Sack
Goldblatt
Mitchell
Barristers
& Solicitors

312 Cooper St.
Ottawa, Ontario
K2P OG7

Tel: (613) 233-4897
Fax: (613) 237-3359
E-mail: stevenshrybman@sgmlaw.com

20 Dundas St. West, Suite 1130
P.O. Box 180
Toronto, Ontario
M5G 2G8

Tel: (416) 977-6070
Fax: (416) 591-7333

Legal Opinion

Establishing a National System of Early Learning and Child Care in Light of Canada's Obligations Under NAFTA and the WTO

Steven Shrybman
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Introduction and Summary

This opinion assesses present plans to establish a national child care program in light of Canada's international trade obligations. It examines how governments may best maintain their policy options relating to early childhood education and child care (ECEC) in light of the constraints imposed by free trade agreements - in particular those dealing with foreign investment and services.

The question we address is this: Do international trade rules limit the range of policy, funding and regulatory options governments may wish to adopt, or abandon, from time to time to ensure that ECEC programs meet and remain responsive to the needs of Canadian children and families?

Our key conclusions are these:

1. In many ways, the trade liberalization objectives of NAFTA and the WTO are fundamentally incompatible with policies that seek to limit market forces in order to achieve societal goals, such as the provision of universal, accessible, high quality and publicly funded ECEC.

2. Acknowledging these contradictions, Canada has taken steps to protect social programs from the full impact of trade disciplines by negotiating exceptions or reservations from the commitments it has made under these trade regimes. Ultimately the future viability of Canada's social programs depends upon the integrity and broad application of these safeguards.

3. Because of these exceptions and reservations, Canadian governments have retained the right to maintain existing and establish new social programs, such as a national ECEC system, free from the constraints imposed by many (but not all) international trade disciplines.

4. However, the scope of these reservations and exceptions is qualified and unlikely to apply if child care services are delivered or provided on a commercial basis. Therefore to ensure the protection these reservations accord, the prudent course is for Canadian governments to establish ECEC programs as public not-for-profit endeavours.

5. Furthermore, the risk of a trade challenge or foreign investor claim is negligible so long as there is no significant foreign investment in the child care sector. But without the protection afforded by NAFTA and WTO reservations, governments will not be able to limit investment by foreign child care companies that are likely to be attracted by increased and stable public funding.

6. For these reasons the most effective strategy for preserving policy flexibility concerning ECEC is to minimize or eliminate the delivery of child care services by commercial or for-profit providers. Conversely, creating a system that allows commercial child care companies to acquire a significant stake in the system represents high-risk behavior that significantly increases exposure to trade complaints and foreign investor claims.

7. The other strategy for preserving social policy options for ECEC is for Canada not to make new trade commitments that would further constrain the capacity of governments to respond to the needs of Canadian society. The Federal government's apparent openness to making trade commitments under the WTO services agreement (GATS) concerning education services it considers to be non-public, further underscores the importance of ensuring that a national ECEC program be established as a public system.

The ECEC Policy Context

In October 2004 the OECD released a report that is sharply critical of Canada's child - care system, describing it as; "a patchwork of uneconomic, fragmented services within which a small "child care" sector is seen as a labour market support, often without a focussed child development and education role." [1]

As noted by one of Canada's leading authorities on ECEC, Martha Friendly, Canada's failure to keep pace with other OECD countries is a consequence of its reliance on the marketplace for development and provision of child care.[2] The result has been limited

[1] OECD Directorate for Education: *Early Childhood Education and Care Policy - CANADA Country Note*, Sept. 2004.

[2] Martha Friendly; *Child Care and Canadian Federalism in the 1990s:*

public investment in child care and considerable reliance on informal care, private fees, and for-profit delivery. In comparison, most other OECD countries have progressed toward publicly managed, universal programs that are focussed on the development of young children.[3]

This is the context that framed the recent announcement by the Federal-Provincial-Territorial Ministers Responsible for Social Services (with the exception of Quebec), that they had agreed on shared principles to guide the development of a new national system of early learning and child care. Their announcement described a broad policy direction for developing ECEC system that would include measurable goals, shared principles, strong accountability, and provincial/territorial flexibility. The Ministers also agreed that core principles would include "quality, universally inclusive, accessible, and a developmental" [sic].[4]

For the moment, there is little guidance as to how the bare bones of the FPT agreement will be fleshed out. Experts and advocacy groups have proposed a number of principles that generally reflect support for the Ministers'approach but would expand upon it by adding requirements that ECEC programs:

> i) operate under the auspices of public government bodies, or non-profit agencies; and
>
> ii) be accountable not only to parents, children, and the communities being served, but also for the effective use of public funds, for good governance, and for the quality of the services provided.

With these policy and program options in mind, we turn to the constraints imposed by NAFTA and WTO agreements on policy and law relating to social services.

The Broad Reach of International Trade Rules

Since the advent of the first free-trade agreement with the United States in 1988, the scope of international trade and investment agreements has been substantially expanded to encompass broad areas of policy, programs and law, which had previously only been matters of domestic and local concern. The WTO framework now includes agreements concerning investment, services, procurement, intellectual property, and many forms of domestic regulation where these impinge even indirectly on trade or foreign investment. The same is true for NAFTA.

The explicit extension of trade disciplines to provincial and municipal governments, and other public agencies, also represents a significant departure from the historic norms of international trade law. The combined effect of these developments has superimposed

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*Canary in a Coal Mine***.** Childcare Resource and Research Unit Centre for Urban and Community Studies University of Toronto,August 2000

[3] OECD note 1.

[4] News Release from the FPT ministers' meeting, http://www.scics.gc.ca/cinfo04/830828004_e.html

broad constraints on the authority of governments at all levels, and many public institutions, that may be ignored only at the risk of retaliatory trade sanctions or damage awards made by foreign arbitral tribunals.

The Risk of Investor-State Claims

Unlike the treaties they supercede, the new generation of international trade agreements are binding *and* enforceable. Moreover, NAFTA investment rules accord foreign investors a virtually unqualified and unilateral right to claim damages for violations of the broadly worded constraints established by these rules.[5]

Furthermore, unlike the state-to-state dispute procedures of NAFTA and the WTO, investor-state claims engender no element of reciprocity because foreign investors have no obligations under the treaty. In addition, foreign investors are indifferent to the diplomatic and political pressures that may discourage governments from invoking formal dispute resolution to challenge popular social programs of another nation. For investors, unlike governments, there are few no disincentives to making claims.

Because they may be so readily invoked, NAFTA investment disciplines present the most significant threat to public policy, programs and law relating to social services.

The Constraints of Trade Disciplines

It is worth briefly describing some of the constraints that would be imposed by trade disciplines were they to apply in this context. These would limit the right of governments to:

- limit foreign investment in the child care sector [NAFTA and GATS: *National Treatment*];

- require that the boards of directors of child care institutions be comprised of parents or members of the communities served [NAFTA Art. 1107: *Senior Management and Boards of Director*];

- expand the sphere of public not-for-profit child care in a manner that diminishes the business of for-profit commercial providers [*NAFTA Art. 1110: Expropriation*][6];

- specify the qualifications for child care staff, or the licensing requirements for child care institutions that "are more burdensome than necessary" or that establish

[5] Under Article 1122 Canada has unilaterally consented to international arbitration of claims arising under the Chapter notwithstanding the absence of any contractual relationship with the foreign investor. While foreign investor must waive their rights to pursue similar claims before domestic courts they need not exhaust domestic remedies before resorting to international dispute resolution [Article 1121]

[6] As discussed below, Article 1110 applies regardless of Canada's reservation.

"unnecessarily" barriers to the supply of child care services by foreign companies [GATS Art. VI: *Domestic Regulation*]; or

- limit the number of companies providing child care services, or the market share they can acquire [*GATS Market Access*].

Governments must now tread carefully when developing new policy and legal initiatives to avoid the risks presented by this new generation of trade agreements. But assessing the nature and extent of the constraints imposed by NAFTA and WTO disciplines is difficult because trade rules concerning investment, services, and procurement are unprecedented, ill-defined, and largely untested. To exacerbate the problem, efforts continue to expand the framework of trade law, and new trade commitments typically apply retroactively.

De Jure vs. *De Facto* Risks

In identifying the potential pitfalls associated with trade rules, two assessments must be made - the first is legal, the other practical. The legal question concerns whether a particular measure[7], such as a requirement that child care centres be public or community based organizations, conforms with trade rules that limit or prohibit measures that exclude foreign service providers.

The second question concerns the actual likelihood of a trade challenge or foreign investor claim even where some action by government may be inconsistent with free trade disciplines. The risks here largely depend upon the extent to which the measure affects the vested interests of our trading partners or foreign investors. In an opinion prepared for the Romanow Commission, a senior trade lawyer who represented Canada during the initial free trade negotiations, put it this way:

> It is easy to invent NAFTA and WTO worst-case scenarios but the actual impact of these agreements must be assessed realistically. An expansion of the public component of the health care system into new areas, with the resulting exclusion of private interests, would result in NAFTA compensation claims or WTO challenges only if the private economic interests adversely affected were significant. If these interests are non-existent or insignificant, the risk of claims or challenges is negligible.[8]

Conversely the presence of significant private or foreign investment interests in a particular sector may create a formidable impediment to establishing new public programs. This is true because NAFTA investment rules effectively entrench private property rights (unlike Canada's constitution), allowing foreign investors to claim compensation when their businesses are adversely affected by public policy or regulatory

[7] Measure is technical term under NAFTA and the WTO. NAFTA Art. 201 defines "measure" to include any law, regulation, procedure, requirement or practice.
[8] Jon Johnson; *How Will International Trade Agreements Affect Canadian Health Care*? Commission on the Future of Heath Care in Canada, Sept. 2002.

initiatives.[9] The result can be observed in New Brunswick's retreat from plans to establish a public auto insurance scheme in the face of threats by the insurance industry to claim compensation under NAFTA if it did so.

With this introduction, we turn to consider the question noted:

Do NAFTA or WTO rules limit the range of policy, funding and regulatory options that governments may wish to adopt, or abandon, from time to time to ensure that child care programs meet and remain responsive to the needs of Canadian children and families?

NAFTA

The right to expand or establish new social programs is one that Canada did reserve under NAFTA. In this regard, Canada's reservation for "social services" provides:

> *Canada reserves the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and* ***child care***. [emphasis added][10]

In the jargon of international trade law, Canada's reservation for social services is "unbound", meaning that Canadian governments are entitled to maintain, expand or establish new social services, such as a national ECEC program. This is true even where such initiatives restrict the rights of foreign investors or service providers, so long as governments respect the limits of the public policy and legal domain carved out by the reservation.

It is important, however, for governments to appreciate that Canada's reservation for social services does have significant limits. To begin with, the reservation doesn't apply to all NAFTA investment and services rules, including the provision concerning expropriation[11] which was invoked by the auto insurance industry to discourage New Brunswick from proceeding with plans to establish public auto insurance.

Another limitation arises from the fact that unlike law enforcement of correctional services, this reservation for child care only applies to "social services established or maintained for a public purpose". Unfortunately the US and Canada have very different views about the meaning of these key but undefined terms. According to the US view:

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[9] **Error! Main Document Only.**David Schneiderman, *NAFTA's Takings Rule: American Constitutionalism Comes to Canada*, University of Toronto Law Journal 499 (1996), at pp. 521-523, and *Investment Rules and New Constitutionalism*, 25 Law and Social Inquiry 757 (2000).

[10] NAFTA Annex II.

[11] Under NAFTA, expropriation is defined much more broadly than under Canadian law, and as noted by the BC Supreme Court is so expansive as to include local zoning bylaws of general application. **

> The reservation in Annex II U-5 (the US equivalent to Canada's) is intended to cover services which are similar to those provided by a government, such as child care or drug treatment programs**.** If those services are supplied by a private firm, on a profit or not-for-profit basis, Chapter Eleven and Chapter Twelve apply. [emphasis added][12]

In other words, child care provided by private companies would not be considered a social service. Consequently child care policies and law that sanctioned such private delivery would not have the protection afforded by the NAFTA reservation. In other words, according to the ranking US trade official of the day, only social programs delivered by governments or public institutions would be protected by this key reservation.

For their part Canadian officials have little to say about the US view, suggesting instead that the scope of this reservation "depends largely on how a country's own government, views the situation."[13] But the suggestion that this reservation is essentially self-defining, is entirely inconsistent with the approach adopted by the NAFTA parties for defining such exceptions, and is very unlikely to persuade an international trade or investment tribunal.[14]

It remains to be seen which view will prevail when a trade panel, or arbitral tribunal convenes to decide the matter. If the protection afforded by this reservation is negated, the policy and regulatory options of governments relating to child care will be significantly constrained. For instance, and as noted, governments would not be able to exclude foreign child care chains from investing in, or even dominating the sector.

Notwithstanding this controversy, it is clear that an ECEC system that allows little if any role for private or commercial providers, is far more likely to fall within the boundaries of this key reservation. As a matter of law, there is a strong rationale for establishing ECEC programs as public, and not-for-profit endeavours.

This conclusion is reinforced when practical realities are taken into account. The absence of significant foreign investment in the child care sector allows Canadian governments to develop a national ECEC program without the threat of foreign investor claims looming over their heads. But this strategic advantage would be lost if new commercial investment is allowed in the sector. This is precisely the predicament that now confronts Canadian governments considering options for expanding the medicare system to include pharmacare and homecare, and confronting large and vested corporate interests in each domain.[15]

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[12] Correspondence from the USTR, Michael Kantor to the Attorney General for the State of Oregon, Mar. 1996

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[14] See for contrast Article 2102 of NAFTA which reserves to the Party's the right *to take any actions that it considers necessary for the protection of its essential security interests* [emphasis added].

[15] See Jon Johnson, note 7.

It is worth noting that prior to being replaced by the CHST, the Canada Assistant Plan (CAP) restricted federal funding for child care to public or non-profit bodies, a constraint that played an important role in limiting the spread of commercial, for-profit child care in many provinces. It is the legacy of that policy that has preserved government options for establishing a national ECEC program.

There is significant international corporate interest in the child care sector, but these corporations have yet to gain a significant foothold in Canada.[16] However, increased and more stable child care funding will no doubt renew interest for companies seeking to expand into new markets.

Finally on this point, it is unclear where the tipping point will be in determining whether an ECEC system is private or commercial in character, particularly if it is a mixed system that accommodates various providers. Certainly one must distinguish between home care and the services provided by transnational child care companies like KinderCare Learning Centers Inc., even though both are technically private for-profit operations.

It may be that even the marginal participation of commercial players in ECEC sector disqualifies a government from claiming the protection of Canada's social services reservation, as a matter of law. But this only underscores the importance of preserving the practical advantage that exists when there is little if any foreign investment in the child care sector, thus leaving governments free to regulate without the imminent threat of foreign investor claims.

The WTO General Agreement on Trade in Services (GATS)

The GATS is important because it applies to all government measures[17] affecting trade in services whether established or maintained by federal, provincial or local governments. The GATS also defines "trade in services" broadly, and includes the delivery of services provided though a "commercial presence." For example, a foreign owned child care company operating in Canada would be engaged in "international trade in services" according to this GATS definition.

However, the GATS also includes a broad exclusion for services provided in the "exercise of governmental authority." These are defined as services provided "*neither* on a commercial basis *nor* in competition with one or more services suppliers" (GATS Article I:3.c) [emphasis added]

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[16] For example ABC Learning Centres Ltd. has established a dominant position is Australia, see summary of news accounts at http://www.childcarecanada.org/index.shtml. Several US based conglomerates including KinderCare Learning Centers Inc., which invested at one time in Canada, have substantial businesses providing child care services see New York (CNN/Money): *Affiliate of ex-junk bond king's company to acquire child care center operator for $550M in cash*, November 6, 2004

[17] "*Measure* means any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form." GATS Article XXVIII, Definitions.

The failure of the GATS to define these terms more precisely has fuelled debate about the scope of this exemption. Nevertheless it is clear that a national ECEC program provided by public institutions on a not-for-profit (ie. non-commercial) basis is far more likely to fall within the scope of this social services exception than one where for-profit or commercial providers are allowed to participate.

However, even where services are subject to the GATS, its most onerous obligations, *National Treatment* and *Market Access*, apply only to services with respect to which Canada has made specific commitments. In doing so, Canada may also qualify its obligations to exclude particular policies and programs.

The unqualified application of these GATS disciplines would seriously limit if not prevent Canada from establishing an ECEC program as a public system. In addition to the threat of investor claims, this was precisely the problem that confronted New Brunswick when it sought to establish a public auto insurance system, because Canada had committed automobile insurance under the GATS, thereby precluding such a public sector insurance plan.

Fortunately, the federal government has made no similar commitments of education or child care services and has vowed not to do so, at least with respect to "public education" services.[18] It is of concern that it has limited this promise to "public" education services, a qualification it has not attached to health services which it has said it will protect whether "public" or not.[19] By doing so, Canada appears to be leaving the door open to making GATS commitments relating to education services that it does not consider to be public. This qualification further underscores the importance of establishing ECEC programs as public systems, which for present purposes should be taken to mean publicly owned and publicly operated.

Turning to practical considerations, as long as Canada makes no commitment of education or child care services, the GATS imposes few if any constraints on Canadian policy and law relating to ECEC. Even if the legal picture changes, foreign governments would likely be reluctant to invoke dispute resolution under the WTO to assail a popular social program, and would have no incentive to do so, unless its resident corporations had a sufficient stake in the Canadian market to warrant such a challenge. Again the prudent course for governments would be to preclude foreign and private investment in the ECEC system they intend to establish.

Procurement

One final area of trade law should be briefly noted because it represents an area where governments, particularly provincial and local governments,[20] still have a fair degree of policy flexibility, and that is procurement.

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[18] citation needed

[19] ***

[20] Neither NAFTA nor WTO procurement disciplines apply to provincial or municipal governments. See NAFTA Articles 1108, 1206 and GATS Article XIII.

Some may argue that if governments procure child care services they will largely be exempt from international trade rules. Thus governments might directly, or through a public agency, tender for childcare services. The successful bidder would then provide services pursuant to a contract with the tendering body.

Quite apart from the policy arguments for and against such an approach, there are two problems with this argument. The first arises from the fact that certain NAFTA investment rules, including the rule on expropriation, apply even to procurement measures. The second, and more important, is that such a tendering regime is unlikely to be considered government procurement because it does not involve the purchasing of products and services by governments and government agencies for their own consumption, direct benefit or use - which is the common understanding of procurement. For these reasons the relative latitude accorded provincial and local governments with respect to procurement will be of little avail in establishing ECEC programs.

Conclusion

The preceding assessment provides only a broad overview of the complex and inter-related trade rules that affect public policy options concerning child care. It should not be taken as comprehensive or complete. Other trade rules, including those concerning subsidies and tax measures might have also been reviewed. A more detailed and in-depth analysis is also possible of the meaning of key NAFTA and GATS terms.

Rather, this assessment has focussed on what we regard as the most critical issue for governments seeking to establish new ECEC programs. This concerns the importance of preserving future public policy options for child care by taking advantage, while preserving the integrity, of exceptions and reservations to both NAFTA and WTO rules that are critical to the viability of social programs otherwise incompatible with free trade objectives.