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## The Framework and Process of Canada-United States Trade Liberalization\*\*

by Frank Stone \*

### I. INTRODUCTION

**T**he Declaration on Trade made by Prime Minister Mulroney and President Reagan at their meeting in Quebec City on March 17-18, 1985, could lead to developments of historic importance in Canada-United States trade relations. The two leaders agreed on the objective of reducing and removing tariff and other barriers to cross-border trade, and called for a report within six months "on all possible ways" to achieve this objective. They also committed themselves to halt protectionism in cross-border trade in goods and services.

They announced the resolution of a number of existing irritants in bilateral trade, or action aimed at resolving them. And, they announced that negotiations would proceed over the following year to liberalize and facilitate mutual trade in a number of important areas, including government procurement, air travel, tariffs, energy products, high technology goods and related services, and intellectual property rights.<sup>1</sup>

In launching this new, ambitious process of negotiations aimed at bilateral trade liberalization, the Prime Minister and the President reaffirmed their commitment to the multilateral trading system embodied in the General Agreement on Tariffs and Trade (GATT), and called for international support for opening a new round of GATT negotiations in early 1986. They stated the new efforts to resolve bilateral impediments to trade would proceed "in a manner consistent with our international obligations." The Declaration did not suggest that the new process of bilateral negotiations would lead to an exclusive free-trade area, or any new comprehensive Canada-U.S. trade agreement, or to preferential trade arrangements.

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\*\* Paper presented at Conference.

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<sup>1</sup> Declaration by the Prime Minister of Canada and the President of the United States of America Regarding Trade in Goods and Services, March 18, 1985.

For reasons that are unclear, the Quebec Declaration avoided the term "negotiations" to refer to the bilateral process regarding trade in goods and services that was launched by the Prime Minister and the President; nevertheless, that term will be used in this paper.

## II. THE EVOLUTION OF CANADA-U.S. TRADE RELATIONS: A SHORT REVIEW

A short review of Canada-U.S. trade relations may be instructive. For a brief period of twelve years in the mid-nineteenth century, a Reciprocity Treaty was in effect between the British North American Colonies and the United States under which tariffs were removed on a range of so-called "natural products," but not on manufactured goods. This arrangement was abrogated by the United States in 1866, partly because of a resurgence of protectionism in the United States after the Civil War. Over the next seventy years, no special trade agreement relationship existed between Canada and the United States. The two countries applied their highest tariffs to each other's goods where these were dutiable. These tariffs were very high, especially on the U.S. side, during the 1920's and early 1930's.

The process of liberalization of Canada's trade with the United States may be regarded as having begun with the two bilateral trade agreements concluded in 1935 and 1938, following the reversal of U.S. protectionist policies under the 1934 Reciprocal Trade Agreements Act.<sup>2</sup> Since the Second World War, this process has continued largely within the multilateral context of the GATT, which for almost forty years has been Canada's main trade agreement with the United States. Under the GATT, seven successive rounds of multilateral tariff and trade negotiations have been held. During these, the two countries bargained down levels of their tariffs on many products traded across the border, and extended the lower rates to other countries in accordance with their respective Most-Favored-Nation commitments. The GATT has also provided a set of agreed rules which govern the policies and practices of the two countries with respect to tariff and non-tariff measures, including those applied to bilateral trade.<sup>3</sup>

Part of this process of post-war liberalization of cross-border trade was accomplished on a bilateral basis, by arrangements concluded outside the GATT framework designed to remove particular obstacles to trade and to deal with special conditions of the bilateral relationship. Although these arrangements are of great importance, they are relatively few in number, especially in the light of the close and intricate relationships between the two economies.

These arrangements include: the 1965 Automotive Agreement,<sup>4</sup> which facilitated the reorganization of production and trade in vehicles and original parts in the two countries; the long-standing arrangements governing the movement across the border of defense goods under the

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<sup>2</sup> Reciprocal Tariff Act of 1934, ch. 474, 48 Stat. 943 (current version at 19 U.S.C. §§1351-54 (1982)).

<sup>3</sup> For an analysis of the GATT from a Canadian perspective see F. STONE, *CANADA, THE GATT AND THE INTERNATIONAL TRADE SYSTEM* (1984).

<sup>4</sup> Agreement Concerning Automotive Products, Mar. 9, 1965, United States-Canada, 17.1 U.S.T. 1372, T.I.A.S. No. 6093.

Defense Production/Development Sharing Program; the special understanding regarding the licensing of controlled strategic exports; and in 1984, an understanding regarding the use of "safeguard" import measures which affect bilateral trade. This understanding, which covers any action taken under GATT Article XIX or any similar emergency actions on imports, builds upon rules already established in the GATT. It provides for advance notice and consultations when either country takes emergency relief action affecting imports from the other.

The reduction or elimination of tariffs on cross-border trade as a result of the GATT negotiations has been impressive. It has been estimated that when the tariff cuts agreed to during the Tokyo Round are implemented (by the end of 1987), 80% of Canada's exports to the United States will enter duty-free, and 15% will be subject to duties of 5% or less.<sup>5</sup> The comparable estimates of U.S. exports entering Canada duty-free is considerably less, about 65%.

However, tariffs will remain, on numerous products, which will impede or block bilateral trade. Moreover, the customs systems of both countries contain administrative and other elements which give rise to uncertainties, such as procedures for the valuation of imported goods and for their classification for customs purposes. Some, but not all, of these customs problems are being alleviated as an outcome of the Tokyo Round.

The GATT rules, as reinforced and extended over time and especially as an outcome of the Tokyo Round, have served to constrain and discipline the use of non-tariff barriers to bilateral trade. Nevertheless, non-tariff measures and "contingency protection" measures, or the threat of their use, present serious obstacles to bilateral trade in certain areas. These include a wide range of measures permitted or mandated by legislation at both federal and state/provincial levels. The list includes anti-dumping duties, countervailing duties (especially on the U.S. side), preferential government procurement or "buy-national" policies, differing product standards and standards systems, and various forms of government intervention in the agricultural sector involving restrictions and prohibitions on imports.<sup>6</sup> The list also includes a variety of policies and

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<sup>5</sup> These estimates can be misleading. They include duty-free trade under the special features of the Automotive Agreement based on actual trade flows in 1976. These calculations give no indication of the volume of trade that is blocked by high tariffs and other barriers, on both sides of the border, which might flow if those barriers were removed.

The results of the Tokyo Round, from a Canadian perspective, were reviewed in GOV'T OF CANADA, MULTILATERAL TRADE NEGOTIATIONS 1973-1979, (Press kit, July 11, 1979). For an account of the results of the Tokyo Round in terms of Canada-U.S. trade see SENATE STANDING COMM. ON FOREIGN AFFAIRS, 3 CANADA-UNITED STATES RELATIONS: CANADA'S TRADE RELATIONS WITH THE UNITED STATES, app. A (Mar. 1982) (available from Minister of Supply and Services Canada).

<sup>6</sup> The Trade Agreements Act of 1979, Pub. L. No. 96-39, 93 Stat. 202 (codified in scattered sections of 19, 26, & 28 U.S.C.). For a review of U.S. trade legislation as amended by the 1979 Act see R. GREY, UNITED STATES TRADE POLICY LEGISLATION: A CANADIAN VIEW (1982).

measures which distort trade flows, such as subsidies in both countries (but especially in Canada) designed to encourage domestic production, to assist regional development, to promote exports or to attract investment.

Each country also has a complex range of policies and measures which affect, or may block, flow of trade in a large sector: services. These policies may be in place for a variety of reasons including the limitations of foreign ownership, cultural development, consumer and privacy protection, and the limitation of employment of foreign workers. A summary view of barriers to cross-border trade was expressed in a recent paper by Simon Reisman as follows:

[W]ith a few exceptions, it is no longer the tariff that troubles Canada in her trade with the U.S.A. Rather it is a range of non-tariff barriers, emergency measures, and threats of restrictive action that create the most severe problems for Canadian trade. This is less true for U.S. exports to Canada where the tariff remains a significant obstacle but where the other constraints are of lesser importance.<sup>7</sup>

One serious consequence for Canada, of actual or threatened measures on the U.S. side which restrict or distort bilateral trade, could be their effect on investment decisions. In the face of the operation of U.S. antidumping and countervailing duty systems, government procurement practices, other policies which impede or distort trade patterns, and potential changes in restrictive U.S. trade policies, Canadian as well as foreign-owned companies may tend to locate new plants across the border in order to avoid risks and uncertainties—even when market considerations favor location in Canada.

### III. THE EMERGING CONSENSUS IN CANADA

Proposals for some form of bilateral free-trade arrangement have been the subject of renewed discussion in Canada. In the mid-1970's, the Economic Council of Canada saw a free-trade area with the United States as the most practical, if not the best, choice for Canada.<sup>8</sup> In 1982, the Senate Committee on Foreign Affairs made a forceful case for negotiating a bilateral free-trade arrangement.<sup>9</sup> The government's study of trade policy in September, 1983, however, concluded that the "evidence to date of the need to proceed towards free-trade is not convincing nor does a call for free-trade command broad support." Instead, it proposed "entering, gradually, into bilateral arrangements to resolve particular issues."<sup>10</sup>

<sup>7</sup> Reisman, *Canada-United States Free Trade*, in U.S. CANADIAN ECONOMIC RELATIONS: NEXT STEPS? (Brookings Inst. 1984).

<sup>8</sup> ECON. COUNCIL OF CANADA, *LOOKING OUTWARD: A NEW TRADE STRATEGY FOR CANADA* (1975) (available from Minister of Supply and Services Canada).

<sup>9</sup> SENATE STANDING COMM. ON FOREIGN AFFAIRS, *supra* note 5.

<sup>10</sup> DEP'T OF EXTERNAL AFFAIRS, CANADA, *A REVIEW OF CANADIAN TRADE POLICY* 212 (1983); See DEP'T OF EXTERNAL AFFAIRS, CANADA, *CANADIAN TRADE POLICY FOR THE 1980'S: A DISCUSSION PAPER* 41-45 (1983) (available from Minister of Supply and Services Canada). See

However, the government of Prime Minister Mulroney, after taking office in September, 1984, made known that several options for further Canada-U.S. trade relations would be considered. Alternative approaches to Canada-U.S. trade were set out in a Discussion Paper issued in early 1985 by the Minister of International Trade.<sup>11</sup> These included: maintaining the status quo; negotiating sectoral or functional arrangements; negotiating a comprehensive bilateral trade arrangement; and concluding a "framework" type agreement. The course of action launched at Quebec City appears to combine the second and third approaches.

Support in Canada for some form of broad, new bilateral trade arrangement has been given over the past year by, among others, the Chamber of Commerce, the Canadian Exporters Association, the Canadian Manufacturers' Association and the Business Council on National Issues. Mr. Donald Macdonald, Chairman of the Royal Commission studying Canada's economic future, has expressed support for bilateral free-trade; and the report of the Commission, due in June, 1985, may well recommend efforts to conclude a new, open bilateral trade arrangement.

At a federal-provincial conference in February in Regina, support for some form of bilateral free-trade arrangement was given by a number of the provincial governments, notably by the government of Alberta.<sup>12</sup> More cautious views, however, have been expressed by the government of Ontario. Many labor unions are negative towards liberalizing Canada's import regime. Critics representing nationalist points of view have warned against the consequences of Canada-U.S. free-trade for Canadian sovereignty and independence.

The federal government has emphasized its desire to take into account the full range of Canadian views on future trade policy. The Discussion Paper referred to above is serving as a basis for a current series of consultations across the country by the Minister of International Trade. Meanwhile, there is a degree of uncertainty about the follow-up, on the Canadian side, to the Quebec Declaration.

#### IV. UNITED STATES RESPONSE

Officials in Washington have indicated that while they would welcome Canadian initiatives for trade liberalization on a bilateral as well as multilateral basis, they would wait for Canadian initiatives relating to any far reaching bilateral trade measures and not take the initiative

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*also* M. HART, *SOME THOUGHTS ON CANADA-UNITED STATES SECTORAL FREE TRADE* (1985) (available from Institute for Research on Public Policy, Montreal).

<sup>11</sup> *DEPT INT'L TRADE (CANADA), HOW TO SECURE AND ENHANCE CANADIAN ACCESS TO EXPORT MARKETS: DISCUSSION PAPER* (1984).

<sup>12</sup> *Gov't of Alberta, Free Trade with the United States: An Alberta Perspective* (Feb. 1985) (unpublished paper presented at the First Minister's Conference on the Economy, Regina, Saskatchewan).

themselves. Nevertheless a fairly solid base exists in Washington for negotiating a new Canada-United States trade regime, though the subject has not aroused widespread public interest.

The 1979 Trade Agreements Act required the President to report to Congress on the possibility of free-trade arrangements with Canada (and Mexico); but the President's subsequent report did not suggest that such an agreement was desirable or imminent, nor how an agreement might be pursued. Since the autumn of 1983, the Office of the U.S. Trade Representative has given positive responses to the Canadian proposals for sectoral negotiations.

However, U.S. government statements have suggested that support for bilateral trade liberalization on a sectoral basis, or on a wider basis, is linked with a broader U.S. strategy for a further round of comprehensive trade negotiations within the GATT.<sup>13</sup> In February, 1984 the two sides agreed to separately examine possibilities for liberalizing trade in several product areas. In late 1984, the International Trade Commission investigated and reported on the probable consequences to the U.S. economy of the removal of trade barriers against Canadian imports in a number of product areas.<sup>14</sup>

## V. U.S. NEGOTIATING AUTHORITY

The precise scope of the existing authority of the Administration to negotiate and agree to removal of tariffs and other barriers to imports from Canada is not entirely clear. Since the 1930's, it has been the general U.S. practice for the Administration to negotiate trade agreements, bilaterally or within the GATT, with authority delegated to it by U.S. legislation requiring approval by a simple majority of the two Houses of Congress, rather than by treaties requiring the consent of two-thirds of the Senate. When legislation to implement particular provisions of trade agreements was required, this involved further Congressional approval.

Section 102 of the 1979 Trade Agreements Act extended, until 1987, the authority contained in the 1974 Trade Act to negotiate agreements on non-tariff barriers. Section 104 of the 1984 Trade and Tariff Act extended this authority to include the reduction or removal of tariffs, subject to agreement by the House Ways and Means Committee and the Senate Finance Committee. Presumably, the precise nature and extent of the Administration's authority to negotiate a bilateral agreement with

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<sup>13</sup> In Oct. 1984, in an address to a conference in Montreal on Canada-U.S. Business Perspectives, Assistant U.S. Trade Representative Bale said:

Serious obstacles have been evolving to the multilateral liberalization process, which require us to consider bilateral, as well as multilateral approaches. . . . We do not believe that we should wait for a multilateral consensus before we take concrete steps to liberalize trade. . . . Thus we have welcomed the Canadian government's initiative to explore possible bilateral liberalization agreements in selected sectors.

United States Embassy, Ottawa, Press Release No. 84-33 (Oct. 1, 1984).

<sup>14</sup> Office of the U.S. Trade Representative, Press Release (Oct. 4, 1984).

Canada—to reduce or eliminate tariff and non-tariff barriers—is a subject that requires expert legal opinion. The same is true of the process for the adoption of legislation to implement particular provisions of such an agreement.<sup>15</sup>

## VI. FOLLOW-UP TO THE QUEBEC DECLARATION

The Quebec Declaration raises a number of important procedural and legal questions with respect to the framework and process of the bilateral negotiations which have been launched. The answers to these questions are by no means clear. Nor does this paper try to address them, in the absence of a clearer indication of the two governments regarding the follow-up to the Quebec Declaration. These questions include:

(1) the organization of bureaucratic arrangements to pursue the negotiations on each side, and the structure within which bilateral negotiations will take place over the next year and beyond;

(2) whether the conduct of the negotiations, or the implementation of their results, will require new legislation in either country;

(3) the eventual outcome of the negotiations, in terms of a possible new comprehensive Canada-United States trade agreement or treaty, and in terms of possible new bilateral institutional arrangements;

(4) problems of accommodating any new preferential elements which may be developed on a bilateral basis with the obligations of the two countries under the GATT, and with their trade relationships with the European Community, Japan and other third countries;

(5) the timing and eventual scope of the bilateral negotiations, and the process by which these are meshed with a new round of GATT negotiations; and

(6) the extent to which bilateral negotiations would be governed by concepts of reciprocity, and whether measures to implement the results would be phased in by the two countries over different periods of time.

## VII. CONCLUSIONS

The approach of Canada and the United States to bilateral trade liberalization, as set out in the Quebec Declaration, appears to be pragmatic and practical. But, it raises a number of important issues with respect to the framework and process for follow-up negotiations. Among other things, the approach of the two countries reflects the high degree of integration of their economies, as well as other special and unique features of the Canada-United States relationship.

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<sup>15</sup> The Quebec Declaration refers to the “reduction” of tariffs on trade between Canada and the United States, not to their “removal.” This is presumably because of constraints in existing U.S. legislation. Moreover, reductions are to be pursued “in a manner fully consistent with their legislative requirements and their international obligations.”



By contrast, post-war efforts toward economic integration and trade liberalization among Western European countries proceeded under a wholly different set of circumstances. These involved important political and strategic, as well as economic considerations, along with strong support from many outside countries, including the United States and, with some reservations, Canada. From the start, the European process was cast in more theoretical and legalistic molds, following largely the models for customs unions and free-trade areas set out in Article XXIV of the GATT.

At the same time, the Quebec Declaration established a process and framework for bilateral trade negotiations which is highly tentative, blurring an uncertain series of bilateral negotiations with an equally uncertain future round of multilateral negotiations, and leaving almost wide open the outcome for a future bilateral regime. An approach of this kind may be the only practical course for Canada and the United States, but the progress of the negotiations and the nature of their outcome will now depend not only on the vigor with which they are pursued by the Ottawa and Washington governments, but equally on demonstrations of support by private sector interests, provincial and state governments, and the U.S. Congress.

Moreover, it is evident that Canada must be prepared and equipped to play the lead role in moving the bilateral negotiations along. In the absence of a strong Canadian lead, U.S. interest can be expected to turn away from bilateral trade issues and focus more on multilateral negotiations in the GATT.

This paper has focused on the framework and process for efforts to liberalize Canada-United States cross-border trade and deal with bilateral trade policy issues. It leaves for others, more qualified, the analysis of the economic benefits and costs to the two countries, and the adjustments in the two economies which would be involved as a consequence of a new trade regime. It also leaves for others the investigation into the political issues in the two countries which may be raised by the dismantlement of barriers to cross-border trade.

If a process of bilateral negotiations along the lines set out in the Quebec Declaration is vigorously pursued, the process itself would serve to dampen protectionist pressures on both sides. An ongoing process of negotiations covering bilateral trade and trade policy issues would focus attention in the United States on Canadian economic and trade problems, and on the important U.S. stake in the Canadian economy. Also, by pursuing bilateral negotiations now, the two countries would encourage broader international agreement to open a new round of tariff and trade negotiations under the GATT.

Finally, it seems essential to launch such a process of negotiations at a period when there is a renewed and positive interest on both sides of the border in the bilateral relationship; when the two governments have both recently been given new and strong electoral mandates.