SCHOOL OF LAW
CASE WESTERN RESERVE UNIVERSITY

Canada-United States Law Journal

Volume 10 | Issue

Article 18

January 1988

The Case against United States-Canada Free Trade

Mel Watkins

The Case Against United States-Canada Free Trade

*by Mel Watkins**

I. Introduction

Free-trade is coming to have a variety of meanings in the Canada-U.S. context. The recent Government of Canada discussion paper *How to Secure and Enhance Canadian Access to Export Markets* sets out four options. The first is the status quo, which leaves three free-trade options. They are, in the present official language (which will do anything to avoid the words "free-trade"): sectoral (free-trade in a specific sector or sectors of the economy, *e.g.*, textiles or petrochemicals); comprehensive (an across-the-board bilateral free-trade agreement); and framework (creating an institutional mechanism to improve Canada-U.S. commercial relations).

We are repeatedly told in Canada that the United States preference is for a comprehensive free-trade agreement. Originally, during the Trudeau Government, the Canadian preference was the sectoral option. On the whole—though with some reservations—the experience with the AutoPact makes Canadians receptive to the sectoral option. However, the job guarantees for Canada that were built into that arrangement are critical to this receptivity. If sectoral integration now means, as it apparently does for the U.S., no such guarantees for Canada, then many Canadians would be opposed to it, at a time when there is an intolerable level of unemployment in Canada.

One suspects that the preference of the present Mulroney Government is the framework agreement. What manifestly lies behind that option is the fear in Canada that the United States will go protectionist against the world, including Canada. Behind the fancy language of "framework agreement" and "secure and enhance access" is the straightforward and understandable Canadian desire to return to the relationship that existed with the U.S. prior to 1971. It was the era of exemptionism, because Canada was exempted, albeit only after special pleading in each case, from American measures such as the Interest Equalization Tax of the early 1960's, or the later directives to multinational corporations to repatriate more profits. That period, which also included the acquiescence of the U.S. to bilateral sectoral arrangements that were special to

* Professor of Economics at University College, University of Ontario; co-editor of *This Magazine*. Professor Watkins has headed a Canadian government task force on foreign co-ownership of Canadian firms and was the chief author of the *Watkins Report*. He writers and lectures extensively on Canadian economic policy.

Canada (automobiles and armaments), ended in 1971 when President Nixon unilaterally declared Canada to be an independent country.

Given the extraordinary trade dependence of Canada on the United States, and the threat of protectionist forces in the U.S. arbitrarily reducing Canadian access to the American market, no sensible person could oppose returning to that earlier arrangement. The problem, however, is that in order to get that exemption, Canada may have to agree to the American preferred option of comprehensive free-trade and risk a further massive dose of continental integration. True, some see that economic integration is itself a virtue. I see it, as I will try to demonstrate, as a price too high for Canada to pay.

It seems to me unlikely that any of the three free-trade options can survive the dual test of feasibility and desirability. Moreover, the severity of the present economic crisis in Canada makes the status quo option unacceptable. So much for the government's four options!

There is, of course, another option that is not mentioned in the government paper but does exist. It is to move to secure the Canadian market for Canadian producers. It would use access to the Canadian market as a bargaining chip to get the multinationals to produce more in Canada and it would enhance domestic content arrangements. In effect, the option is to put in place an industrial strategy based on greater self-reliance and less dependence for Canadians. The details have been cogently set out by Abraham Rotstein in his study for the Canadian Institute on Economic Policy: *Rebuilding the Canadian Economy*.

II. Economists and Dissent to Free Trade

To be an economist and to oppose free-trade is tantamount to heresy. Nothing is more central to orthodox economic theory than the case for free-trade based on comparative advantage without impediments from tariffs or other barriers (and its concomitant, the case for free mobility of capital with no discrimination based on nationality). But theory hardens into ideology, and intellectual paradigms become monopolies of knowledge whose practitioners are intolerant of dissent. (I have tenure and do not have to worry about my heresy.)

It is, nevertheless, intellectually legitimate to have doubts and to dissent. In fact, there have always been doubters and dissenters amongst economists about free-trade. Nor is it politically illegitimate to have such doubts. In the present election campaign in Ontario, the three major political leaders are all opposed to free-trade.

Economists need to remind themselves that the mighty John Maynard Keynes published an article in 1933 (on the occasion of the last great economic crisis) entitled *National Self-Sufficiency*, in which he questioned the virtues of interdependence. His subsequent role at Bretton Woods in creating the institutions for a more interdependent post-

World War II economy may reflect a change of mind, or it may signify the inevitable corruption of the intellectual by power.

There have also been schools of dissent. Economic history— in which I was originally trained—emerged as a subset of economics in reaction to the free-trade bias of British-centered neo-classical economics, with its false claim to universality. Economic historians, then and now, have found no clear correlation between free-trade and economic growth. Some have claimed the converse. The great classical economist, David Ricardo, used as the example of his famous Law of Comparative Advantage with Mutual Gains from Trade, England specializing in manufacturing cloth and Portugal in making wine. Textbooks still use this example, but never point out the uncomfortable fact that Britain went on to become the workshop of the world while Portugal remained backward and marginalized.

Those who know economic history could cite the record of industrialization behind tariff walls (or their non-tariff barrier equivalents) of the United States, Germany and Japan. In 1828 the U.S. passed a tariff known as the "Tariff of Abominations." It was the highest the world has ever seen, and resulted in one of the most rapid growth periods the American economy has ever experienced. In Germany and Japan, the pursuit of protectionist policies has not been inconsistent with rapid economic growth.

In Canada, the best description of our economic history has been given by the late Harold Innis in his "staples approach." Innis taught us that Canada was a staples producer, a hinterland that produced staples and exported resources to more advanced industrialized areas, and that the resulting Canadian economy was, therefore, vulnerable and dependent. He warned of the limitations of the price system for the periphery and insisted on a positive role for the state. The thrust of his advice, particularly in his later years immediately after World War II, was that Canada should lessen its dependence on the United States. Canada remains a dependent staples economy. Trade policy, including any free-trade arrangements with the United States as imperium, needs to be judged explicitly within that context.

Innis' work slips into the second of the more fundamental schools of dissent, that of political economy. Political economists (amongst whom I would count myself) doubt the certainty of mutual benefits from trade and point towards cumulative tendencies to underdevelopment and towards persistent disparities between countries. They see orthodox theory as the ideology of the powerful and dominant, and speak of the imperialism of free-trade. They do not see the harmonies of the market, but conflict between capital and labor—where capital is the mobile corporation which treats the world as its oyster and labor is immobile people rooted in communities, including national communities. They understand why workers, and their unions, and their political parties, tend to doubt the virtues of free-trade. Hence, in Canada, political economists tend to be economic nationalists.

Political economists read Canadian history as showing that the Canadian business elite has always had a *comprador* cast of mind. The tendency for more than a century has been for that elite to be integrated into the American elite, and to be continentalist rather than either nationalist or internationalist. (One of the myths of Canadian history is that we fluctuate between nationalist policies and internationalist policies. The reality is that our policies have more consistently been of a continentalist nature. Was Canada's famous national policy, the "High Tariff of 1879" economic nationalism, or was it a variety of continentalism to attract branch plants?)

This attitude suggests that Canadian business will go for free-trade if it believes it can thereby secure its continental niche. Canada-U.S. free-trade would lead to a further integration of elites, and would thereby enhance the continentalist orientation of Canadian business. As evidence of the differing interests of capital and labor, Canadian trade unions are moving in precisely the opposite direction, as shown by the breaking away of the Canadian UAW from the American union. All forces in Canadian society are not simply moving towards integration.

Dissent from the free-trade doctrine is, then, legitimate both intellectually and in terms of flowing from popular social forces. It is even legitimate for Americans to dissent, as is done most cogently by the economic commentator Robert Kuttner in his new book, *The Economic Illusion*. He reminds us that in the real world comparative advantage (which is said to dictate what we must do) is not God-given, but created by mere mortals, and that governments play a role under the rubric of industrial policy that is often decisive.

The risk, Kuttner states, is that the theory of free-trade becomes an ideology which prevents governments from formulating effective industrial policies. American industrial policy becomes a combination of *ad hocery* and arms spending. This latter point is serious: the United States has a major industrial policy which is based on spending by the Pentagon. (Although this spending is potent, it is more likely to weaken the U.S. industrial base than strengthen it.) According to Kuttner, the U.S. then tries to make the rest of the world follow suit. It tells other countries that their national policies are market imperfections that must go—that they too should spend more on arms. I would add that Canada is already being affected by these misguided American practices and would simply become more susceptible to them with the quantum leap in economic integration that would come from free-trade.

III. The Risks for Canada

Why is free-trade between Canada and the United States on the agenda of politics now? For Canada—which, it seems, has primarily put it there—the answer is fear of U.S. protectionism: if the wall goes up, we want to be inside that wall, not outside. That is fair enough, but we should all stop for a moment and contemplate what this means.

In the past, the virtues of free-trade were always preached to Canadians in terms of our growing up, taking on the world, becoming mature and competitive, and loyally following American leadership into a world free of barriers to trade. But now we are being told that we should abandon Canadian protectionism—for what? The answer, it turns out, looks suspiciously like North American protectionism. (And, if someone objects that the U.S. intends bilateralism to become multilateral, then Canada will have gained no preferential access to the American market and will have gained little, if anything.) Is this free-trade? Or is it a new form of protectionism?

There is certainly a deep irony here. When the U.S. practices free-trade, Canada follows, with some Canadians advocating going further and seeking free-trade with the U.S. But if the U.S. ceases to practice free-trade, we are still told to seek free-trade with the U.S. The contradiction is real; it inheres in dependency and impotence. No matter what the United States does, Canada receives the same advice. I become suspicious of this.

Where does this leave us with respect to the economic benefits for Canada, so much extolled by economists? The scenario that is now being talked about sounds more like containing damage or minimizing economic costs. The rationale is, after all, to secure trade. If it can then be enhanced, fine, but that will be a bonus and is not thought necessary to justify the exercise. Let us be honest about what we are talking about. We are not talking about increasing the standard of living and creating jobs; we are talking about protecting the standard of living and protecting jobs. This is not a solution to the present economic crisis and the intolerable level of unemployment, but a way to keep them from getting worse.

And if the point is to secure trade, to secure access to the American market, what is the likelihood that it will also secure—meaning entrench—the nature of that trade: Canada's status as a staple producer and resource hinterland? If almost five centuries of history be our guide, it is extremely difficult for Canada to break out of this pattern. There is no reason to believe that North American free-trade will do it. I would read economic history as showing us that peripheral areas like Canada would need much tougher state policies to succeed; not market policies, but intervention policies. However, under free-trade with the U.S., precisely the opposite will happen; instead of more policy there will be less.

This reads very differently from what my economist colleagues have been telling me over the years. Am I too gloomy? Are there perhaps economic benefits in the long-run for Canada? The answer is: yes, perhaps, but perhaps not. International trade theory, Keynesianism, and common sense all tell us that there are no guarantees as to where jobs will be located under free-trade. Nor can we say how gains will end up being distributed. It is evident from the persistence of regional disparities within countries that a free-trade area is not a universal panacea. From the Canadian experience, sectoral arrangements fare better but are not without problems. To quote political scientist Stephen Clarkson from his excellent book *Canada and the Reagan Challenge*:

> The sectors of Canadian industry that have experienced modified forms of free-trade—automobiles, defense production, farm equipment—have not produced economic salvation. They have generated technologically dependent, managerially backward and economically weak industries that provide a cautionary rather than exemplary experience. . . . There is little evidence . . . that the United States would want to establish a free-trade zone with Canada on any basis other than as a resource satellite.

There is, as well, a phenomenon that did not exist in Ricardo's time, the vexing issue of foreign ownership—with which Canada is uniquely endowed—and how it affects the distribution of those mutual gains. If the tariff facilitated foreign ownership, what will happen under free-trade? Would foreign ownership fall, and if it fell what would replace it and what would happen to jobs? Under free-trade, would Canada have to treat foreign capital better so that it would stay? Could Canada have any policy towards foreign ownership at all given American tendencies to define such policies as protectionist? Significantly, the better to pave the way toward trade negotiations with the U.S., Canada unilaterally further emasculated an already weak Foreign Investment Review Agency and renamed it Investment Canada.

A good deal is known about the behavior of foreign subsidiaries in Canada with respect to exports and imports and how that has worked to inhibit industrialization. Statistics Canada data show the high propensity of foreign subsidiaries to import from parent companies. Government archives enable scholars to document the long history of export-blocking by parents *vis-a-vis* subsidiaries. How would free-trade, particularly when preceded by the weakening of any policy toward foreign ownership, remove these structural deficiencies? Do we think these things that have been around for a century are just going to go away?

The bottom line, though, on this matter of economic effects is to link it with the question of political effects—the effects on sovereignty. This means, concretely, the capacity to formulate policy and to give it effect. This is not an abstract question, but one of very practical importance.

The widely held perception in Canada is that free-trade with the U.S. would lessen an already limited Canadian autonomy. Even people who expect economic benefits fear political costs. And, if there are political costs, can there be economic benefits? We are always told that free-trade will create winners and losers, but surely no government would simply sit back and casually watch that happen, doing nothing no matter what the outcome. Is it not rather the case that winners emerge out of a creative interface between business and government, involving positive and creative government policy? The great risk for Canada is succinctly put by Clarkson: "The price for admission to the American market would be the economic policies needed to put Canadian industry in a position to compete there."

The risk, in the language of economics, is harmonization of the policies of Canada and the United States. Specifically, it is the tendency of Canadian policy to ape American policy, if not *de jure* then *de facto*, because of pressures to do the same as the U.S. in order to keep jobs on the Canadian side of the border. Robert White, the Canadian director of the UAW, told the National Economic Conference in Ottawa in March:

> A policy [of free-trade and economic integration with the U.S.] would mean that whenever Canada attempts to pursue different social priorities or our own industrial strategy, we would be warned that either such a policy would leave us less competitive [e.g., if we wanted to increase layoff protection] or that it would be viewed as an 'unfair' subsidy to make us more competitive [e.g., an attempt to attract investment to Quebec or the Maritimes].

The Federal New Democratic Party issued a similar warning in February:

> The requirements of free-trade between the two nations would mean a number of concessions from Canada. For example, if our tax rates were higher than those levied on corporations in the U.S., we would be pressured to cut them in order not to penalize companies operating in Canada; where our environmental safeguards were more stringent we would be pressured to lower them to prevent Canadian producers from operating at a competitive disadvantage; where our wages were higher, as they are in some industries and regions compared to those in the southern U.S., we would be under pressure to cut them; and obviously we would be under considerable pressure to do away with FIRA....Such pressures would mean the end to Canadian sovereignty in crucial areas of policy. By pushing for free-trade and further economic integration we invite political integration.

I would only add that we can observe in British Columbia how these kinds of policies, pursued in the name of international competitiveness, have had disastrous consequences for the economy.

IV. Conclusion

Canada has a distinctive political culture that has withstood deepening economic integration with the U.S., but there presumably are limits. Would an already timid foreign policy become totally syncophantic of American policy—on Central America, on "Star Wars"? Some argue that a free-trade area would tie America's hands in the face of Canadian actions and thereby free Canada to become more independent. I am doubtful, however, that anyone can tie America's hands and, in any event, I fear that Canadians would become even less willing to try to be different.

There is a further point on macroeconomic prospects: it may not make sense for Canada to tie itself yet more tightly to an American economy as problematic as that economy appears to be. The case can be made that the American economy is waning in terms of its global hegemony and industrial efficiency, and that it is being grossly mismanaged. Its present prosperity is substantially a tribute to enormous arms spending, or military Keynesianism, at the cost of an escalating budget deficit. It is one thing for Canada to be tied to an efficient, well-managed, benign economy, another to be tied yet more tightly to a crisis-ridden economy that seems at times resolved to solve its problems without regard to the interests of others. There is a need for Canada to attempt to distance itself more from the United States, difficult as that would be.

The thrust of my remarks is that, if the U.S. moves to protectionism, Canada should try for exemptions—but not at any price. If relief cannot be obtained, this would strengthen the existing case for policies of self-reliance. As I stated at the outset, all can agree that the status quo is not good enough. What Canada needs is to "secure and enhance" its market for domestic producers. It needs to move, not along American lines— to deregulation, more *ad hocery,* and arms-spending style job creation, but along an indigenous path to a comprehensive industrial policy and conscious economic planning.