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Old Wine in New Bottles? An Overview of Two Centuries of Free Trade between the United States and Canada

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On February 5, 2003 the Maine International Trade Center and University of Maine Canadian American Center co-sponsored a day-long forum on the challenges and opportunities of free trade between Canada and the United States. In the first of two articles generated by this forum, we present the edited remarks of Scott See, a University of Maine Libra Professor of History, who gave audience members a whirlwind overview of the history of Canadian-American free trade from the Revolutionary War era up to passage of the Free Trade Agreement in 1989. We follow this article with a companion piece written by Howard Cody, University of Maine Professor of Political Science and Canadian-American Studies, who begins with the passage of the Free Trade Agreement and brings readers up to the current, post September 11, 2001 era, where trade and border security concerns have become inextricably combined in the minds of many, particularly Americans.

INTRODUCTION

My task is to provide readers with a succinct and hopefully useful overview of the Canadian-American trade relationship leading up to the passage of the Free Trade Agreement (Canada and the United States) and North American Free Trade Agreement (Mexico, Canada, and the United States) because, in myriad ways, they reflect historical paradigms. The saga of North American trade patterns has been shaped and defined by economic forces, political agendas, social and cultural considerations, and ideals of nationalism and sovereignty. Familiarity and similarities notwithstanding, the current trade relationships also raise questions about what—if anything—is unique about them.

The essence of the Canadian-American relationship over the last two centuries can be encapsulated by two quotes from history, the first of which comes from Prime Minister Pierre Elliott Trudeau. Trudeau—a towering political figure in Canada who was either loved or reviled depending on which side of the political divide one stood—first took office in 1968 and stepped down for the last time in 1984. Throughout his tenure, he professed a decided ambivalence about the United States. For example, he was an extreme critic of the ongoing Vietnam War and, generally, expressed a wariness about having a close relationship with the United States on a variety of levels. Shortly after taking office, Trudeau remarked about the Canadian-American relationship, "living next to you [Americans], is in some ways like sleeping with an elephant; no matter how friendly or even-tempered is the beast…one is affected by every twitch and grunt."

With his customary wit, Trudeau summed up two sentiments that are held by many Canadians even today. The first is that although it is generally considered favorable living next door to the United States, Canadians are affected dramatically by its every action and policy. The second is that Trudeau captured the ambivalence many Canadians shared and continue to have about establishing a closer trading relationship with the United States.

In contrast, 50 years prior to Trudeau's now famous comment, United States President William Howard Taft remarked publicly that he hoped that Canada—by engaging in more trade with the Americans—would diminish its historic ties with Great Britain and move ever closer to the United States. Although Taft did not elaborate on what he meant by his "parting of the ways" observation, some American politicians at the time were exploring the concept of a single continental trading arrangement; a few even hinted at the possibility of the future annexation of Canada. Thus, Taft articulated a pervasive sentiment held by Americans even today, which links closer economic and cultural ties with Canada to some form of formalized political connection.

These two quotes from Prime Minister Trudeau in the 1960s and President Taft a half century earlier capture much of the ideals and tensions that have existed in the trading relationship between Canada and the United States over the last two centuries. This article provides a whirlwind overview of Canadian-American trade beginning with the Revolutionary War era. Two themes underpin and define this brief history: first, the expansion of trade between the two countries did not unfold in a linear fashion; instead it was subject to periods of expansion as well as retraction. Second, sharply mixed opinions exist on both sides of the border even today about the wisdom of forming a closer trading relationship, especially among Canadians. Importantly, this ambivalence, and sometimes outright opposition, can often be visibly detected in border states such as Maine.

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THE REVOLUTIONARY WAR ERA

The American Revolutionary War represents the great divide between what is now called Canada and the United States. Thirteen colonies carved themselves off from the British Empire and its remaining North American colonies, and began a republican experiment in the late eighteenth century. The colonies to the north, which did not join in this enterprise, were called British North America until, in 1867, four reconfigured their relationship with Great Britain to form the Dominion of Canada.

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The carving process in 1776 was not only politically defined, but also social and cultural in nature. Nonetheless, the trade relationship between the colonies and the states did not cease. Instead it remained strong, especially in New England and the Atlantic region of British North America. In fact, it continued to thrive through the late eighteenth century and into the early nineteenth century, despite the outbreak of the War of 1812 that was triggered, in part, because the Americans were extremely upset over having their trade disrupted on the high seas by Britain's vaunted navy. Vibrant trade—both legal and illegal—continued throughout the late eighteenth and early nineteenth centuries. Intriguing tales of illegal trade are well remembered in places like Passamaquoddy Bay, which was an illicit trader's haven, and also in Vermont's Smuggler's Notch, which gained a notorious reputation as a trading route for illegally moving goods northward across the border.

THE ANNEXATION MOVEMENT

In the mid-nineteenth century, a couple of events shook up and redefined the relationship between the young and rapidly expanding United States and the remaining colonies in British North America. The first event occurred in the 1840s, when Great Britain moved aggressively to embrace the principles of free trade. Because Great Britain was leading the world industrially, it was well positioned to open up markets around the globe, and it experienced some measure of success in doing so. However, the British North American colonies, which were still directly attached to Britain, found themselves struggling with the ramifications of this policy. This kindled numerous discussions and political debates about crafting a closer trade relationship with the United States as one way of coping with Britain's move to free trade.

In 1849, this thinking underpinned what was quickly dubbed the Annexation Movement. Roughly 300 merchants in Montreal began to articulate publicly the idea of joining the United States. Their argument was strictly economic and, on those grounds, annexation of the fledgling British North American colonies to the United States made perfect sense. In fact, the merchants argued, a continental trade zone was essentially a foregone conclusion, so why not enter into robust negotiations with the Americans?

Obviously, the annexation movement failed. Nonetheless, it left behind a viewpoint that persists even today, which is that tighter trade relations between Canada and the United States might blur the boundaries between the two countries to the point where they will ultimately disappear. Canadians, in particular, still wrestle with this notion, often with a sense of foreboding.

RECIPROCITY, 1854-1866

The trade relationship between British North America and the United States (and, in particular, between New England and present-day Quebec) continued to gain pace through the 1850s. Formal trading routes were established and railroads began to crisscross eastern North America. In 1853, the Saint Lawrence and Atlantic Railway opened; it brought goods from Montreal to Portland—Maine's so-called "ice-free" port. This route was especially important during the winter months, when the frozen Saint Lawrence River prohibited maritime trade. Later, this railway was incorporated into the Grand Trunk Railway.

At the same time, other railways began to reach both eastward and westward across the continent. Trading routes continued to be strengthened and many citizens on both sides of the border enthusiastically discussed and debated the merits of facilitating trade and improving an infrastructure of railways and waterways that would link more closely British North America and the United States. The push to expand trade between the two countries came to fruition in an agreement called Reciprocity, which lasted from 1854-1866.

As its name implies, Reciprocity was a reciprocal trade agreement between the British North American colonies and the United States, and it suited both their needs, at least in certain sectors of the economy. For the Americans, on the eve of the traumatic Civil War, it appealed to both southerners and northerners. Southerners applauded the idea because they thought it would strengthen British North America to better withstand Northern pressures. Northerners championed Reciprocity for the opposite reason; some thought it would be a crucial step toward the ultimate annexation of British North America. The end result was that many Americans embraced the idea of strengthening trade with the British North American colonies.

On the other side of the border, most British North Americans supported the idea because they had ample staple goods—in particular fish, farming, mining, and timber products—that they wanted to move to the United States. Thus, the overriding issue for Canadian producers was to increase their ability to sell primary resources in the United States without confronting the obstacle of a large tariff barrier.

Reciprocity lasted 12 years, ending in the wake of the American Civil War. Historians have long identified a rosy glow that accompanied memories of this period. Reciprocity is typically recalled as a powerful and generally positive arrangement and, even though terminated by the Americans in 1866, this recollection shaped future conversations about trade between the two countries. In fact, economic and political leaders on both sides of the border revisited the issue of reciprocity every decade until it became a reality again in the 1980s.

THE "AGE OF PROTECTIONISM"

Upon terminating the Reciprocity agreement, the United States moved aggressively in the late nineteenth century to protect its markets by instituting some of the highest tariffs in the country's history. The notorious McKinley Tariff in 1890, for example, applied an average tax of almost 50% on imported items. By erecting such high tariffs, American politicians and businessmen sought to shield their own emerging industries. This era, remembered by many as the age of protectionism, witnessed similar actions unfolding on the other side of the border.

As mentioned above, four provinces (Ontario, Quebec, New Brunswick, and Nova Scotia) banded together to form the Dominion of Canada in 1867. One of the important agenda items of the new Canadian administration, led by Sir John A. Macdonald, was to create a National Policy in the 1870s. Thus, while the Americans were throwing up high tariff barriers, the Canadians reciprocated with their own National Policy.

Like American programs at the time, and for similar reasons, Prime Minister Macdonald's National Policy imposed high tariffs to safeguard the country's fledgling industries. It also called for the aggressive development of Canada's western territory, the construction of an intercontinental railway system, and other improvements in the country's transportation infrastructure. The National Policy included schemes to attract large numbers of immigrants who would help to turn the country into an agricultural powerhouse, and thanks to the efforts of administrators appointed by one of Macdonald's successors, Liberal Prime Minister Wilfrid Laurier, this aspect of the National Policy enjoyed phenomenal success. Canada's burgeoning wheat production in the early twentieth century provided compelling evidence of this accomplishment.

THE "PROGRESSIVE ERA"

The protectionist pendulum began to swing back in the early part of the twentieth century. In the United States, politicians, economists and social scientists studied trade intensively, and concluded that a move to reduce tariffs or to promote general free trade would be advantageous for American interests. The Canadians were engaged in a similar discussion largely because their producers of staple items, especially farmers in the developing West, wanted to move their products into American markets. Once again, the two countries revisited the issue of reciprocity.

In 1911 discussions between the two countries culminated when they came close to enacting parallel trade legislation that would have dramatically reduced most tariffs. William Howard Taft was president of the United States; Wilfrid Laurier was prime minister of Canada, a position he had held since 1896. Most of the tariffs both countries wanted to drop governed staple items such as fish, timber goods, and farming products. The two countries engaged in a protracted series of negotiations. The United States Senate quickly passed its version of the reciprocity agreement and then waited for the Canadians to enact parallel legislation that would have implemented the arrangement.

However, the Canadian supporters of reciprocity encountered dramatic obstacles in their attempts to follow suit. In essence, efforts in Canada ground to a halt on the issue of reciprocity. The federal election campaign of 1911 became, in large part, a referendum on the issue, and Canadians found themselves dramatically divided over whether such legislation furthered their national and business interests. Prime Minister Laurier's Liberal party aggressively promoted the idea of reciprocity, maintaining that a tighter trade relationship with the United States would ultimately strengthen Canada. The opposition Conservative party cleverly argued that reciprocity would be catastrophic for the country's future. Led by the articulate politician Robert Laird Borden, opponents argued persuasively that if Canadians enacted parallel reciprocal trade legislation, the country might cease to exist. Over time, they maintained, the boundaries between the two countries would become less and less important in a reciprocal trade environment.

The Conservative argument triumphed; indeed, in 1911, the Liberals went down in defeat. Reciprocity was not embraced by the Canadians, and the agreement to enact parallel legislation collapsed. It did so largely because the Conservatives successfully employed what was then, and is still today, an emotionally charged argument among Canadians: A closer trade relationship with the United States might lead to a form of continentalism and thus facilitate the demise of Canada as an independent nation-state.

THE 1920s AND EARLY DEPRESSION

Notwithstanding the failure of a reciprocal trade agreement in 1911, the economies of both Canada and the United States burgeoned in the early twentieth century. This can be attributed in part to the First World War, when industrial booms took place on both sides of the border to support the allied efforts. In terms of understanding the trade relationship between the two countries, the 1920s marks a decade when Canada crossed two significant divides. One is that during that decade Canada's most important trade relationship—as defined by import and export volume—statistically shifted from Great Britain to the United States. The second is that for the first time in history total investment dollars flowing from the United States to Canada exceeded the infusion of pounds from Great Britain. For one dramatic example, by 1929 American investors owned over one-third of Canada's pulp and paper industry. American corporations energetically engaged in the construction of branch plants in Canada, with investment for capital construction and operations flowing into Canada and profit dollars flowing back to corporate head offices in the United States.

An old saying that makes the rounds in studies of the Canadian-American relationship applies with special relevance during this time: "When the United States sneezes, Canada catches a cold." This notion was clearly illustrated when the American stock market experienced its famous crash late in 1929, an event that helped to trigger the Great Depression of the ensuing decade. Although North Americans recall the trauma of this economic collapse with particular poignancy, it was in fact part of an international depression. For Canadians, virtually all of the investment dollars flowing from the United States dried up by 1930. Canadians found themselves mired in a depression that, statistically speaking, was even bleaker than that experienced by their neighbors to the south.

Although trade between the two countries had been steadily increasing throughout the 1920s, both countries reacted to the Great Depression by throwing up high tariff barriers. President Herbert Hoover and many congressional politicians advocated bold protectionism to save the American economy. In Canada, Liberal Prime Minister Mackenzie King was replaced by Conservative Richard Bedford Bennett soon after the start of the Great Depression. Like Hoover, Bennett called for high tariffs as a means to protect Canadian interests; armed with such tariffs, he promised to "blast" the country out of the quagmire of depression.

MOST-FAVORED-NATION STATUS

Unfortunately for both countries, high tariff barriers only exacerbated the situation. Rather than propelling their way out of the financial doldrums, Canadians and Americans became mired in an even deeper depression largely as a result of their "solution" of exorbitantly high tariff barriers. By 1935, despite the good will generated by Franklin Delano Roosevelt's famous New Deal (he was elected president in1933), it was evident that a new trade model for the North American countries was needed. After a series of negotiations in 1935—Mackenzie King had recently defeated Bennett to regain his position of prime minister—the two countries formalized a new relationship that granted each other "most-favored-nation status."

In practical terms, the trading partners formulated a series of agreements that facilitated the movement of goods across the border. Interestingly, most of the Canadian goods exported to the United States were staple items, whereas most of the American goods flowing north were manufactured commodities. The granting of most-favored-nation status, therefore, embodied an intriguing mélange of agreements that were not entirely reciprocal.

Sweeping global events affected the Canadian-American trade relationship late in the Depression years. The Second World War, which broke out in Europe in 1939, accelerated the economic and defense connections between Canada and the United States. This came about largely because the two countries swiftly became partners in the formidable allied relationship that staved off and ultimately defeated the Axis powers of Germany, Japan, and Italy. As a result, the two North American nations strengthened their mutual defense structures as well as their economic reliance on one another. These dynamics led to important consequences that would long survive the war, particularly for Canada.

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The same two leaders who had negotiated the most-favored-nation status met at the Roosevelt homestead in New York for a series of talks that culminated in what is called the Hyde Park Agreement in Canadian-American history. Essentially, the negotiators built a rudimentary framework for further tightening the trade relationship between the two countries, largely to facilitate the closer integration of their respective wartime defense industries. Interestingly, the agreement was negotiated before the December attack on Pearl Harbor, which, of course, led directly to the United States' participation in the war. The fact that an agreement was signed prior to America's involvement in the hostilities is an indication of just how closely the United States planned to work with the Allied powers even before it became an active belligerent.

The Hyde Park agreement—and the Second World War in general—further entrenched the interconnectedness of the two countries' economies. By 1948, the two countries entered into a series of negotiations to put together a free trade agreement. Canada was still led by Prime Minister Mackenzie King, who was in power on and off throughout the early 1920s to the late 1940s. Harry S. Truman became president on the death of Roosevelt in the closing months of the war in 1945. In part, events in North America were being shaped as Western European ideals gained hold in the postwar era. Both the Canadians and Americans played a role in the passage of the General Agreements on Tariffs and Trade (GATT) in 1947, and Canada eagerly participated in America's successful Marshall Plan for the reconstruction of a war-torn Western Europe.

In 1968, newly elected Prime Minister Pierre Elliott Trudeau ushered in an era of ambivalence concerning his country's relationship with the United States.

Still, despite transatlantic trends at the time, and the intertwining of the two countries' economies, formal trade negotiations once again failed, largely because the Canadians balked for some of the same reasons that were expressed in 1911. Sensing that a large number of Canadians would perceive an even closer trading relationship with the United States as an indicator of the erosion of Canadian sovereignty, King pulled out of the negotiations.

THE AUTO PACT TO THE FREE TRADE AGREEMENT

Even without a formal agreement, however, trade continued apace into the 1950s and through the 1960s. The two countries easily remained each other's largest trading partners, and it appeared inevitable that the relationship would continue to grow closer. By the 1960s, for example, American interests accounted for 75% of all foreign investment in Canada. In 1965, Canada and the United States entered into the "Auto Pact," which some scholars consider a prototype for the Free Trade Agreement (FTA) and North American Free Trade Agreement (NAFTA). President Lyndon B. Johnson and Prime Minister Lester Pearson negotiated a trade agreement that essentially integrated the automobile industry on both sides of the border. Chrysler, Ford, and General Motors interwove the manufacture of parts and production of their automobiles by using factories in Canada and the United States. Although the Auto Pact targeted only one sector of the industrial economy, the ideal of full integration became a positive model of what can happen with a closely integrated trading relationship. The Auto Pact garnered vocal critics in both countries; nonetheless, it served to fuel the discussion of free trade in the 1980s.

In 1968, newly elected Prime Minister Pierre Elliott Trudeau ushered in an era of ambivalence concerning his country's relationship with the United States. This encompassed not only trade, but also other aspects of foreign and domestic policies. In what was perhaps a classic example of Trudeau's ambivalence, his administration created the Foreign Investment Review Agency (FIRA). Following a series of alarming reports about Canada's close trading relationship with the United States that depicted the degree to which the two economies were integrated, as well as the dramatic level of American ownership of Canada's industry and resources, many Canadians expressed a belief that the country's independence faced immediate peril. Although others at the time and since labeled this an alarmist viewpoint, Trudeau's administration picked up on this sentiment and, in response, established FIRA in 1973. The agency consisted of a council charged with the review of all foreign investment coming into Canada. The evaluators were to determine whether these investments would be in the best interests of Canadians. In practice, FIRA accepted over 90% of the money coming into Canada, which led critics to blame Trudeau for creating a costly and lumbering bureaucratic enterprise that did nothing to change the status quo and, perhaps, limited the prospects for Canada's future economic growth by souring the country's relationship with the United States.

Despite such criticism, FIRA remained viable until the 1980s. However, that decade witnessed a sea change of leadership and a transatlantic trend toward conservatism spearheaded by Prime Minister Margaret Thatcher in Great Britain, President Ronald Reagan in the United States, and Prime Minister Brian Mulroney in Canada. This convergence of ideological forces helps to explain the free trade agreement that later emerged between Canada and the United States. Conservative ideals, including the desire to lower tariff barriers and move swiftly toward systems of international free trade, enjoyed widespread support in all three countries. The majority of voters, as measured by the popularity of political leaders, supported these trade ideals. Significantly, concerns about an erosion of sovereignty were muted in Canada.

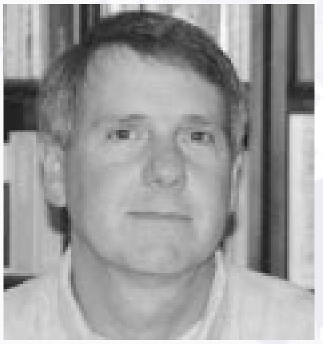
To signify this trend, Prime Minister Mulroney renamed FIRA "Investment Canada." Although FIRA was originally designed to scrutinize every dollar coming into the country, Investment Canada was reformulated to encourage and seek out foreign investment with the idea that more capital would inevitably serve Canada's interests. Thus, the stage was set for a protracted series of negotiations that ultimately led to the passage of the 1989 Free Trade Agreement between Canada and the United States.

CONCLUSION

This brief historical overview of trade between Canada and the United States from the Revolutionary War era to the eve of the current FTA and its successor, NAFTA, illustrates two powerful themes. First, the idea of free trade between the two countries is not a recent concept; it is instead an old ideal that has been revisited many times, and partially embraced on several occasions, by the two countries. Even today, the possibility remains of continued expansion or retraction of free trade between the North American partners.

The second theme is that there are critics of free trade on both sides of the border whose arguments often mirror one another. Even in the United States, for example, free trade opponents argue that a closer relationship with Canada might diminish American sovereignty. As addressed above in several case studies, this belief replicates Canadian fears that have been articulated since the nineteenth century. Certainly, the strength of this viewpoint in Canada and America has waxed and waned depending on the overall health of the economy and the agendas of contemporary political and business leaders.

Readers are left to conclude whether or not the FTA and NAFTA discussed by Howard Cody in the next article should be properly considered "old wine in new bottles." If the "old wine" of familiar historical patterns resonates, then the reader is still challenged by the prospect of evaluating whether or not it is a vintage that merits its price and is worthy of continued consumption.



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