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*by Simon S. Reisman**

I. INTRODUCTION

The Conference program has allocated the entire afternoon to the relevance of the AutoPact for integration of other Canada-U.S. industrial sectors. It would seem that the Conference planners anticipated that an examination of the Automotive Agreement would enlighten us in selecting other sectors and in designing terms and conditions that would encourage agreement between our two governments to extend the scope of sectoral free-trade.

If this was indeed the expectation, I must confess immediately that if I adhered strictly to the allocated subject I would leave you a good deal of free time this afternoon. Accordingly, I will first talk about the *Automotive Agreement*, but then extend my remarks beyond that topic and venture into the realm of a comprehensive free-trade agreement between our two countries. And, I would like to go a little beyond that. But let's see whether we can find inspiration in the AutoPact—its origin, terms and history—to help us with the issue of regional free-trade in other sectors. Can this pattern be extended to other industries?

II. THE AUTOPACT

A. Conditions Before the Automotive Agreement

A word first about the structure of the Canadian car industry at the time that we entered into the AutoPact. Virtually the entire production of cars and trucks in Canada was then, and is now, accounted for by wholly-owned and controlled subsidiaries of the Big Four American motor vehicle corporations. The pattern was somewhat different in the production of original equipment parts. Less than half the total output in Canada was in the hands of the Big Four, one-quarter was accounted for by ten independent multinational companies, and about 400 smaller companies, most of which were Canadian owned, produced the balance of the original equipment parts. Labor in the industry was then repre-

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sented by a common international union. Geographically, the industry was concentrated in a relatively compact region abutting both sides of the border.

In terms of what, where and when to produce; where and from whom to source components and materials; industrial relations; pricing policy; government relations; and other key decision areas, the automotive industry on both sides of the border was dominated by a handful of giant enterprises, which made all these key decisions. Taken together these characteristics facilitated the negotiation of a bilateral sectoral trade agreement. But in terms of finding similar conditions in other industries, it would have to be acknowledged that the automotive sector is rather unique.

What about the origin of the AutoPact and its motivation? Neither the United States nor Canada set out to negotiate a free-trade arrangement in automotive products. It came to pass not by inspiration, not by deliberate policy planning, but as a response to necessity.

During the 1950's and early 1960's, the Canadian auto industry found itself plagued by intense international competition and a reduced capability for meeting that competition because of rapid technological change. To keep up with the new technology required capital investment in all segments of the industry, on a scale well beyond the capacity or economic justification of truncated, relatively small-scale enterprises—whether foreign owned or Canadian. The very survival of the industry required a massive restructuring, and this could not be accomplished either within the existing policy framework or within the limitations of the small Canadian market.

Canada tried to escape this dilemma by introducing a not atypical Canadian commercial policy invention: combining elements of free-trade with continued protection. Now that is quite a trick. The first experimenting was a duty-remission scheme, for imported transmissions and engines, equivalent to any increase achieved in exporting Canadian made components. Success in this encouraged Canada to broaden the policy whereby duty would be remitted on any vehicle or component import if matched by equivalent exports of vehicles or parts. The effect of this operation was to reduce the import duty which was paid on both components and parts. In essence the project was designed to encourage specialization, larger production runs, and reduced costs, through expanding exports to offset the larger imports such a system would entail.

The United States was reasonably tolerant of the 1961-62 experiment, but became less so when Canada broadened the scheme to take further advantage of the specialization efforts involved. In response to complaints by its auto parts producers, the U.S. launched a countervailing duty investigation to determine whether the Canadian measure was equivalent to a subsidy. Canada argued that its measures reduced rather than raised duties, expanded rather than contracted trade, and were really not a subsidy.

The U.S. investigation was never completed because both countries were sufficiently concerned about the impact that an adverse ruling would have on trade and other relationships to force them to seek a more constructive solution. Intensive negotiations over several months led to the AutoPact. It is not clear who was the real driver in finding the qualified free-trade solution. I have always been prepared to give Phil Trezise all the credit and he has always insisted that I must share the blame.

I am not sure what moral to draw from this episode. Do we have to get into a crisis situation affecting an industry before we are inspired to find reasonable solutions based on freer trade? None of the recent or current inquiries into alleged trade misdemeanors—steel, lumber, manufactured foods containing sugar, fish, potatoes, pork—would seem to lend themselves to resolution in the form of sectoral free-trade arrangements.

B. Terms and Conditions of the Agreement

What of the substance of the AutoPact—its terms and conditions? Can we find a model there which would serve in crafting an agreement suitable for other industrial sectors?

In broad terms, the AutoPact provided for free-trade between the two countries in vehicles and original equipment parts. Replacement parts, tires, batteries and used cars were excluded. A number of safeguards were written into the agreement, and there were certain commitments made by the motor vehicle manufacturers relating to their production plans. Together, these satisfied Canada that the transition to free-trade would be orderly and would take place in a framework of expanding production. The U.S. holds that the safeguards were meant to disappear after a transitional period—albeit of undefined duration. For its part, Canada has argued that safeguards are needed to ensure that its industry can participate on a fair and equitable basis in an expanding North American market. Things are quiescent now, but the peace remains uneasy.

The Agreement was unlimited in duration but subject to termination on one year's notice by either party. It has now been in force for twenty years with only minor changes. Over its life there have been complaints on both sides—depending on how the balance of trade was working out. For many years the U.S. had a surplus. In the past two years the surplus has been in Canada's favor—to a massive degree: Canadian exports of automobiles and automotive parts to the United States exceeds total Canadian exports for all products to all other countries in the world. It is a figure of about $28 billion for 1984, compared to $24 billion for all other exports to the rest of the world.

At the time we negotiated, the U.S. team urged that we put a three year limit on the transitional period. The Canadian side resisted on the grounds they could not tell in advance what a three year period would do. What we were worried about was that there seemed to be institutional barriers and attitudes, particularly on the part of the United States management of large concerns operating on both sides of the border, about depending on Canada as a source of supply for finished cars.

I recall a discussion with the chief executive officer of the largest of these corporations. He said: "We are the car manufacturers of the world. We would not dare put cars in a showroom with a Canadian made label." Two years later, this same man said to me: "People come into our showrooms and they want to know if a car was assembled in Canada, because that is the car they want." I have felt for some time that those safeguards have outlived their usefulness. They are a nuisance and limit the gains we can make from the free-trade arrangement. I would hope that in future arrangements we do not try to replicate the notion that safeguards need to last beyond some relatively short and firm period.

C. Results from the AutoPact

A fair reading of the results of the AutoPact is that both sides have benefited. Canada has benefited relatively more than the U.S., but this is inevitable in any situation where the U.S. begins with a massive home market and Canada begins with a small protected market. The AutoPact rescued Canada from the inefficient high-cost assembly and parts production associated with a small market, short runs, small scale, and highly differentiated models and parts. By encouraging the production of a more limited range of cars and original equipment parts for the whole North American market, Canada developed the capability of competing fully with assembly and parts plants in the U.S. And in some instances it led the way in cost cutting and overall efficiency.

For its part the U.S. has also benefited. The Canadian market is a richer and bigger market for automotive products and the U.S. has shared in its growth. The major companies are U.S. owned and they enjoy a better return on capital which is manifest in the form of better profits. A trade-war was averted that would have been costly for both counties—critically so to Canada.

Can we conclude from this that the U.S. would be willing to accept trade agreements, in particular sectoral agreements, which would include safeguards for Canada of unlimited duration? I believe, in this respect, the AutoPact is *sui generis*—and will not be repeated. Canada may need transitional periods to adjust to a free-trade regime, either sectoral or comprehensive, but there is little justification for indefinite transitional safeguards.

A more technical matter relates to the international acceptability of sectoral free-trade arrangements. The United States sought and obtained a GATT waiver for its measures under the AutoPact. Canada did not need a waiver because it extended the right of free entry to automotive products from any source, providing the importer qualified as a bona-fide automobile manufacturer and met certain conditions. I doubt that the U.S. would wish to seek such a waiver again; or if it did, that the GATT countries would acquiesce, considering the AutoPact has not, even now, matured into a full free-trade arrangement.

D. Conclusions Relevant to Free-Trade Arrangements

What can we conclude about the relevance of the AutoPact for other sectoral arrangements? I would say it is relevant—but not very. Future sectoral free-trade deals, if any, will have to be quite different in a number of important respects. Furthermore, I must confess skepticism about sectoral deals. They do not really solve Canadian problems. They yield only limited benefits; they are difficult to negotiate; they bring out protectionist sentiments; and, they would be resisted by the GATT countries. I think they would divert us from arrangements that are much more important and more significant—whether on a multilateral or on a comprehensive basis.

However, there are some important lessons to be learned from the AutoPact experience, should our two countries decide to work out a more comprehensive free-trade agreement:

1. The AutoPact has produced large, tangible benefits for both countries. These take the form of lower prices for consumers, higher wages for labor, and more profits for investors—all made possible by higher productivity. Over the past twenty years, I estimate that in 1985 dollars these benefits have exceeded $30 billion for Canada. The benefits of a comprehensive free-trade arrangement would have been a large multiple of that figure. Based on research done by professionals in business and professors at institutes, a matured comprehensive free-trade agreement could add $40 billion per annum (in current dollars) in additional output, about 10% in terms of GNP and earned dollars. And those benefits could be available each year for as long as the comprehensive free-trade agreement remained in effect.

2. The partner with the smaller markets and the higher protection stands to gain relatively more because it has more distance to go in greater efficiency and higher productivity associated with scale and specialization.

3. By the same token, the weaker partner at the beginning of the process has a higher price to pay during the period of adjustment. There are also more risks for the weaker partner from possible interruption in the arrangement or, at the extreme, abrogation. The large investments required to gear up to a continental market would depend upon a reasonably favorable and stable commercial policy environment.

4. It would therefore be reasonable for the weaker partner to be granted a transitional period during which to restructure. It would be no

less reasonable for the stronger partner to ask that the transitional period be of firm duration and that it be unwound in accordance with a firm timetable of progress towards symmetry.

5. Finally, lack of clarity in the terms of the AutoPact led to a great deal of controversy and acrimony which threatened to overturn the agreement and at times even threatened to sour the overall relationship. It would be vital therefore, in any comprehensive agreement, to avoid ambiguities, however convenient they may appear to be during the negotiations.

In Toronto recently, I spoke at a conference on trade issues sponsored by the Ontario Economic Council. I examined the various trade policy options open to Canada against the background of our commercial policy history. I will not repeat that speech here but from what I have already said it would not surprise you to know that I rejected the sectoral free-trade approach. I did so because I believe it is inadequate for our needs, impractical of implementation, and no longer a serious option in the view of both our governments. I think the only real option for Canada today is to try to make a bilateral free-trade arrangement with the United States to cover virtually all goods and services—a comprehensive free-trade agreement that would meet the full strictures of the GATT.

Such an option has, of course, high risks for Canada. But I believe these risks are well worth taking if we could negotiate an agreement with the U.S. that recognized these risks and made reasonable provision to reduce them to manageable proportions. It would require that the U.S. be willing to accept an arrangement that was asymmetrical, regarding rights and obligations, for a transitional period. It would further require that the U.S. provide the highest possible level of assurance against the risks of abrogation or impairment of benefits— particularly during the all important transitional period, when Canadian industry would be engaged in massive investments to facilitate the restructuring process required.

The concluding part of my Toronto speech went as follows:

> Would the United States be willing to go the extra mile in recognizing the Canadian sensitivities and would they be willing to accept arrangements which were in some respects asymmetrical as to timing, exceptions, governmental assistance and other particular features that assist the Canadian restructuring process?
>
> We will never know, of course, unless we try and see what we can achieve through negotiations. A major difficulty, I fear, is that in economic terms the benefits from free-trade will be asymmetrical. United States industries already have their mass market and the potential gains from new investment and improved productivity are certain to be less impressive than in Canada. In the practical world in which we live, Americans would, I suspect, have to see concrete benefits in other areas if they are to accept the terms and conditions that Canadians would justifiably request in a negotiation.

III. Trading Water with the United States

It is this thought—the need to find some major attractions for the U.S. side in other areas, which has led me to a rather bold and controversial proposal. Given the extreme sensitivity of the subject I am about to raise, some of you may think that I have taken complete leave of my senses. (Remember, this was addressed to a Canadian audience—I would never admit to Americans that I may have taken leave of my senses.) But I am willing to take that risk. Perhaps it will help move the debate forward. Certainly it will heat it up.

The subject is water. For some years now, a group of Canadian engineers, under the leadership of Thomas Kierans of Newfoundland, who had a leadership position in the James Bay Project, have been developing the concept of harnessing the flow of fresh water into James Bay. The idea is to provide a new, large, reliable and renewable source of fresh water to meet the requirements of both Canada and the United States into the indefinite future.

This is fresh water that becomes salt water as it flows through James Bay into Hudson Bay and from there into the Arctic and Atlantic oceans. It is totally wasted for fresh water use. Exploratory engineering studies on this subject have been presented and discussed at conferences in both the U.S. and Canada in recent years, and a great deal of interest has been shown. This concept, know as the Grand Canal Project, entails the conversion of James Bay from a salt water body to a fresh water lake by means of a sea level dike across the mouth of the Bay. In California, they have done some very extensive work of a similar kind, so the technologically is available. This can be done—if there are good reasons for doing it.

Some of this fresh water, pouring into James Bay from some twenty rivers, would be fed into the Great Lakes-St. Lawrence water basin through the Grand Canal system. This system would consist of a series of canals, dams, pumping stations and underground water tunnels; it would also make use of the northern rivers as well as the Ottawa and French River systems.

The Grand Canal Company is actively promoting the project and, in cooperation with several reputable engineering companies (three of them Canadian, one of them American), is at present embarking upon feasibility studies covering the whole range of engineering, environmental and economic issues involved. I am personally associated with the ongoing work of the Grand Canal Company, as an advisor on the economic and financial aspects.

Let me give you some idea of the dimensions of this project. It would move into Lake Huron a volume of fresh water equivalent to twice the flow of the Great Lakes system. Once in the Great Lakes, it would be available to stabilize water levels in that system. The bulk of the water would be available for transfer through a North American water grid to

Western Canada and to the mid-West and other parts of the United States where fresh water is badly needed and becoming increasingly scarce.

No technological problems are anticipated with the engineering aspects of this project—given other proven experience, such as the California State Water Project. The main issue is environmental. And the people who have worked on this believe they can establish with hard facts that the project will not negatively effect the environment.

The magnitude of the Grand Canal Project is five times the size of the Apollo Moon project and would cost roughly $100 billion current dollars. It would take ten years to construct and put into operation, although it could be put into operation in phases.

The urgent need for fresh water in the United States would make that country an eager and receptive partner. Canadians would be in a very strong bargaining position for obvious reasons: it is Canada's water. If studies confirm, as I believe they will, that this project makes good sense for Canada in terms of our overall concerns and interests—in particular the environmental concerns—I am satisfied that Canada would reap enormous economic benefits. And though it may not be widely known, very important sectors of the United States economy are increasingly concerned about the supply of fresh water. In the next five to fifteen years this may reach severe crisis proportions.

The benefits to Canada will be several. First, the construction of the project itself would produce 150,000 direct and another 150,000 indirect jobs, to supply the goods and services needed to support this mammoth undertaking. A good deal of this demand would inevitably spill over into the United States. It does not take too much imagination to visualize the array of machinery, equipment, vehicles, steel, cement, lumber, pumps, turbines, energy, and the whole range of engineering, financial and other services that would be required for a project of this kind.

Second, there are the ongoing benefits for Canada once the project has been built. There would be availability of ample fresh water for Canadian arid regions. It would contribute effective flood control not only in the Great Lakes region, but over the whole geographical area served by the new water grid. There would be immense new opportunities for the native people that now inhabit the region to participate in the construction of this project as well as in the continued operations that follow.

A third benefit would be the substantial economic rents to be earned by the owners of the resource (it is expected the price to be obtained for the new water would more than pay for the capital outlay and operating costs). What this entails is that water be treated as a "good," as a resource. For too long we have treated it as a free good. One of the difficulties that has led to, of course, is wastage and inadequate emphasis on conservation. The advantage here is, as long as God rains on us, the "good" would be renewable—and that is likely to be for a long time.

Finally, and most importantly, there would be the bargaining leverage which Canada could exercise by virtue of owning this water and being in a position to control its use. I believe this project could provide the key to a free-trade agreement with the United States which would combine terms and conditions to meet many of the Canadian concerns about transition and stability.

I believe we could negotiate a partnership with the United States based on this project to include the following terms and conditions:

(1) Virtually all the capital required would come from the United States;
(2) a good price for the water at its full commodity value;
(3) a commitment by the United States to clean up the acid rain problem—we're talking about fresh water, let us keep it fresh;
(4) a firm undertaking by the United States whereby virtually all Canadian goods and services would have immediate free access to the U.S. market—unencumbered by tariffs, non-tariff barriers, emergency import restrictions or any other impediment. That is, treatment for Canadian goods and services on exactly the same basis as domestic U.S. goods and services.
(5) Canada would have a ten year transitional period during which to organize its industries to compete in the continental market, after which the agreement would become fully reciprocal. And we would move toward reciprocity during that ten year period as quickly as the circumstances allowed.

I can say all these brave things because I do not have responsibilities in these areas today—somebody else will have to do it. I am in the happy position of a consultant. We advise, put forth these bold ideas—somebody else worries about picking up the pieces. It will be for governments and officials and those people who have responsibilities to make judgments about whether there is any sense in this.

In terms of benefits for Canada, the water project is viable on its own merits, just as the free-trade idea is viable on its own. These are separate, distinct and viable propositions. Properly handled they can be made to reinforce each other. This mega-project, with all the attendant benefits apart from the trade possibilities, would make a significant contribution to overcoming our current economic problems for many years to come. If we had the imagination to link it to our trade objectives it could put us on a course of economic growth and development that would assure us of full employment and rising standards of living for the indefinite future.

Now, I recognize that water has figured prominently in Canada's relationship with the United States throughout our history. There is perhaps no other subject in our national affairs that arouses as much emotion, controversy, dogma and prejudice. There is perhaps no other resource that holds as much promise for our economic future or as much danger if we do not use it in a timely and just manner. Do we have the flexibility of mind to approach this subject with open minds, free from preconceived ideas and the prejudices of the past? Do we have the courage and the imagination and the audacity to take on these two big projects, free-trade and fresh water, at the same time?

I have personally tried out these ideas on leaders in government and business on both sides of the border. I have been greatly heartened by the initial response. The initiative would have to come from Canada—Americans are fully aware how sensitive these issues are in the Canadian scheme of things.

I feel confident that if we were able to work out an agreement for free-trade and water sharing it would be a good thing for both countries, and it would set a good example for the world. It would make us richer. It would make us better neighbors because it would remove many of the frictions about which we have been quarreling for years. It would not weaken Canadian sovereignty or weaken our ability and our resolve to exercise our independence. Indeed it would, by enriching us, raise our confidence and strengthen our will and ability to grow and to contribute to the world as a strong and free nation.

Thank you.