only mechanism within the WTO that works to defuse trade tiffs, said Robert Wolfe, professor emeritus at the School of Policy Studies at Queen's University in Kingston. Transparency rules that require countries to notify each other of new regulations, and panels and committees where frustrations can be aired all work to head off arguments before they enter the dispute mechanism.

“The rules of the road avoid a lot of conflict so it doesn't all come down to the appellate body,” Wolfe said.

Still, the loss of the appeals panel has prompted Canada and others to react. Ottawa has already signed an interim dispute mechanism with the EU that will kick in to handle disagreements when they emerge. On Friday, EU officials in Geneva met with officials from countries including China and Russia to try to bring others into the fold.

“Canada and the EU have come to an agreement that really will serve as a model to preserve the two stage dispute settlement system,” Mary Ng, Canada's Minister for Small Business, Export Promotion and International Trade told the Financial Post. “Rules based trade is what gives businesses around that world that stability they need to plan. We all need to work together to preserve these ties to create mutual prosperity.”

Also this week, the EU said any country that refused to participate in the alternate mechanism and blocked a WTO panel decision, would face retaliatory measures determined by the EU itself.

“They're doing it to save multilateralism, to do something to keep the system functioning and this could be it,” said Lester of the CATO Institute. “It's not like the EU and Canada even have any disputes at the moment, so they're not going to be using it, they're setting it up as a model and saying ‘hey this is the kind of thing that could work and saying let's all do this.’ So it's a bilateral experiment to come up with a multilateral solution. We'll see if it works.”

“I'd like to see it but I think it's going to be hard for them all to agree on it.”