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# The rationalization of the United States and Canadian automotive industry, 1960-1975.

David Michael Flynn  
*University of Massachusetts Amherst*

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THE RATIONALIZATION OF THE UNITED STATES AND  
CANADIAN AUTOMOTIVE INDUSTRY: 1960-1975

A Dissertation Presented

By

DAVID MICHAEL FLYNN

Submitted to the Graduate School of the  
University of Massachusetts in partial fulfillment  
of the requirements for the degree of

DOCTOR OF PHILOSOPHY

September 1979

International Business

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THE RATIONALIZATION OF THE UNITED STATES AND

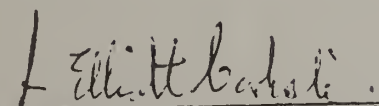
CANADIAN AUTOMOTIVE INDUSTRY: 1960-1975

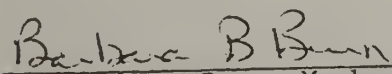
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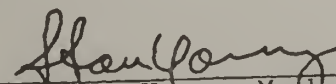
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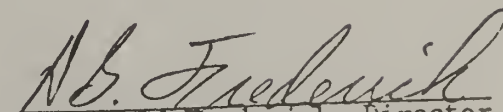
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Dedication

With my deepest feelings of love and gratitude, I dedicate this work to my families, the Flynn's and the Carlisle's. Through their support and love, I have come to this most joyful point in my personal and professional development.

## Preface and Acknowledgements

Cooperation is a primary dictate in the development of the world social, political and economic system. It is under this premise that I pursued the answers of a free trade agreement between the United States and Canada.

The United States-Canadian Automotive Agreement of 1965 was written in the interest of cooperation for the benefit of both nations. Precise measurement of the effectiveness of the Agreement, can only be assumed given the inadequacy of available data and the reluctance of the automobile companies to release information termed confidential.

Cooperation has, however, prevailed in the completion of this study. First among all, I must extend my sincerest appreciation to my advisor and mentor, Dr. A. Elliott Carlisle. Through his insight, patience and devotion, I have realized achievement.

Dr. George S. Odiorne, an endlessly energetic and insightful man, has helped me in these pursuits and many of my educational experiences.

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The cooperative spirit of all these people has reinforced my spirit always to remain strong and to be shared with them.

David M. Flynn  
May 1979

ABSTRACT

The Rationalization of the United States and  
Canadian Automotive Industry: 1960-1975

May, 1979

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Directed by Dr. A. Elliott Carlile

The question addressed in this study is whether the objectives of the United States-Canadian Automotive Agreement of 1965 have been met through 1975. The objectives are stated as follows:

- (A) The creation of a broader market for automotive products within which the full benefits of specialization and large scale production can be achieved;
- (B) The liberalization of the United States and Canadian automotive trade in respect to trade barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries;
- (C) The development of conditions in which forces may operate effectively to attain the most economic pattern of investment, production and trade.

Focus

In the pursuit of this question of the effectiveness in attaining the originally stated objectives, I have also pointed out some shortcomings of the United States-Canadian Automotive Agreement. These may have impeded the continued achievement of the Agreement objectives. Insights from government and automotive personnel provide insights beyond the raw economic data.

The relationship between classical and neo-classical trade theory and the U.S.-Canadian automotive market provides new insights into why nations trade within the same industry. Comparative advantage is not the only directive.

Economic efficiency is the theme of the Agreement. This study provides other criteria for policy development in international markets.

### Findings

The generalized finds of the study are summarized as follows:

- (1) Integration of the U.S.-Canadian automobile market has improved from the 1960-1966 levels as measured by the changes in dollar and unit automobile imports.
- (2) The efficiency of the Canadian automotive market has not significantly improved due to the Agreement.
- (3) The Canadian consumer-taxpayer's relative position has not improved after the Agreement as measured by lower relative prices of comparable automobiles produced in Canada and the U.S. These results were compared to the tariff revenues lost from free trade. Also Canadian consumption of U.S.-Canadian type automobiles has not significantly increased as a result of the Agreement.
- (4) Canada's gain in automotive employment and earnings does not reflect Pareto optimal results and thus a loss to U.S. automotive workers.
- (5) Intraindustry trade increased after the Agreement, inconsistent with the Hecsher-Ohlin factor proportions theory of international trade.

### Conclusion

Canada has benefitted from the freer trade agreement, however investment policies of the U.S. automobile companies have been biased toward

the U.S. There is a need for new investment into capital and skill intensive sectors of the Canadian automotive industry. This can be achieved through further cooperation between the auto companies and the Canadian government with the precondition of national planning in the Canadian economy.

Free trade agreements between the United States and Canada are recommended for other industries with the intention of further integrating the U.S. and Canadian markets. As economic integration is being achieved, the intention of moving beyond bilateralism toward multilateralism should be prioritized in fulfillment of the objectives of the General Agreement of Tariffs and Trade (GATT).

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## CHAPTER I

## PURPOSE AND SCOPE OF STUDY

Introduction

The question as to whether policy formulation is a science has been frequently addressed by academics and practitioners. A science can be viewed as a set of paradigms which are generally accepted at any particular time and by their nature tend to be relatively inflexible. And as further elaborated by Thomas Kuhn:<sup>1</sup>

No part of the aim of moral science is to call forth new sorts of phenomena; indeed those who will not fit the box are often not seen at all ... normal scientific research is directed to the articulation of those phenomena and theories that the paradigm already supplies.

This inflexible view of science is quite contrary to the nature of policy and strategy formulation as James Brian Quinn states:<sup>2</sup>

...the process [of strategy formulation] is rarely completely orderly, rational or consistent. Instead the executive responds opportunistically to new threats, crises, and proposals ... Establishing strategic goals for complex organizations is a delicate art [and not a science], requiring a subtle balance of vision, entrepreneurship and politics. At the center of the art one finds consciously managed processes of "broad goal setting" and "logical incrementalism." ... they tend to develop such goals through very complicated, largely political, consensus building processes that are outside the structure of most formal management systems and frequently have no precise beginning or end.

Therefore, policy formulation will not be treated as a science here because it "does not meet the scientific requirement that the phenomena under investigation be fixed, consistent and natural."<sup>3</sup>

In this research, I evaluate the economic policy choice of rationalization of automotive production through the most economic use of the resources of land, labor, capital and management in the Canadian and United States automobile industry. Strategy formulation of the firms operating within this market is constrained by the provisions of the Automotive Agreement of 1965 between the governments of Canada and the United States. The effectiveness of their strategies is evaluated through the benefits and losses that accrue to the people of Canada and the United States.

### Focus

... every man who lives by supplying any want, dreads anything which tends either to dry up that want or to supply it more easily and abundantly. It is to his interest that scarcity should reign in the very thing which it is his function to make abundant, and that abundance should reign everywhere else ... The desire for relative scarcity in his own skill, or his own commodity is therefore only too natural and intelligible in any man. It is the desire for the conditions that will secure to him what everyone desires. Only these conditions must, by their nature<sup>4</sup>, tend to exclude others from the privileges they secure to him.

It is under this guise that so often a tariff or some other trade barriers are erected to stifle competition from foreign imports.

On October 4, 1904, Ford Motor Company of Canada started to assemble automobiles in what had previously been the Walkerville Wagon Company. Gordon M. McGregor, President of this company raised the necessary \$125,000 to start the Ford Motor Company of Canada, backed by the vision and imagination of Henry Ford. The Ford Motor Company was the first company to manufacture automobiles in Canada. Honourable W. S. Fielding, Minister of Finance, described in the House of Commons, the experience of Ford's entry into Windsor:

I think, Sir, as to whether or not it is adequate protection [35% tariff to protect the thriving Canadian carriage industry], we have some evidence of a gratifying character that the tariff, without being evasive, is high enough to bring some American industries into Canada looks very much like a tariff which affords adequate protection.<sup>5</sup>

It was behind this tariff wall, which changed in 1936 to 17-1/2 per cent, that the Canadian automobile industry developed. Its development was thwarted by its limited production runs of any particular model of automobile. This is attributed to the Canadian automobile industry's supplying the limited but varied "wants" of the Canadian and Commonwealth market.

In free trade theory, it is held that through parallel increase in specialization and coordination both at the domestic and international levels, that serves as a major aspect of the process of economic growth itself. An obvious corollary is that a conscious effort to slow down the trend toward greater interdependence would have a negative effect on the rate of economic growth.<sup>6</sup>

In 1963, the Canadian government in attempts "to move towards complementary economic specialization in automobile production almost without regard to the Canadian-United States border"<sup>7</sup> revealed the Drury Plan. The plan, in essence, remitted the duty on all motor vehicle imports dollar for dollar for the equivalent increase in Canadian content for export. The remission plan had many critics, especially independent parts manufacturers of the United States, who were being underpriced. In Adam Smith's words, the remission was a "bounty" and it could be considered so in the United States courts.

The Modine Manufacturing Co., of Racine, Wisconsin, petitioned the U.S. Treasury Department's Commissioner of Customs to determine whether a bounty or grant, direct or indirect had been given under the Canadian export incentive program. If prima facie evidence was found, countervailing duties of up to 25% would be levied on imported Canadian automotive products. Before the case was concluded, the United States-Canadian Automotive Agreement was signed on January 16, 1965.

It is this agreement that has brought the United States and Canada together in the joint United States-Canadian automotive market in attempts to rationalize automobile production in this larger market.

In this study, I seek to determine if the objectives of the Agreement were met, which are as follows:

- (A) The creation of a broader market for automobile products within which the full benefits of specialization and large scale production can be achieved.
- (B) The liberalization of United States and Canadian automotive trade, in respect to tariff barriers and other factors tending to impede it with a view to enabling the industries of both countries to participate on a more fair and equitable basis in the expanding total market of two countries.
- (C) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production and trade.<sup>8</sup>

In the pursuit of these answers, I also point out some shortcomings of the United States-Canadian Automotive Agreement that may impede the most



economically efficient rationalization of automotive production. Insights from government and automotive company personnel will be used in this evaluation. The history of the Canadian automotive industry will be discussed so as to develop a strong foundation for past, present and future developments of the United States-Canadian Automotive Market.

The theory of economic integration is addressed in relation to the future further development of free trade between Canada and the United States. I also develop the product-cycle view of the evolution of trade patterns as is put forth by Raymond Vernon<sup>9</sup> in its relation to the automobile industry. The analysis in most cases is limited to the automobile statistics and not of trucks, buses, snowmobiles and other special carriers.

### Problem

The benefits to be expected from trade liberalization may be classified into consumption and production gains and those resulting from economies of scale. Consumption gains appear in the form of lower prices to the consumer. Production gains accrue as inefficiently produced domestic output is replaced by imports. This permits the reallocation of some domestic land, labour, and capital away from low productivity industries into more productive employment of those industries in which the country has a comparative advantage. Economies of scale gains occur through larger more efficient plants resulting in larger production gains.<sup>10</sup>

Canada has benefited from economies of scale arising from not only larger more efficient plants but also from the increased length of production

runs. In the first case, the larger plants result in lower costs per unit of output because of labor specialization. In the latter case, the fewer the number of differentiated products manufactured in each plant, the lower are per unit costs, because of savings in inventories of intermediate inputs and outputs, downtime of machines, and stoppages in work as dies and other tools are changed. Also, machines can be constructed specifically for long high-speed runs and labor has to learn fewer tasks.<sup>11</sup>

This study will explore the degree to which integration of Canadian and United States automobile production operations have occurred since the signing of this freer trade agreement. The efficiency of Canadian operations was a major impetus for the signing of the Agreement. This issue will be analyzed through a comparison of the increased production in relation to the increased employment. Scale economies suggest the significance of this hypothesis as economic integration occurs through this bilateral free trade agreement.

As the Canadian automobile industry moves toward greater efficiency to a more equitable level with its U.S. counterpart, benefits will accrue to the Canadian consumer-taxpayer and the automobile wage earner. The benefits to the consumer become obvious through lower relative automobile prices outweighing the tariff revenues lost as automotive products are granted free entry into the Canadian market as a result of the Agreement. The wage earner benefits through increased wages as a result of the economic integration of two markets sharing a common boundary. The theory of economic integration suggests equalization of costs of the factors of production as the comparative advantage of each country changes to the comparative advantage of the now larger more efficient North American automobile market.

It is important to note that the effects in the short run are less significant as the Agreement dictated greater production in the more costly Canadian automotive industry. A situation of trade diversion was more significant in the short run than in the long run when the efficiency gains occurred as economies of scale were achieved.

### Methodology

One important aspect of the statistical evaluation of the hypotheses is in determining the status of the automobile industry had the Agreement not occurred. The assumptions will be made explicit which are necessary to address this issue of "in the absence of" the Agreement. Interview data is used from personal interviews with Canadian and United States automotive personnel and government officials to provide expert insight and enhance the timeliness of the research. The greatest portion of the economic data is from secondary sources of the U.S. and Canadian government, automobile companies, and the Motor Vehicle Manufacturers Association.

A British economist's view that automobiles will turn out to be the textiles of tomorrow is addressed through a theoretical presentation of the product cycle view of trade evolution.<sup>12</sup> This analysis along with a discussion of free trade theory and economic integration appears in Chapter III. The hypotheses previously mentioned are tested in the fourth chapter. Summary of the results and conclusions appear in Chapter V. The concluding sixth chapter suggests the need of other than economic criteria in decision making for the U.S./Canadian automotive industry.

Footnotes

<sup>1</sup>Thomas S. Kuhn, The Structure of Scientific Revolutions (Chicago: The University of Chicago Press, 1970), P. 25.

<sup>2</sup>James Brian Quinn, "Strategic Goals: Process and Politics," Tuck Reprint Series No. 139-1978, Dartmouth College.

<sup>3</sup>Stanley Young, "Organizational Behavior as a Cultural Phenomenon," School of Business Administration Working Paper #73-3, University of Massachusetts, Amherst, Massachusetts.

<sup>4</sup>P. H. Wicksteed, The Common Sense of Political Economy and Selected Papers and Reviews on Economic Theory (London: G. Routledge and Sons, Inc., 1953), pp. 351-353.

<sup>5</sup>James G. Dykes, Background on the Canadian-United States Automotive Products Trade Agreement (Toronto, Canada: The Motor Vehicle Manufacturers Association, September, 1974), p. 2.

<sup>6</sup>Richard Blackhurst, Nicolas Marian and Jan Tumler, Trade Liberalization, Protectionism and Interdependence (Geneva: GATT Studies in International Trade, Number 5, November, 1977), p. 4.

<sup>7</sup>Dykes, Op. Cit., p. 45.

<sup>8</sup>"The Agreement Concerning Automotive Products Between the Government of the United States of America and the Government of Canada," Article I, see Appendix A.

<sup>9</sup>Raymond Vernon, "International Investment Trade in the Product Cycle," Quarterly Journal of Economics, Vol. 80, May 1966, pp. 190-207.

<sup>10</sup>Blackhurst, et. al. op. cit., pp. 25-28.

<sup>11</sup>Herbert G. Grubel, International Economics (Homewood, Illinois: Richard D. Irwin, Inc., 1977), p. 80.

<sup>12</sup>Charles P. Kindleberger and Peter H. Lindert, International Economics (Chicago: Richard D. Irwin, Inc., 1978), p. 77.



## C H A P T E R II

HISTORY OF TRADE BETWEEN THE UNITED STATES AND CANADA  
FROM 1854 TO 1975Brief History Of Trade Reciprocity

In 1854, the United States drew up the Reciprocity Treaty with Canada which was the first in its trade history. This Treaty was signed in 1855 and under this agreement free trade was established for natural products. Arrangements were also made for the joint sharing of the Atlantic Coast fisheries, both countries' canal systems, and in addition, it provided for the use by American ships of the St. Lawrence River and by Canadian ships of Lake Michigan. Although the reciprocity treaty proved to be of greater advantage to Canada, largely due to the lower factor costs in Canada, the total trade between the two countries over eleven years increased about threefold.<sup>1</sup> The treaty was subsequently repealed in 1866 due to the increase in Canadian protectionist policies and the need for the increased revenues in both countries achieved through tariffs.

Despite his passage of the Tariff Act in 1909 which slighted reciprocity, President Taft again drafted legislation for reciprocity with Canada and a preliminary agreement was signed on January 21, 1911. This agreement provided for free trade of certain food items, decreased rates on others, and equalized rates on automobiles and agricultural machinery and it was passed by Congress on July 22, 1911. However, except for the free importation of

print and wood pulp, the Reciprocity Treaty with Canada never went into effect. The liberal administration of Sir Wilfred Laurier was defeated in Canada and with this defeat the advocates of free trade with the United States lost their influence. James Eayrs, in his observation on reciprocity, stated:<sup>2</sup>

Both Canada and the United States have adhered to the ideology of freer trade, with the world outside and each other. Both have allowed their doctrinal commitment to be named by the protectionist practices. Protection by one country becomes a problem for the other. The magnitude of the problem is greater for Canada, the welfare of Canadians being more dependent upon access to the American market than the welfare of Americans upon access to the Canadian market. But it is no small problem for the United States either.

The issue of reciprocity with Canada didn't come out again until the passage of the Canada-United States Agreements of 1935 and 1938. These Agreements were the first large-scale commercial agreements between the United States and Canada to be carried to a successful conclusion since the aborted Reciprocity Treaty of 1854. The United States was granted most-favored-nation status and in some products tariff reductions were below Canada's intermediate rates. This narrowed Great Britain's most-favored-nation status. However, they did not constitute a significant departure from traditional commercial policy but rather signified a return to the status quo that existed before the disruptions of the early 1930's.<sup>3</sup>

While there have not been any reciprocal agreements of the traditional kind between Canada and the United States since 1938, important reciprocal reductions in tariff have occurred under the General Agreement on Tariffs and Trade (GATT) which was signed in Geneva, Switzerland, on October 30, 1947.

The basic purpose of this agreement which originally covered 33 members and now covers 70 countries (representing four-fifths of world trade) is stated as follows:

Recognizing that their relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, insuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the World and expanding the production and exchange of goods;

Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminating treatment in international commerce;

Perhaps the most important part of the agreement was the Most Favored Nation Treatment clause appearing in Part 1, Article 1 of GATT. Under this clause each member gets the benefit of every tariff reduction made by the other. It also forbids discrimination and prohibits quotas, protective internal taxes, restrictive customs and administrative devices and other non-trade barriers. Exceptions are made for countries in balance of payments difficulties and for those imposing similar quantitative controls upon their domestic output, e.g. agriculture.

From the numerous individual tariff negotiations carried on under GATT, concessions covering over sixty thousand items have been agreed upon. These comprise more than two-thirds of the total import trade of participating countries and more than half of the total number of commodities involved in world trade.<sup>4</sup>

Antecedent Conditions of the "Agreement"

United States and Canadian Automotive Production and Consumption Before 1965. Throughout the post World War II period and prior to the signing of the United States-Canadian automotive agreement, General Motors, Ford, Chrysler and American Motors (the Big Four) were the major motor vehicle producers in both the United States and Canada. In 1964, in terms of quantity, they accounted for 99.9 per cent of the passenger cars (see Tables 1, 2 and 3).

Passenger automobiles have comprised the bulk of motor vehicle production in the United States and Canada since World War II. By 1960 United States production of passenger automobiles numbered 6.6 million units increasing to 7.7 million units in 1964 (see Tables 3 and 4). Canadian production of passenger automobiles totalled 325,000 units in 1960 and 559,000 units in 1964 (see Tables 5 and 6). In terms of the numbers produced, Canadian production of automobiles constitutes 4.6 per cent of the total United States-Canadian production in 1960 and 6.7 per cent in 1964 (see Table 7). In 1964, Canadian production of motor vehicles was the highest that it had ever been in Canadian automotive history. Due to this predominance of passenger automobile production in overall motor vehicle production, this study will cover the passenger automobile industry and will exclude trucks, buses and special purpose vehicles. Also, although original equipment parts makes up 65-75 per cent of the cost of completed vehicles in the United States and 44 per cent of total production, and in Canada, 81.6 per cent of total production was by independent vehicle parts manufacturers (see Tables 4

and 8). Independent parts venders are highly dependent on orders from the large motor vehicle manufacturers.<sup>5</sup> Thus, specific discussion of the original equipment parts industry will be excluded from this report.<sup>6</sup>



TABLE 1

United States-Canadian-type passenger automobiles:<sup>a</sup>  
 Share of United States production, by manufacturer,  
 1960-74, January-June 1974, and January-June 1975  
 (in per cent)

Year	General Motors	Ford	Chrysler	AMC	Big Four	All other	Total
1960	47.7	28.2	15.2	7.2	98.3	1.7	100.0
1961	49.5	30.6	11.7	6.7	98.5	1.5	100.0
1962	53.9	27.9	10.3	6.5	98.6	1.4	100.0
1963	53.5	25.5	13.7	6.3	99.0	1.0	100.0
1964	51.1	27.7	16.0	5.1	99.9	0.1	100.0
1965	53.0	27.5	15.7	3.7	99.9	0.1	100.0
1966	51.7	28.2	16.8	3.2	99.9	0.1	100.0
1967	55.5	22.9	18.4	3.1	99.9	0.1	100.0
1968	51.9	27.1	17.9	3.0	99.9	0.1	100.0
1969	53.7	26.3	16.9	3.0	99.9	0.1	100.0
1970	45.5	30.8	19.4	4.2	99.9	0.1	100.0
1971	56.7	25.4	15.0	2.8	99.9	0.1	100.0
1972	54.0	27.2	15.5	3.2	99.9	0.1	100.0
1973	54.3	25.8	16.1	3.7	99.9	0.1	100.0
1974: January- June	46.8	30.2	17.6	5.3	99.9	0.1	100.0
1975: January- June	54.7	27.8	12.3	5.1	99.9	0.1	100.0

SOURCE: Canadian Automobile Agreement; United States International Trade Commission Report on the United States-Canadian Automobile Agreement: Its History, Tariffs and Impact and the Ninth Annual Report of the President to the Congress on the Operation of the Automotive Products Trade Act of 1965; Committee on Finance. United States Senate, Russel B. Long, Chairman, January, 1976. United States Government Printing Office, Washington, 1976. 62-4780. P. 237.

<sup>a</sup>The term "United States-Canadian-type" motor vehicles is used to describe motor vehicles produced in the United States and/or Canada by firms headquartered in the United States or Canada. It does not include United States--or Canadian-- made vehicles produced by such firms as Volvo or Renault which are headquartered in third countries.

TABLE 2

United States-Canadian-type passenger automobiles:  
Share of Canadian Production, by manufacturer,  
1960-74, January-June 1974, and January-June 1975  
(in per cent)

Year	General Motors	Ford	Chrysler	AMC	Big Four	All other	Total
1960	53.9	28.9	15.5	---	98.3	1.7	100.0
1961	51.2	30.0	14.3	2.6	98.1	1.9	100.0
1962	53.6	27.6	11.8	5.1	98.5	1.9	100.0
1963	49.7	26.8	16.3	5.7	96.8	1.5	100.0
1964	44.2	27.5	18.8	6.3	97.4	3.2	100.0
1965	49.8	24.0	19.2	4.4	99.7	2.6	100.0
1966	41.2	28.7	25.0	4.8	100.0	0.1	100.0
1967	44.0	25.0	26.3	4.7	100.0	---	100.0
1968	38.2	32.4	24.7	4.7	100.0	---	100.0
1969	38.4	38.4	19.7	3.5	100.0	---	100.0
1970	24.6	43.7	26.4	5.3	100.0	---	100.0
1971	37.8	36.5	21.7	4.0	100.0	---	100.0
1972	31.1	40.3	23.4	5.2	100.0	---	100.0
1973	33.4	38.0	22.3	6.3	100.0	---	100.0
1974	40.8	34.9	19.3	5.0	100.0	---	100.0
1974: January- June	41.7	32.7	19.7	5.9	100.0	---	100.0
1975: January- June	41.8	28.8	25.1	4.3	100.0	---	100.0

SOURCE: Canadian Automobile Agreement, op. cit., p. 241.

TABLE 3

United States-Canadian-type passenger automobiles:  
 United States Production, by manufacturer, 1960-74,  
 January-June 1974, and January-June 1975  
 (in thousands of units)

Year	General Motors	Ford	Chrysler	AMC	Big Four	All other	Total
1960	3,193	1,892	1,019	486	6,590	113	6,703
1961	2,727	1,690	649	372	5,438	84	5,521
1962	3,741	1,935	717	455	6,848	95	6,943
1963	4,078	1,941	1,048	480	7,547	75	7,621
1964	3,956	2,146	1,242	394	7,738	7	7,745
1965	4,949	2,566	1,468	346	9,329	6	9,335
1966	4,449	2,425	1,446	279	8,599	6	8,605
1967	4,117	1,696	1,364	230	7,407	6	7,413
1968	4,593	2,397	1,586	268	8,844	5	8,849
1969	4,421	2,163	1,392	243	8,219	5	8,224
1970	2,980	2,017	1,273	276	6,546	4	6,550
1971	4,853	2,196	1,288	236	8,553	5	8,558
1972	4,776	2,401	1,366	279	8,822	6	8,828
1973	5,253	2,496	1,556	356	9,661	6	9,667
1974	3,571	2,205	1,177	351	7,304	5	7,309
1974: January- June	1,788	1,153	672	201	3,814	3	3,817
1975: January- June	1,715	870	386	160	3,131	2	3,133

SOURCE: Compiled from automotive production data published in Automotive News, Ward's Automotive Reports, and material supplied to the United States International Trade Commission by the Motor Vehicle Manufacturers Association (United States) and by individual manufacturers.



TABLE 4

United States-Canadian-type passenger automobiles:  
 United States-Canadian-type trucks and buses, total  
 United States-Canadian-type on-the-highway motor  
 vehicles, and original-equipment motor-vehicle parts:  
 United States production in terms of transfer values,  
 1960-74, January-June 1974, and January-June 1975  
 (in millions of United States dollars)

Period	On-the-Highway motor vehicles			Original equip- ment motor- vehicle parts
	Passenger automobiles	Trucks and buses	Total	
1960	10,198	2,700	12,898	9,092
1961	11,278	2,262	13,540	10,166
1962	14,326	2,688	17,014	12,654
1963	16,394	3,109	19,503	14,562
1964	15,809	3,315	19,124	15,094
1965	21,486	3,802	25,288	19,467
1966	21,390	4,057	24,447	18,892
1967	18,102	3,798	21,900	16,808
1968	22,739	4,695	27,434	19,464
1969	22,375	5,307	27,682	20,764
1970	17,238	4,872	22,110	17,058
1971	24,585	6,364	30,949	22,458
1972	26,734	8,112	34,846	24,253
1973	30,511	10,556	41,067	29,235
1974	24,711	11,003	35,714	29,138
1974: January- June	11,728	5,832	17,560	13,548
1975: January- June	12,343	4,959	17,302	15,170

SOURCE: Partly estimated on the basis of firm's responses to the questionnaires of the United States International Trade Commission.

TABLE 5

United States-Canadian-type passenger automobiles:  
 Canadian production, by manufacturer, 1960-74,  
 January-June 1974, and January-June 1975,  
 (in thousands of units)

Year	General Motors	Ford	Chrysler	AMC	Big Four	All other	Total
1960	175	94	50	---	319	6	325
1961	167	98	45	9	321	6	327
1962	229	118	51	22	420	8	428
1963	265	142	87	30	524	8	532
1964	246	153	105	35	539	18	557
1965	351	169	136	31	687	19	706
1966	286	198	173	33	690	2	692
1967	312	178	187	33	710	--	710
1968	338	287	219	42	886	--	886
1969	392	391	201	36	1,020	--	1,020
1970	223	396	239	49	906	--	906
1971	406	392	233	54	1,074	--	1,074
1972	354	459	266	59	1,138	--	1,138
1973	392	445	261	74	1,172	--	1,172
1974	478	409	226	58	1,171	--	1,171
1974: January- June	278	218	131	39	666	--	666
1975: January- June	223	154	134	23	534	--	534

SOURCE: Compiled from automotive production data published in Automotive News, Ward's Automotive Reports, and material supplied to the United States International Trade Commission by the Motor Vehicle Manufacturers Association (United States and Canada) and by individual manufacturers.

TABLE 6

United States-Canadian-type passenger automobiles:  
 United States-Canadian-type trucks and buses, total  
 United States-Canadian-type on-the-highway motor  
 vehicles, and original-equipment motor-vehicle parts:  
 Canadian production in terms of transfer values,  
 1960-74, January-June 1974, and January-June 1975  
 (in millions of United States dollars)

Period	On-the-Highway motor vehicles			Original equip- ment motor- vehicle parts
	Passenger automobiles	Trucks and buses	Total	
1960	532	153	685	234
1961	522	135	668	224
1962	732	183	915	305
1963	977	219	1,196	406
1964	995	262	1,257	402
1965	1,378	309	1,687	462
1966	1,365	382	1,747	641
1967	1,448	430	1,878	856
1968	1,902	541	2,443	971
1969	2,299	644	2,943	1,341
1970	1,993	550	2,543	1,453
1971	2,552	629	3,181	1,338
1972	2,720	786	3,506	1,716
1973	3,155	975	4,130	2,066
1974	3,713	1,177	4,890	2,276
1974: January- June	1,777	598	2,375	1,052
1975: January- June	1,795	703	2,498	1,076

SOURCE: Partly estimated on the basis of firm's responses to the questionnaires of the United States International Trade Commission.

TABLE 7

United States-Canadian-type passenger automobiles:  
 Canadian production as a share of total  
 United States-Canadian production, by manufacturer,  
 1960-74, January-June 1974, and January-June 1975  
 (in per cent)

Year	General Motors	Ford	Chrysler	AMC	Big Four	All other	Total
1960	5.2	4.7	4.7	---	4.6	5.0	4.6
1961	5.8	5.5	6.9	2.4	5.6	6.7	5.6
1962	5.8	5.7	6.6	4.6	5.8	7.8	5.8
1963	6.1	6.8	7.7	5.9	6.5	19.4	6.5
1964	5.9	6.7	7.8	8.2	6.5	73.1	6.7
1965	6.6	6.2	8.5	8.2	6.9	25.0	7.0
1966	6.0	7.5	10.7	10.6	7.4	----	7.4
1967	7.0	9.5	12.1	12.5	8.7	----	8.7
1968	6.9	10.7	12.1	13.5	9.1	----	9.1
1969	8.1	15.3	12.6	12.9	11.0	----	11.0
1970	7.0	16.4	15.8	14.8	12.2	----	12.2
1971	7.7	15.3	15.3	15.4	11.2	----	11.2
1972	6.9	16.0	16.3	17.5	11.4	----	11.4
1973	6.9	15.1	14.4	17.2	10.8	----	10.8
1974	11.8	15.6	16.1	14.2	13.8	----	13.8
1974: January- June	13.5	15.9	16.3	16.3	14.9	----	14.9
1975: January- June	11.5	15.0	25.8	12.6	14.6	----	14.6

SOURCE: Canadian Automobile Agreement, op.cit., p. 247.

TABLE 8

Original-equipment motor-vehicle parts:  
 United States production, by class of producer  
 in terms of transfer values, 1960-74  
 January-June 1974, and January-June 1975

Period	Motor vehicle Manufacturers	Independent parts producers	Total	Independents as a per cent of the total
	<u>Million U.S. dollars</u>	<u>Million U.S. dollars</u>	<u>Million U.S. dollars</u>	<u>Per Cent</u>
1960	4,718	4,374	9,092	48.1
1961	5,678	4,448	10,166	44.1
1962	7,065	5,589	12,654	43.6
1963	8,209	6,353	14,562	43.9
1964	8,465	6,629	15,094	44.3
1965	10,839	8,628	19,467	44.3
1966	10,645	8,247	18,892	43.7
1967	9,461	7,347	16,808	43.7
1968	11,222	8,242	19,464	42.3
1969	11,973	8,791	20,764	42.3
1970	9,472	7,586	17,058	44.5
1971	13,037	9,421	22,458	41.9
1972	13,799	10,454	24,253	43.1
1973	16,002	13,233	29,235	45.3
1974	16,176	12,962	29,138	44.5
1974: January- June	7,492	6,056	13,548	44.7
1975: January- June	7,807	7,363	15,170	48.5

SOURCE: Partly estimated on the basis of firm's responses to the questionnaires of the United States International Trade Commission.

Consumption of new passenger automobiles in the United States and Canada grew very quickly following World War II, from 1.9 million vehicles in 1946 to 6.7 million vehicles in 1950. From 1950 to 1960 sales of passenger automobiles in the United States and Canada exceeded the 1950 level only in 1955 when United States-Canadian sales amounted to 7.6 million vehicles. In 1960, consumption amounted to 7 million units, but in 1963 it amounted to 8.1 million units and in 1964 it amounted to 8.7 million units (see Table 9).

Non-United States-Canadian produced passenger automobiles accounted for a substantially larger share of Canadian consumption throughout the post-World War II period than was the case in the United States. These third-country inputs accounted for less than 1% of United States consumption in 1950 as compared with 20% in the same year in Canada. During the late 1950's third countries rapidly increased their share of the United States and Canadian markets, to 10.3 per cent of the United States market and 25.8 per cent of the Canadian market in 1959. The growing popularity of United States-Canadian-type small passenger automobiles which had been introduced in the late 1950's reduced the third-country share of the United States market to 6 per cent by 1964 and their share of the Canadian market to 11.2 per cent in the same year. However, for the first half of 1975, third country imports represented 20.3% of the total United States consumption and 15.0% of the total Canadian consumption (see Tables 10 and 11).

Canada Consumed 4% of the United States-Canadian-type passenger automobiles in 1950, 5% in 1960 and 6.6% in 1964. Canadian production of these vehicles was 2.5% in 1950, 2.8% in 1960 and 4.0% in 1964. These production figures assume a 60% Canadian content in Canadian vehicles produced (base



level Canadian sourced parts and labor set by the Canadian government). In contrast with Canada's share of United States-Canadian production, a "gap" existed between it and Canada's share of United States-Canadian production of 1.5% in 1950, 2.2% in 1960 and 2.6% in 1964. Canada has argued that in an integrated motor vehicle industry such gaps should not exist and that some means should be available to aid in closing them and thereby achieving a fair share of the United States-Canadian market<sup>7</sup> (see Tables 7 and 12).

TABLE 9

New Passenger automobiles: United States consumption,  
Canadian consumption, and total United States-  
Canadian consumption, 1960-74, January-June 1974,  
and January-June 1975

Year	United States	Canada	Total	Canada as a per cent of the total
	<u>1,000 units</u>	<u>1,000 units</u>	<u>1,000 units</u>	<u>Per Cent</u>
1960	6,577	448	7,025	6.4
1961	5,855	437	6,292	6.9
1962	6,930	502	7,441	6.7
1963	7,557	542	8,099	6.7
1964	8,068	607	8,675	7.0
1965	9,315	685	10,000	6.8
1966	9,009	684	9,693	7.1
1967	8,357	667	9,024	7.4
1968	9,404	738	10,142	7.3
1969	9,447	756	10,203	7.4
1970	8,385	636	9,021	7.1
1971	9,729	745	10,474	7.1
1972	10,487	813	11,200	7.3
1973	11,351	935	12,286	7.6
1974	8,701	872	9,573	9.1
1974: January- June	4,649	389	5,038	7.7
1975: January- June	4,101	340	4,441	7.7

SOURCE: Compiled from automotive registration and retail sales data published in Automotive News, Ward's Automotive Reports, Canadian Automotive Trade, and material supplied to the United States International Trade Commission by the Motor Vehicle Manufacturers Association (United States and Canada), and by individual manufacturers.



TABLE 10

New Passenger automobiles: United States consumption, of United States-Canadian-type vehicles, United States consumption of Non-United States-Canadian-type vehicles; United States-Canadian-type vehicle consumption to the total, 1960-74, January-June 1974, and January-June 1975

Year	U.S.- Canadian	Non-U.S.- Canadian	Total	Non-U.S.- Canadian-type as a per cent of the total
	<u>1,000 units</u>	<u>1,000 units</u>	<u>1,000 units</u>	<u>Per Cent</u>
1960	6,076	501	6,577	7.6
1961	5,475	380	5,855	6.5
1962	6,600	339	6,939	4.9
1963	7,171	386	7,557	5.1
1964	7,584	484	8,068	6.0
1965	8,746	569	9,315	6.1
1966	8,351	658	9,009	7.3
1967	7,578	779	8,357	9.3
1968	8,418	986	9,404	10.5
1969	8,385	1,062	9,447	11.2
1970	7,154	1,231	8,385	14.7
1971	8,263	1,466	9,729	15.1
1972	8,958	1,529	10,487	14.6
1973	9,631	1,720	11,351	15.2
1974	7,332	1,369	8,701	15.7
1974: January- June	3,946	703	4,649	15.1
1975: January- June	3,268	833	4,101	20.3

SOURCE: Compiled from data published by Automotive News, Ward's Automotive Reports, and material supplied to the United States International Trade Commission by the Motor Vehicle Manufacturers Association (United States).

TABLE 11

New passenger automobiles: Canadian consumption of United States-Canadian-type vehicles, Canadian consumption of Non-United States-Canadian-type vehicles, total Canadian consumption of passenger automobiles, and the ratio of Non-United States-Canadian-type vehicles consumption to the total, 1960-74, January-June 1974, and January-June 1975

Year	U.S.- Canadian type	Non-U.S.-Canadian type			Non-U.S.-Canadian type as a per cent of the total			
		Assembled in Canada		Total 1,000 units	Assembled in Canada		Total Per Cent	
		Other 1,000 units	Total 1,000 units		Other Per Cent	Total Per Cent		
1960	322	-	126	126	448	-	28.1	28.1
1961	336	-	101	101	437	-	23.1	23.1
1962	427	-	75	75	502	-	14.9	14.9
1963	488	1	53	54	542	0.2	9.8	10.0
1964	539	2	66	68	607	0.3	10.9	11.2
1965	609	3	73	76	685	0.4	10.7	11.1
1966	609	4	71	75	684	0.6	10.4	11.0
1967	585	6	78	82	667	0.6	11.7	12.3
1968	622	6	110	116	738	0.8	14.9	15.7
1969	616	16	124	140	756	2.1	16.4	18.5
1970	478	18	140	158	636	2.8	22.0	24.8
1971	546	20	179	199	745	2.7	24.0	26.7
1972	598	17	198	215	813	2.1	24.3	26.4
1973	740	10	185	195	935	1.1	19.8	20.9
1974	731	10	131	141	872	1.1	15.1	16.2
1974: January-June	326	8	55	63	389	2.1	14.1	16.2
1975: January-June	289	9	42	51	340	2.6	12.4	15.0

SOURCE: Compiled from automotive registration, retail sales, and production data published in Automotive News, Ward's Automotive Reports, Canadian Automotive Trade, and material supplied to the United States International Trade Commission by the Motor Vehicle Manufacturers Association (United States and Canada).

United States and Canadian trade in automotive products before 1965.

Canada's automotive industry developed largely through the American Motors Corporation, Chrysler Corporation, the Ford Motor Company, General Motors Corporation and Studebaker-Packard Corporation. As previously mentioned in the first chapter, the Ford Motor Company was the forerunner in the development of the Canadian auto industry and exclusive rights to manufacture Ford cars in Canada were granted by Henry Ford in 1904 to a group of Canadian businessmen. From that time until the agreement, much of the development of Canada's automotive industry is attributed to the high tariff wall of 17.5% and the access by Canadian automotive producers to the markets of the British Commonwealth. [ The Royal Commission on Canada's Economic Prospects reporting on the Canadian automotive industry, makes the following observation: ]

The customs tariff, including Empire Content requirements and tariff preference in Empire Markets, has been of major significance in the development of the Canadian automotive parts industry. Prior to 1926, the rates of duty on automobiles and automobile parts were such that a large measure of protection was provided to the Canadian industry, particularly in view of the preference granted in Empire markets with a 50 percent Empire content. The provision for a 99 percent drawback of duty paid on imported parts and materials incorporated in vehicles exported...

The effect of the content revision of 1936 has undoubtedly spurred the manufacture of additional automotive parts in Canada. With pressure to achieve the higher content of 60 percent purchasing departments of the major manufacturing companies were forced to canvass Canadian sources of supply more carefully and, where possible, award business locally.

In support of the aforementioned position of the large American producers manufacturing and selling for Canada and the British Commonwealth,

Canada's exports to the United States for completed passenger vehicles was less than 1,000 for 1951-1959, 1,000-2,000 from 1960-1963 and 12,000 in 1964 (see Table 13). The jump in exports was said to be largely attributed to Studebakers' transfer of its entire United States vehicle assembly operation from South Bend, Indiana, to Hamilton, Ontario. The United States' position as an exporter of completed passenger vehicles showed a decrease from 37,000 in 1958 to 27,000 in 1960 and 7,000 in 1963 increasing to 15,000 vehicles in 1964 (see Table 14).

Motor vehicle parts used for Canadian vehicles were made substantially according to the same specifications as for United States vehicles. Realizing the potential advantages of economies of scale through longer production runs and the high cost of machinery, a greater per cent of the motor vehicle parts were made in the United States factories, than in Canadian factories (see Table 15).<sup>1</sup> This observation is supported by V.W. Bladen.<sup>9</sup>

Costly high speed, single-purpose machinery, the capacity of which, in many cases, is in excess of the requirements for the Canadian market, has developed [in the United States for these parts]. The parts manufacturer in Canada with comparatively lower volume output cannot, as a rule, expect to take sufficient advantage of the economies that can be achieved with this type of machinery to justify its purchase. He has had to adapt general purpose machinery to his operation and, though he has not been able to avoid adding something to cost. While on the average, labour rates in the automobile industry are somewhat lower in Canada than in the United States, the labour cost per unit in production nevertheless tends to be higher in Canada by reason of frequent changes in "setups" for comparatively small production runs.

TABLE 12

United States-Canadian-type passenger automobiles:  
 Canadian consumption as a share of total United States-  
 Canadian consumption, by market segment, 1963-74,  
 January-June 1974 and January-June 1975  
 (in per cent)

Year	Passenger automobiles having wheelbases measuring--				Total
	Less than 100 inches	100- 111.9 inches	112- 119.9 inches	120 inches or more	
1963	0.8	5.3	5.3	9.5	6.4
1964	1.0	5.4	6.0	9.2	6.6
1965	1.1	5.1	5.8	9.4	6.5
1966	1.5	5.3	6.1	9.8	6.8
1967	1.8	6.8	6.5	9.1	7.2
1968	2.7	6.7	6.4	8.4	6.9
1969	3.1	6.9	6.5	7.3	6.8
1970	5.7	6.5	6.0	6.4	6.3
1971	5.1	7.4	6.3	5.9	6.2
1972	5.0	8.4	6.3	5.6	6.3
1973	8.0	8.4	6.6	6.6	7.1
1974	8.5	9.9	9.0	8.8	9.1
1974: January-June	7.3	7.9	7.4	7.8	7.6
1975: January-June	5.2	7.7	8.8	9.5	8.1

SOURCE: Canadian Automobile Agreement, op.cit., p. 230.



TABLE 13

United States-Canadian-type passenger automobiles:  
 United States imports from Canada, by manufacturer  
 1960-74, January-June 1974, and January-June 1975  
 (in thousand of units)

Year	General Motors	Ford	Chrysler	AMC	Big Four	All other	Total
1960	--	2	--	-	--	a	2
1961	--	1	--	-	1	a	1
1962	--	1	--	-	1	a	1
1963	--	1	--	-	1	a	1
1964	--	2	--	-	2	10	12
1965	--	2	20	-	22	11	33
1966	3	62	85	9	159	2	161
1967	87	94	118	27	326	-	326
1968	118	180	149	33	480	-	480
1969	196	292	158	31	677	-	677
1970	127	304	209	42	682	-	682
1971	249	290	203	38	780	-	780
1972	205	356	224	52	837	-	837
1973	236	349	215	62	862	-	862
1974	265	311	183	43	802	-	802
1974: January- June	154	164	106	30	454	-	454
1975: January- June	128	110	114	18	370	-	370

SOURCE: Compiled from data on the destination of factory sales supplied to the United States International Trade Commission by the Motor Vehicle Manufacturers Association (United States).

<sup>a</sup>Fewer than 500 vehicles.



TABLE 14

United States-Canadian-type passenger automobiles:  
 United States exports to Canada, United States exports to  
 all other countries, and total United States Exports, 1960-74,  
 January-June, 1974, and January-June 1975

Year	U.S. exports to Canada	All other U.S. exports	Total	Exports to Canada as a per cent of the total
	<u>1,000 units</u>	<u>1,000 units</u>	<u>1,000 units</u>	<u>Per Cent</u>
1960	27	118	143	18.6
1961	16	125	141	11.3
1962	17	163	180	9.4
1963	7	187	194	3.6
1964	15	183	198	7.6
1965	47	158	205	22.9
1966	122	140	262	46.6
1967	246	120	366	67.2
1968	289	126	415	69.6
1969	286	131	417	68.6
1970	246	114	360	68.3
1971	352	111	463	76.0
1972	382	89	471	81.1
1973	476	103	579	82.2
1974	485	109	594	81.6
1974: January- June	271	59	330	82.1
1975: January- June	270	40	310	87.1

SOURCE: Compiled from data on the destination of factory shipments submitted to the United States International Trade Commission by the Motor Vehicle Manufacturer's Association (United States).

TABLE 15

Canadian Exports and Imports of  
Motor Vehicle Parts and Accessories

Year	Exports	Imports	Net <sup>a</sup>
1921-1925	17,949,433	73,045,733	- 55,100,300
1926-1930	15,009,920	176,288,551	-161,278,631
1931-1935	9,354,062	80,859,949	- 71,495,887
1936-1940	21,780,469	154,401,961	-132,621,492
1941-1945	530,350,044	367,136,397	+163,203,647
1946-1950	79,379,674	557,116,600	-477,736,926
1951	32,452,366	222,673,220	-190,220,854
1952	29,936,828	215,381,310	-185,444,382
1953	21,694,774	249,554,022	-227,859,248
1954	24,042,483	201,661,365	-177,618,882
1955	27,908,767	280,594,431	-252,685,664
1956	26,516,135	321,156,442	-294,640,307
1957	20,606,695	290,707,653	-270,100,958
1958	20,513,546	269,208,124	-248,694,578
1959	35,016,228	325,244,873	-290,228,645
1960	41,783,399	331,958,952	-290,175,553
1961	28,963,926	343,201,740	-314,237,814
1962	33,613,378	463,122,352	-429,508,974
1963	59,633,748	575,352,452	-515,718,704
1964	105,247,777	672,548,533	-567,300,756
1965	181,648,471	868,220,745	-684,572,274

SOURCE: Motor Vehicle Manufacturers' Association, Facts and Figures of the Automotive Industry, 1966.

<sup>a</sup>Imports (-), exports (+).

Tariff structures of the United States and Canada before 1963. The most-favored-nation-tariff rates for automobiles imported into the United States have been lower than those in Canada and after the Second World War were 10% ad valorem. This rate continued to decline until it was 6.5% in July of 1963. (The rate was reduced to 9.5% on June 30, 1956; 9% on June 30, 1957, 8.5% on June 30, 1958; 7.5% on July 1, 1962 and 6.5% on July 1, 1963).

The rates of duty on original parts was 25% ad valorem after World War II which was later reduced to 8.5% in July, 1963. (The rate declined from its 25% to 12% on January 1, 1948; 11.5% on June 30, 1958; 9.5% on July 1, 1962; and 8.5% on July 1, 1963).

The tariff rates in Canada for imported automobiles had not changed much since 1936 at which time 17.5% ad valorem was the applicable rates for both completed vehicles and most parts. Other parts were subject to a 25% tariff. Certain parts that were not produced in Canada and were to be used in completed motor vehicles, were allowed duty free entry into the country. This concession was granted in the case that the parts were used to meet a certain content requirement in the completed vehicle and these percentages varied from 40, 50 to 60 per cent. The greater the number of vehicles produced by the individual producer, the higher the applicable content requirement percentage. Content requirements refers to the percentage of factory cost, not including duties and taxes incurred within the British Commonwealth.<sup>10</sup>

The Bladen Report. In August, 1960, V. W. Bladen was appointed a Royal Commissioner with the duty of inquiring into the competitive positions and prospects of the automobile and automobile parts industries and recommending measures "to improve the ability of such industries to provide increased employment in the economic production of vehicles for the Canadian market and export markets." This report presented seven recommendations based on the above requests, the most important of which was the "extended content plan." This plan was later put into effect with tariff legislation of 1962 and 1963 and will be discussed later. The plan was designed to increase the amount, and the efficiency, of protection accorded to the automotive and especially the auto parts manufacturers in Canada, and to extend such protection into the subsidization of exports. These intentions, and their likely high cost to the Canadian consumer were partly disguised by the Commissioner's emphasis on the free trade and price reducing aspects of his plan and his failure to recognize that tariffs collected on imports, though a cost to the consumer, are not a cost to the country, and further, if tariff receipts are traded off against increased domestic production the Government may well have to replace the lost revenue by imposing other taxes on the public. In addition the plan was designed to favor the small producers, with the intent of preserving competition in the industry.<sup>11</sup>

The Report begins with a brief outline of the historical background of the industry, which is particularly noteworthy for its statement of the economic intent and effects of the content provisions introduced in

the tariff revision of 1936. This outline discusses the development of the Canadian automotive industry in relation to the strong economic power of the European motor vehicle producers which had the advantage of low wages and high technology and argues that accordingly the low volume Canadian automobile producer is at a competitive disadvantage. The report goes on to discuss various topics involving tariff administration.

V. W. Bladen takes a position between free trade and protectionism in his recommendations. Free trade is rejected on the following ground: "The decision was taken long ago to manufacture automobiles in Canada. Today, many thousands of workers and considerable capital resources are committed to the industry. Considering the state of development which the automotive industry has achieved in Canada, it would be socially irresponsible to adopt any policy which might lead to its drastic contraction."<sup>12</sup> The author understands the needs for protection in the early stages of industrial development, however the industry had developed considerably from the original 1910 Ford of Canada automotive plant. The validity of this statement is eloquently contested by Harry G. Johnson:

... suffice it to remark here that the implied doctrine that no mistakes should ever be admitted, and no errors ever corrected, if anyone might be hurt thereby is an exceedingly poor basis for intelligent policy making, especially in allegedly free-enterprise economy, and a perfect recipe for the preservation of augmentation of the wasteful inefficiency and the strangulation of economic growth.<sup>13</sup>

Increased protection is rejected by Bladen on the grounds that "there is a point beyond which the cost of having an automobile industry in Canada



would be so high as to become politically intolerable to the consumer."<sup>14</sup> The Report also makes the point that tariffs at a much higher level would not only involve resource misallocation but might so choke off demand as to frustrate the expected expansion of the industry.

Basically, the plan was to assume an increased level of Canadian content in the production of motor vehicles. This was achieved by duty remittance on imported parts if the added Canadian content was equivalent. As H. G. Johnson further points out:

... it is perhaps one of the most ingenious devices for evading the rules of GATT yet invented, and a creditable product of the Canadian penchant for devising schemes to apply genteel pressure on the big American companies to change their policies in Canadian operations--a penchant invariably indulged in at the ultimate expense of the average Canadian citizen.<sup>15</sup>

In conclusion, the favoring of the small producer of motor vehicle parts conflicts with the intent of increased production in the Canadian market. The development of the Canadian automotive industry is dependent largely on the policies and practices of the large automotive producers. Restriction on their production and the development through the extended content requirement, which favors small producers of motor vehicle parts (through a lower content requirement) minimizes the possibility of the development of economies of scale.

#### Consequences of the Bladen Report.

October 1962. Under an Order in Council, the 25% most favored-nation tariff on automatic transmissions was suspended. This suspension was subject to the condition that the Canadian content of automobile parts exported by



the producer exceeded that of the 12 month period ending October 31, 1962 (the base period).<sup>16</sup> That is, for every dollar of Canadian content of exports of parts during the base period from November 1, 1961, to October 31, 1962, duties would be remitted on a dollar of transmissions or engine imports. The duty remittance also applied to stripped engines but was limited to 10,000 engines for each producer.

October 1963. The policy initiated by the Order-In-Council of October 22, 1963, (PC 1963-1/1544) expanded the previous October plan of remittance of duty on transmissions and engines. Under the new Order tariffs on all imports of motor vehicles and original equipment parts were to be remitted to the extent that the Canadian content of exports exceeded that of the base period (November 1, 1961, to October 31, 1962).

Paul Wonnacott made an interesting evaluation of the 1963 duty remittance plan in relation to a free trade situation:

... there will be a restraint on the balance of trade arising from automobile transactions with Canada having an overall automobile balance which is favourable by at least the amount of Canadian exports in the 1961-62 base period. This restraint will insulate the Canadian market from import competition; thus, Canadian automobile prices may remain considerably higher than those in the United States. Also Canadian exports will be subject to U.S. duties averaging between 6-1/2 and 8-1/2 percent. It is unlikely that any large proportion of this tariff will be shifted to U.S. consumers as producers; thus it will fall primarily on Canadians, either in the form of higher automobile prices or in the form of lower wages in the automobile industry.<sup>17</sup>

The results of both the 1962 and 1963 duty remission plans appeared to have been successful judging by the response of the supposed threatened independent auto parts manufacturers in America. The duty remission plans of

1962 and 1963 were also referred to as the Drury Plan as discussed in the first Chapter. The Honorable C. M. Drury was the Minister of Industry for Canada during this time period.

Opposition to the Duty Remission Plans in the United States. The plans made no distinction regarding the end use of the exported parts which were the basis for the duty-remission credits to the Canadian vehicle manufacturers, and they had been adopted without consultation with or agreement by the United States government. The exported Canadian parts could be disposed of in the United States either as replacement parts or as original parts. This possibility was seen by the American manufacturers as a threat that subsidized low-cost Canadian parts would dominate their market. Some also viewed it as a means by which the motor vehicle manufacturers, who also supplied the United States "after market" could gain greater control over that market by supplying it with less expensive Canadian-made parts. A threat also was felt by the manufacturers of original parts also regarded on similar grounds.<sup>18</sup>

As mentioned earlier, the Modine Manufacturing Company of Racine, Wisconsin, a producer of automobile radiators, filed a petition with the Commissioner of Customs under Section 303 of the Tariff Act of 1930. The petitioner charged that the Canadian export-incentive program constituted a grant on the exportation of automobile parts to the United States and requested a countervailing duty of 25% be levied on imports of such products from Canada.<sup>19</sup> On July 21, 1964, the Automotive Service Industry Association, a trade association which then represented some 5,000 American

producers, rebuilders and distributors of automobile parts filed a brief with the United States Bureau of Customs in support of Modine's position.

On June 3, 1964, the Treasury Department instituted an investigation to determine whether the Canadian export-incentive plan in fact constituted the payment or bestowal of a bounty or grant within the meaning of Section 303.<sup>20</sup>

On January 12, 1965, the Automotive Service Industry Association together with four independent parts manufacturers filed suit against the Secretary of the Treasury in the United States District Court for the District of Columbia, asking a writ in the nature of mandamus be issued compelling the Secretary to levy the countervailing duties under the petitions of April 15, 1964, and July 21, 1964.<sup>21</sup> On January 16, 1965, four days after the suit was filed, the Automotive Agreement was signed and Canada amended the Order in Council to provide that duty remissions would not be paid as a result of any exportation after January 17, 1965. In view of Canada's action, the Treasury Department terminated the investigation on January 18.<sup>22</sup> The District Court action filed by the Automotive Industry Association was dismissed without prejudice on May 18, 1965.<sup>23</sup>

The Agreement Concerning Automotive Products Between  
the Government of the United States of America and the  
Government of Canada, and the "Letters of Undertaking"  
Relating to the Agreement

Introduction. On January 16, 1965, Prime Minister Pearson of Canada and President Johnson of the United States signed the Agreement Concerning

Automotive Products between the Government of the United States of America and the Government of Canada (see Appendix A).

The three basic objectives appear in Article 1 of the Agreement. The first is to create a broader market for automotive products to permit achievement of the full benefits of specialization and large scale production. The second objective is the liberalization of United States and Canadian automotive trade in respect to tariff barriers and other factors tending to impede this trade with the idea of participation in the expansion of the North American automotive market on a mutually fair and equitable basis. The third objective is the development of conditions in which market forces may operate effectively to obtain the most economic patterns of investment, production and trade.

Prime Minister Pearson said at the time of the Agreement: "In effect we have agreed to rationalize the production of our respective industries and to expand our production and trade through a dismantling of tariff and other barriers in the automotive field." Important to note is that free trade in automotive products is not established, freer trade is, as involves the Canadian importation of automotive parts and vehicles. Prior to the Agreement, Canada permitted duty free entry of original-equipment parts of a class or kind not made in Canada provided the manufacturers maintained "commonwealth content" at 60% of the cost of production (for the Big Four) of motor vehicles as mentioned earlier in discussion of the 1963 duty remission plan. While new motor vehicles may be entitled to duty-free treatment by the Canadian government under the Agreement, this treatment is available only for vehicles imported by a manufacturer. Also while all original equipment parts



may now qualify for duty-free entry into Canada as opposed to only those of a class or kind not made in Canada, the 60% "Canadian value added" requirement effectively remains, including a few additional commitments. The most immediate change of significance resulting from the Agreement was the repeal of the duty-remission plan of 1963 (see Table 18). A summary of the American and Canadian terms of the Agreement and of the commitments made by the motor vehicle manufacturers to the Canadian government is presented in this report (see Table 19). Following is a discussion of the obligations.

TABLE 16. A Comparison of Protective Conditions and Restrictions Imposed by the Government of Canada Affecting Automotive Production and Trade Before and After the Agreement

Canadian Measures Prior to the Agreement	Canadian Measures Under the Agreement
<p>The relatively high most-favored-nation rate of duty on motor vehicles (17.5% ad valorem) and parts (17.5% and 25% ad valorem), 1/ encouraged certain levels of motor-vehicles production in relation to sales of motor vehicles in Canada.</p>	<p>The relatively high most-favored nation rates of duty on motor vehicles (15% ad valorem) and parts (15% and 20% ad valorem), 1/ 2/ and the requirements in Annex A of the agreement which limit duty-free treatment to motor vehicles and parts imported by a manufacturer of motor vehicles in Canada, maintain at least the pre-agreement levels of motor-vehicles production in relation to sales of motor vehicles in Canada.</p>
<p>A provision in the Canadian tariff structure provided duty-free treatment of certain original-equipment parts of a class or kind not made in Canada, if a manufacturer maintained a certain percentage (60% for the major producers) of Canadian content in its total production in Canada. 3/</p>	<p>The first collateral commitment in the "letters of understanding" requires a manufacturer to maintain "Canadian value added" in the production of motor vehicles and original-equipment parts as a certain percentage of the cost of vehicles of each class sold in Canada (50% for passenger automobiles).</p>
<p>The duty-remission plans of Canada which provided for the remission of duties on automotive imports to the extent that a manufacturer increased the Canadian content in its exports of automotive products, provided an incentive for increased levels of production in Canada, regardless of the level of consumption in Canada.</p>	<p>The second collateral commitment in the "letters of undertaking" which requires a manufacturer to increase "Canadian value added," in the production of motor vehicles and original-equipment parts by a certain lump sum in 1968, requires an increase in the value of Canadian production regardless of the level of consumption in Canada.</p>
<p>1/ The enumerated rates of duty on parts apply to most parts. 2/ These small reductions in duties came in 5 states as a result of the Kennedy Round negotiations. 3/ Annex A of the agreement, which provides conditional duty-free treatment for imports of motor vehicles and original equipment parts, is similar in substance to the provision in the Canadian tariff structure prior to the agreement which provided conditional duty-free treatment on certain imports of original-equipment parts of a class or kind not made in Canada. However, the comparisons in this chart are based upon similarities in the impact of the various measures, not upon their substantive similarities.</p>	<p>1/ The enumerated rates of duty on parts apply to most parts. 2/ These small reductions in duties came in 5 states as a result of the Kennedy Round negotiations. 3/ Annex A of the agreement, which provides conditional duty-free treatment for imports of motor vehicles and original equipment parts, is similar in substance to the provision in the Canadian tariff structure prior to the agreement which provided conditional duty-free treatment on certain imports of original-equipment parts of a class or kind not made in Canada. However, the comparisons in this chart are based upon similarities in the impact of the various measures, not upon their substantive similarities.</p>

SOURCE: Canadian Automobile Agreement, *op. cit.*, p. 36.



TABLE 17. United States-Canadian Automotive Trade Arrangement

The Agreement	Canadian Terms	Collateral Commitments by the Motor Vehicle Manufacturers to the Canadian Government
<p><b>American Terms</b></p> <p><b>Obligations:</b>                      Duty-free treatment of imports from Canada of motor vehicles and of parts for use as original equipment.</p> <p><b>Limitations:</b>                      (1) Some special purpose vehicles are specifically excluded.                      (2) Replacement parts for servicing existing vehicles are excluded as are all trailers, tires, and tubes.                      (3) Canadian products to qualify for duty-free entry must meet certain "content requirements" which limit the amount of material produced in countries other than the United States or Canada that can be included in them.</p>	<p><b>Obligations:</b>                      Same as for the United States except that duty-free treatment is not limited to the United States but is extended to all countries.</p> <p><b>Limitations:</b>                      (1) Some special purpose vehicles are specifically excluded.                      (2) Replacement parts for servicing existing vehicles are excluded. All tires and tubes are excluded.                      (3) The right to import vehicles is limited to qualified manufacturers of motor vehicles. Parts can be imported by independent parts manufacturers provided they are on order from a qualified motor vehicle manufacturer.                      (a) To qualify, a manufacturer must maintain the same level of vehicle production as existed in the base year (see text of study).</p>	<p>(1) To increase in each model year over the preceding model year, the dollar value of Canadian value added in the production of vehicles and original equipment parts by an amount equal to approximately 60 percent of the growth in the market for autos, trucks, and buses sold by each company for consumption in Canada.</p> <p>(2) To increase (in addition to (1) above the dollar value of Canadian value added in the production of vehicles and original equipment parts by US \$241 million by the end of model year 1968. This increase is over and above the absolute Canadian value added set as a minimum in model year 1964 by the Agreement.</p>

SOURCE: Canadian Automobile Agreement. *op. cit.*, p. 35.

Obligations of the United States under the Agreement. Under the terms of the Agreement, the United States is obligated to accord duty-free treatment to imports from Canada of motor vehicles and of parts for use as original equipment in the manufacture of motor vehicles. This obligation, however, is subject to three major limitations.<sup>24</sup>

1. A number of special purpose vehicles are specifically excluded from duty-free treatment, namely electric trolley buses, three-wheeled vehicles, trailers accompanying truck tractors, and vehicles specifically<sup>25</sup> constructed and designed to perform special services or functions.

2. The Agreement does not apply to replacement parts of parts sold in the after-market for use in servicing existing vehicles; it applies only to parts and fabricated components for use as original equipment in the manufacture of identified motor vehicles. In addition, trailers, tires and tubes are specifically excluded from coverage, whether for the replacement market or for use as original equipment.

3. Before Canadian products can qualify for duty-free entry they must meet certain content requirements, which say that they can contain only a limited amount of material produced in countries other than the United States and Canada. Until January 1, 1968, motor vehicles are limited to 60 percent of foreign content and 50 percent after that date. Chassis and parts are limited to 50 percent foreign content and is measured as follows:

$$\text{Foreign content} = \frac{\text{Value of materials from third countries}}{\text{Total appraised customs values of the item on entry into the United States}}$$

The value of materials from third countries is calculated as the value at the Canadian port of entry, exclusive of landing cost and Canadian duty.

Obligation of Canada Under the Agreement. As for the United States, Canada is obligated under the Agreement to accord duty-free treatment to imports from the United States of motor vehicles and parts for use as original equipment in the manufacture of motor vehicles. The limitations imposed by the Canadian government include safeguards to guarantee minimum levels of Canadian automotive production.

The major limitations regarding imports into Canada are:<sup>26</sup>

1. Certain special purposes vehicles, and chassis designed primarily for them, are specifically excluded from the terms of the Agreement. Some of these are electric trackles, buses, amphibious vehicles, off-the-road vehicles, mobile cranes, wreckers and other related special purpose vehicles (see Annex A of Appendix A).

2. Replacement parts intended for sale in the after-market are specifically excluded. All tires and tubes, both for replacement and for use as original equipment are also excluded. The Agreement covers only those parts and accessories and their sub-components that are imported for use as original equipment in specified classes of motor vehicles to be produced in Canada of that class of vehicle.

3. The right to import motor vehicles duty-free is restricted to qualified Canadian manufacturers of specified classes of motor vehicles. For the purpose of the Agreement, there are three separate classes of vehicles: (1) passenger automobiles, (2) buses, and (3) specified commercial vehicles.<sup>27</sup> The right to import parts free of duty is also limited to the same qualified manufacturers of vehicles, but an additional provision specifies that independent parts-makers who are producing components on order from these vehicle manufacturers can also take advantage of the terms of the Agreement.

The third limitation is different than that stipulated by the United States. It is designed to guarantee a continuing minimum level of motor vehicle production in Canada. There are three criteria that must be met by Canadian motor vehicle manufacturers to qualify for the right to import a given class of motor vehicle and any required original parts into Canada duty-free.

The first criterion for qualification requires that the Canadian company must have produced motor vehicles of the class under consideration in each quarter of the base year which is defined as the 1964 model year (August, 1963, to July, 1964). In addition, the company must have produced that class of vehicles in Canada during the 12-month period in which the importation is made, the periods to begin August 1 and end July 31. The Canadian government has also retained the right to give certain "non-qualified" producers the right to duty-free entry.

The second criterion is that in the model years following the designated base year, the manufacturer must maintain the same ratio between the Canadian vehicles which are produced and all vehicles of the class which are sold for consumption in Canada is achieved during the base year.<sup>28</sup> In no case can this ratio be less than 75 to 100. This provision ensures the continuance of a Canadian motor vehicles assembly industry. It also permits large companies to rationalize their production by simplifying their product mix through longer production runs achieving economies or near-economies of scale. Rationalization of assembly facilities in this way can reduce the cost penalties incurred as a result of the complex mix of vehicles typical of production.

Third, Canadian motor vehicle manufacturers must maintain at least the same amount (in absolute dollar terms) of "Canadian value added" in the production of vehicles of a class during the base period. This Canadian-value-added requirement is approximately equivalent to the manufacturers' factory selling price, excluding the cost of imported materials and parts used in the manufacture of the vehicle. This ensures that the pre-Agreement mix of vehicles will be at least maintained.

Commitments by the Motor Vehicle Manufacturers. In addition to the commitments under the Agreement itself, each of the major Canadian motor vehicle assemblers submitted a letter of undertaking so as to "fully and equitably participate in the expanding North American market" as requested by the Canadian government. In these letters of undertaking two separate commitments were made as follows (see Appendix A):

1. To increase the dollar value of Canadian value added (CVA) in the production of vehicles and original parts in each model year compared to the preceding model year. The amount of the increase is to be



approximately equal to 60 percent of the growth in the sales of automobiles, trucks, and buses, by each company for consumption in Canada.<sup>29</sup>

2. In addition, to increase by \$241 million the dollar value of Canadian value added in the production of vehicles and original equipment parts by the end of model year 1968. This increase is over and above the absolute Canadian value added set as a minimum in model year 1964 by the Agreement. The amounts of increase subscribed by the major vehicle producers are as follows:

	<u>Millions of Dollars</u>	
	<u>U.S. Dollars</u>	<u>Can. Dollars</u>
General Motors Corporation	\$111.9	\$121.0
Ford Motor Company	68.9	74.2
Chrysler Corporation	30.5	33.0
American Motors Corporation	10.4	11.2
All others	19.6	20.6
Total	<u>\$241.0</u>	<u>\$260.0</u>

The first commitment guaranteed that Canadian production of motor vehicles and original-equipment parts would grow proportionately to the growth in the Canadian market. This commitment is not very different from the pre-Agreement 60% provisions for the free entry of automotive parts. This commitment to expand Canadian value added in automotive production is not tied to specific classes of vehicles or parts. Thus, this commitment could be met in any one or combination of the following ways:<sup>30</sup>

1. Increasing the use of Canadian-produced parts and components in its current Canadian vehicle production.
2. Increasing overall vehicle assembly in Canada through the expansion of its Canadian assembly facilities.
3. Exporting parts and components produced in Canadian captive facilities to its United States assembly plants or overseas generally.
4. Purchasing parts and components for United States production and overseas needs from independent Canadian parts manufacturers.

Alternatives 1 and 3 "... apparently resulted in pressure on United States parts manufacturers to expand or establish parts production facilities in

Canada."<sup>31</sup> Significant under this commitment is that growth in Canadian production was guaranteed as a percentage of the growth in Canadian sales, even though Canadian production includes a substantial amount of production for export to the United States. This assumed a stable Canadian automotive industry even though the United States industry was depressed at times.

The second commitment allows the Canadian automotive industry to increase its absolute share in total North American production of motor vehicles. The United States Tariff Commission estimated that this increase of \$241 million in United States dollars raises the minimum level of Canadian production of the base year by about one-third.

#### Past studies and reactions to the Agreement.

##### "Some effects of the United States-Canadian Automobile Agreements"

H. Helmers, 1967. Ph.D., 1967, University of Michigan, Business Admin-

istration.<sup>32</sup> Henrik Olaf Helmers' study sought to determine "whether or not the altered marketing and production structures within the automotive industry (specifically the automotive metal stamping segment) by the United States Canadian Automobile Agreement had ... a detrimental effect on the independent producers of parts in Canada and the United States."

The summary of Helmers' findings are:

1. The independent automotive stampers account for about 52 percent of all automotive stampings produced.
2. The Canadian and American stampings industries are similar in both size distribution firms and in capability to produce.
3. The Canadians have lower labor and material costs that can be advantageous in price competition with the Americans, and they have the potential capability to produce for the new North American Market. But they lack a developed knowledge of that market. The Americans, although at some disadvantage in labor and material costs, have an



operating capability to produce for the new market. And they have a working knowledge of that marketplace.

This last finding is significant to this study especially since a later report shows certain Canadian automobile prices higher than in the United States. These figures are as recent as mid-1975.

Helmers concludes in his study that:

1. The Agreement need not be detrimental to either the Canadian or American metal stampings segments of the industry, provided that each recognizes its individual advantages and disadvantages and adjusts to the new marketplace as it would in any new business situation.
2. The findings of the study cannot be applied to all the segments of the automotive parts and accessories industry covered by the Agreement. However, the study does provide guidelines for ascertaining the probable changes in the competitive structure of each segment.
3. An extension of this type of trade arrangement to other Canadian and American industry sectors is possible. Consideration should be given to the change in the competitive structure and the compatibility of the trade arrangements with the General Agreement on Tariffs and Trade (GATT).

United States International Trade Commission Report on the United States-Canadian Automotive Agreements. Its history, terms, and Impact.<sup>33</sup> The study involved a comprehensive analysis of the economic impact the Agreement had on the trade balance in automotive products between the United States and Canada, changes in production, investment, employment, and related areas.

A brief overview of the results will follow, however a detailed analysis of this report represents a study in itself. One of the concluding statements of this report supports one of my reservations stated earlier concerning application of the Agreement to the Theory of International Trade: "The agreement as implemented by Canada is not a free-trade agreement, and it has

primarily benefited the Canadian economy."<sup>34</sup> Another similar observation stated in this report provides additional insight into the actual effects on trade between the two countries.

The statement reads as follows:<sup>35</sup>

Indeed, when the agreement is examined in its totality, it is manifest that the only true concessions granted in the agreement are those granted by the Government of the United States according duty free treatment to imports of automotive products manufactured in Canada. Other than the provisions in the agreement providing for consultations between the two Governments, the agreement contains no substantive concessions on the part of the Government of Canada except those that are subject to the commitments and obligations to the Government of Canada in Annex A and the "letters of undertaking."

Following is a list of the major findings of this committee report.

1. Trade on automotive products between the United States and Canada has increased vigorously over the past 10 years under the agreement and the Canadian manufacturers have been able to an extent to rationalize the production to take advantage of greater economics of scale.
2. Canadian per-capita registration of passenger automobiles is nearly equal to that of the United States.
3. Passenger automobiles sold in Canada continue to be relatively more expensive at the retail level than comparable passenger automobiles in the United States.
4. The impact of the agreement on automotive production in the U.S. and Canada and the labour of automotive trade between the two countries is influenced largely by the impact of the restrictions imposed as conditions for duty-free entry by the Government of Canada in Annex A of the Agreement, and the commitments in the "letters of undertaking."
5. Restrictions in Annex A did permit an immediate rationalization of production pursuant to greater economies of scale.
6. The Canadian affiliates of the Big Four manufacturers have consistently exceeded their 1964 rates of assembly to consumption for passenger automobiles, since 1968 and the minimum "Canadian value added" restriction in the production of motor vehicles in Canada is no longer a significant restriction, due to the effects of inflation and the growth in the Canadian market.

7. If Canada had implemented the agreement without any restrictions whatsoever, the balance of automotive trade would have changed significantly in favor of the United States. (This suggests Canada's perspective in regard to desired growth in automotive trade exemplified through the restrictions in the Agreements).

8. The "letters of undertaking" benefit the original equipment parts producers in Canada. This is because Canadian manufacturers can meet their commitments to the Canadian government through sourcing of original-equipment parts producing facilities in Canada.

9. The start up of assembly operations by motor vehicle manufacturers, not established in Canada in 1964, contributed to an additional increase in Canada's share of the United States-Canadian motor vehicle production and employment.

10. The substantial deficit that existed during the 1968 through 1972 in automotive trade with Canada must have existed because of the Canadian manufacturers substantially exceeding the requirements in Annex A and the "letters of undertaking."

11. The capacity established by the Canadian affiliates of the major motor-vehicle manufacturers, in anticipation of the meeting their requirements for a growth in the Canadian market did not materialize, became excess capacity in Canada, and since the United States is Canada's only export market for the United States-Canadian type motor vehicles and the United States market was relatively strong during the years 1968 through 1971, the United States moved into a substantial automotive trade deficit with Canada.

Reactions to the Agreement. Mr. Trezise, United States Assistant Secretary of State for Economic Affairs, who was largely responsible for the writing of the Agreement, says the concessions granted to the Canadian government were to represent a transition from protected to free trade. He goes on to say, "This is a North American Auto Industry--the same companies, the same cars--I just want to get the Canadian government out of the decision making part of the auto business."<sup>36</sup> A Canadian newsman told Iron Age, "It has worked so well for Canada ... beyond our fondest hopes." He also pointed out that Canadian auto production is weighted toward small cars which would affect the automotive trade balance with the United States.<sup>37</sup> Carl E. Beigie, an international economist

with Irving Trust Company said there has been a marked increase in efficiency of Canadian plants, with auto production expanding three times faster than employment.<sup>38</sup>

Mitchel Sharp, Canadian Affairs Minister, said in regard to the restrictions on the Agreement that "... we are not prepared to say when the safeguards should be removed."<sup>39</sup> An international economist points out that Canadians want to maintain the restrictions in order to keep the image of some control even though the commitments have been far exceeded.<sup>40</sup>

Edward N. Cole, President of General Motors in 1971, pointed out that the "... sharp increase of cars manufactured outside North America has altered the balance in benefits for both of our countries as a result of the Automotive Trade Agreement ..."<sup>41</sup> In response, Jean-Luc Papen, Canada's Minister of Industry, Trade and Commerce says the energies of both countries "... might well be spent in meeting this challenge." He goes on to say that "... the Agreement has been and should continue to be for both parties, one of the most successful trading arrangements in either country's history."<sup>42</sup>

An article in Iron Age<sup>43</sup> said the "... trade arrangement is advantageous to multinational automakers. They can ignore borders and concentrate on maximizing the efficiency of all North American productions and distribution operations." Then President Nixon suggested in his annual report to Congress on the Agreement, "retention of the restrictions in the agreement would be contrary to the premise on which the U.S. entered the agreement and that the three transitional restrictions--Canadian value added tax, production sales value and duty-free entry to manufacturers only--were no longer warranted and should be eliminated."<sup>44</sup>



Richard J. Fordick reports in his 1974 article in Automotive Industry:<sup>45</sup> "While there are any number of areas ripe for improvement, it is also obvious that the Agreement has played an important role in the shaping of the North American auto industry, providing many benefits for both sides." Ian Anderson, A.M.C. Vice President of Finance, noted that even a small company, such as American Motors Corporation, could not compete if it were forced to duplicate its manufacturing facilities in both countries.<sup>46</sup> This would have resulted without the Agreement. A dissenting note was given by United Auto Workers President, Leonard Woodcock, in his request for the elimination of the price differential between the higher Canadian auto prices and the United States auto prices.

### Conclusion

The Agreement has increased the size and economic capabilities of the North American Automotive industry. Canada has had more to gain due to the relative inefficiency of the Canadian automotive industry to the United States industry prior to 1965.

The Agreement once signed by the governments of the two countries became a vehicle for the "rationalization of automotive production" for the Big Four automobile companies operating both in the United States and in Canada prior to 1965. The effectiveness of the Agreement will be evaluated in the following chapters.

## FOOTNOTES

<sup>1</sup>Sidney Ratner. The Tariff in American History. (New York: D. Van Nostrand Company, 1972), p. 26.

<sup>2</sup>James Eayrs. "Having a Continent: The Hard Issues," in John Sloan Dickey (Ed.), The United States and Canada. (Englewood Cliffs, N.J.: Prentice Hall, Inc., 1954), p. 78.

<sup>3</sup>J. H. Young. "Canadian Commercial Policy," Royal Commission on Canada's Economic Prospects, 1957, pp. 39-40.

<sup>4</sup>Sidney Ratner. Op. Cit., p. 50-51.

<sup>5</sup>Paul Wonnacott and Ronald J. Wonnacott. United States-Canadian Free Trade: The Potential Impact on the Canadian Economy. Canadian-American Committee sponsored by National Planning Association (USA) Private Planning Association of Canada. Harvard University Press, September, 1967.

<sup>6</sup>See H. Helmers' Dissertation on the metal stamping business. Ph. D., University of Michigan, 1967. "Some Effects of United States-Canadian Automobile Agreement."

<sup>7</sup>Canadian Automobile Agreement, Op. Cit., p. 66.

<sup>8</sup>Sun Life Assurance Company of Canada. The Canadian Automotive Industry, prepared for the Royal Commission on Canada's Economic Prospects (Ottawa: Queen's Printer and Controller of Stationary, 1956). The tariff revision of 1936 made the rate of duty on all motor vehicles 17.5 percent irrespective of value. And it also provided for conditional free entry for parts, provided these parts were of "a closer kind not made in Canada." Further, certain Empire (later Commonwealth) "content" requirements had to be met for some parts. These provisions replaced the "domestic drawback" system of the earlier tariff.

<sup>9</sup>Canada, Report: Royal Commission on the Automobile Industry (Ottawa: Queen's Printer and Controller of Stationary, 1961), p. 25. This report is commonly known as the Bladen Report which will be discussed later in this report. Dean Bladen was appointed by the Royal Commission to undertake this study.

<sup>10</sup>Canadian Automobile Agreement, Op. Cit., pp. 71-74.



<sup>11</sup>Harry G. Johnson. "The Bladen Plan for Increased Protection of the Canadian Automotive Industry," Canadian Journal of Economics and Political Science, p. 212.

<sup>12</sup>Bladen Report, Op. Cit., p. 48.

<sup>13</sup>Harry G. Johnson, Op. Cit., p. 213.

<sup>14</sup>Bladen Report, Op. Cit., p. 48.

<sup>15</sup>Harry G. Johnson, Op. Cit., p. 221.

<sup>16</sup>P.C. 1962-111536, October 26, 1962. The suspension of a 25 percent import duty on automatic transmissions was terminated by the Order. Glass fabrics, and rubber products (including tires and tubes) did not count toward export credits against duties, nor did the Canadian content of finished automobiles. Canadian content is that portion of the value of an article produced in Canada derived from indigeneous Canadian sources.

<sup>17</sup>Paul Wonnocott. "Canadian Automotive Protection: Content Revisions, the Bladen Plan, and Recent Tariff Changes," Canadian Journal of Economics and Political Science, February, 1965, p. 14.

<sup>18</sup>H. Helmers. "Some Effects of the United States-Canadian Automobile Agreement." Dissertation, University of Michigan, 1967, p. 33.

<sup>19</sup>Before the Commissioner of Customs: Memorandum in Support of Petition for Issuance of a Countervailing Duty Order Pursuant to Section 303, Tariff of 1930, with respect to Motor Vehicle Radiators Exported from Canada with Benefit of a Bounty or a Grant, April 15, 1964.

<sup>20</sup>29 F.R. 7249.

<sup>21</sup>Automotive Service Industry Association et al. v. Dillion, D.D.C. Civil No. 79-65.

<sup>22</sup>30 F.R. 764.

<sup>23</sup>Canadian Automobile Agreement, Op. Cit., pp. 76-77.

<sup>24</sup>H. Helmers, Op. Cit., pp. 36-37.

<sup>25</sup>"Motor vehicles specially constructed and equipped to perform special services or functions" are covered by item 692.15 of the Tariff Schedules of the United States (TSUS).

<sup>26</sup>Canadian Automobile Agreement, Op. Cit., pp. 40-41.

<sup>27</sup>Motor trucks, motor truck chases, ambulances, ambulance chases, and hearses and hearse chases.

<sup>28</sup>This ratio is measured according to net sales value for vehicles produced and vehicles sold. Net sales value is approximately equal to the manufacturer's selling price.

<sup>29</sup>Growth in the Canadian market is defined as the difference between the cost to the manufacturers of vehicles of each class sold in Canada during the relevant model year and the cost to the manufacturer of vehicles of each class sold during the 1964 "base" year.

<sup>30</sup>H. Helmers, Op., Cit., p. 46.

<sup>31</sup>Canadian Automobile Agreement, Op. Cit., p. 94.

<sup>32</sup>H. Helmers, Op. Cit., pp. 1-4.

<sup>33</sup>Canadian Automobile Agreement. Op. Cit., pp. 37-51.

<sup>34</sup>Ibid., p. 51.

<sup>35</sup>Ibid., p. 50.

<sup>36</sup>D. N. Williams. "Shifting Auto Trade Grinds Gears by D. N. Williams," Iron Age, June 4, 1970, p. 55.

<sup>37</sup>Ibid.

<sup>38</sup>Ibid.

<sup>39</sup>"Politics Pack Auto Trade Talks," Iron Age, December 3, 1970, p. 51.

<sup>40</sup>Ibid.

<sup>41</sup>"Canadian Auto Pact. . . . A good deal all want to change," Industry Week, July 12, 1971, p. 57.

<sup>42</sup>Ibid.

<sup>43</sup>"U.S. Canadian Auto Pact: Who Knows What Deficit Lurks Where?," Iron Age, March 22, 1973, p. 17.

<sup>44</sup>Ibid.

<sup>45</sup>Fodick, Richard J. "U.S.-Canadian Pact Re-Examined," Automotive Industry, June 1, 1974, p. 4.

<sup>46</sup>Ibid., p. 49.

## C H A P T E R III

## INTERNATIONAL TRADE THEORY AND ECONOMIC INTEGRATION

Early Trade Thought (1500-1750)

Mercantilism and the rise of the nation-state. The centralization of authority within the four most powerful European governments began in France, in the reign of Louis XI (1461-83). In Spain, another of the four great powers of the early modern period, national unity was achieved in 1469, with the marriage of Ferdinand of Aragon and Isabella of Castile. The reigns of Henry VII (1485-1509), Henry VIII (1509-47), and Elizabeth I (1558-1603) saw a similar process of centralization in the government of England. The Dutch Republic was the last of the four nations to become a state, achieving independent status in 1609, after forty years of conflict with Spain.<sup>1</sup>

With the consolidation of European nation-states came early attempts to describe international trade in terms of theoretical principles. Specifically, the theory of mercantilism describes international trade as it developed among these centralized governmental units, whose independent existence determined the mercantilists' principle objective--that of increasing the power and wealth of the state. The mercantilists held that, in order to achieve this objective, a nation should always strive to prohibit the outflow and encourage the inflow of such precious metals as gold and silver. This exaggerated emphasis on individual accumulation of bullion (bullionism) is described by August Hecksher as follows:

Within the state, mercantilism pursued thorough-going dynamic ends. But the important thing is that this was bound up with a static conception of the total economic resources in the world; for this it was that created that fundamental disharmony which sustained the endless commercial wars. Both elements together implied that the position of a particular country could change and was capable of progress, but that this could only happen through acquisitions from other countries. This was the tragedy of mercantilism. Both the Middle Ages with their universal static ideal and "laissez faire" with its universal dynamic ideal avoided this consequence.<sup>2</sup>

Underlying the concept of mercantilism was a principle very similar to the present-day monetary approach to a country's balance of payments which holds that a nation can only gain through foreign trade if it has a favorable balance, or if the value of its exports exceeds that of its imports.

The decline of mercantilism. In the eighteenth century, primarily because of the increasing wealth and influence of the businessman, the market began to operate as a freer system in which supply and demand were the primary determinants of price. Price fluctuations, therefore, corresponded to fluctuations in the market. Restrictive price regulations by such government agencies as the English Privy Council gave way to market regulation of supply and demand.<sup>3</sup> Mercantilist overemphasis on accumulation and hoarding of wealth received continual criticism. Clearly a new theory of international trade was needed to describe this shift of emphasis.

It was during this period that John Locke and Dudley North further developed the quantity theory of money. The basis of this theory was similar to the principle behind today's fluctuating currency exchange system in that the supply of money adjusts itself automatically among nations according to the needs of trade.<sup>4</sup> Prices reflected the flow of the currency. David Hume



analyzed this principle of price-specie flow in a series of theses which can be summarized as follows:<sup>5</sup>

Prices in any one country are determined by the quantity of money; prices in different countries are interdependent--a low-price country can undersell a high-price country; such underselling will lead to a flow of specie to the low-price country; raising prices there and lowering them in the other country. Equilibrium is finally reached with some common relationship between national price levels.

A freely floating system of exchange will, in theory, fluctuate as one country's currency becomes abundant and therefore less valuable in terms of its power to purchase imports, while its exports become less expensive in comparison to those of other countries. The currencies of the other countries weaken correspondingly, and the system moves back towards equilibrium as the original weak country's currency gains strength.

### Classical Trade Theory

Adam Smith and David Ricardo. After Hume, Adam Smith became the guiding economic spirit of his day with the publication of his eminent work The Wealth of Nations (1776). As an apostle of free trade Smith showed that trade among nations enables each to increase its real wealth by taking advantage of the principle upon which all increase of wealth rests, the division of labor.

It is the maxim of every prudent master of a family never to attempt to make at home what it will cost him more to make than to buy. The taylor does not attempt to make his own shoes, but buys them at a shoemaker. The shoemaker does not attempt to make his own clothes, but employs a taylor. The farmer attempts to make neither the one nor the other, but employs those different artificers. All of them find it for their interest to employ their

whole industry in a way in which they have some advantage over their neighbors, and to purchase with a part of its produce, or what is the same thing, with the price of a part of it, whatever else they have occasion for.

What is prudence in the conduct of every family can scarce be folly in that of a great Kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage...

Adam Smith spoke only of absolute advantage, however. He assumed that trade would not take place unless each participating country could produce a particular good at a lower absolute cost than any other country. He failed to recognize that countries could trade profitably with only a comparative advantage. It was David Ricardo who, with his Principles of Political Economy (1817), developed a more viable explanation of trade. He propounded a theory of value in which he assumed that the value of any commodity in international exchange depended upon its relative or comparative labor cost rather than on its absolute labor cost.<sup>7</sup> As Ricardo explained it, the comparative cost explanation of trade depended on the immobility of capital:

Experience...shows that the fancied or real insecurity of capital, when not under the immediate control of its owner, together with the natural disinclination which every man has to quit the country of his birth and connections, and intrust himself, with all his habits fixed, to a strange government and new laws, check the emigration of capital. These feelings, which I should be sorry to see weakenend, induce most men of prosperity to be satisfied with a low rate of profits in their own country, rather than seek a more advantageous employment for their wealth in foreign nations.

Although David Ricardo primarily explored the supply side of trade, his views continue to have general relevance to today's international trade practices. In the following section the timeliness of his insights in the light of some examples of present-day thought will be demonstrated.

### Extensions of the Classical Theory

The Hecksher-Ohlin model. Eli Hecksher and his student Bertil Ohlin expanded Ricardo's theory of comparative cost to include increasing and decreasing cost industries where Ricardo had assumed constant costs. The Hecksher-Ohlin explanation of trade can be summarized in the following manner: (1) different goods require different factor proportions, and (2) different countries have different relative factor endowments. This second assumption takes into account the chance of two countries' having the same factor proportions (i.e., land, labor, and capital) by postulating different factor efficiencies.<sup>9</sup> In this latter case demand for goods in both countries would also have to be similar. The real world of trade involves many goods, different supply-and-demand patterns, and technological differences, all of which create a variety of trade possibilities among all nations of the free economic world.

The Product Cycle Hypothesis.\* According to another theory, developed by Raymond Vernon,<sup>10</sup> international trade is based less on "comparative cost doctrine and more upon the timing of innovation, the effects of scale economies and roles of ignorance and uncertainty in influencing trade patterns."<sup>11</sup> Vernon suggests through his product cycle model of international trade that

\*The Product Cycle Hypothesis of International Trade must not be confused with the Product Life Cycle of Marketing.

there are three stages in the trade cycle of a product: (1) the new product stage, (2) the maturing product stage, and (3) the standardized product stage. The time period for the completion of the stages and the shape of the cycle will be determined by the income elasticity of the product, the degree of economies of scale within the industry, and the international tariffs and transportation costs.

In the new product stage of Vernon's trade cycle, the product itself may be quite understandardized. Its inputs, its processing, and its final specifications may be only broadly determined. There is also a low price elasticity of demand for the output of individual firms, owing either to a high degree of product differentiation or to the existence of monopoly market power. In this first stage the need for effective communication with all phases of the market is critical. There is usually considerable uncertainty about specifications of inputs needed for production, and about the specifications most likely to result in the manufacture of a successful product.<sup>12</sup>

In the maturing product stage, a certain degree of standardization usually takes place. Production processes become cost efficient as cost cutting becomes a primary motive in product output. Efforts to achieve cost efficiency force the commitment to mass output, which should result in economies of scale for the producer. The producer may also consider a shift in production facilities, depending on the marginal production cost and the balance between export transportation costs and the average projected costs of production in the market of import. In the later part of this stage, if production facilities have been set up overseas, as is often the case, the



possibility of exporting back to the United States may have to be taken into account. In a situation where economies of scale are being fully exploited, and the free trade exists, the principle differences between any two locations are likely to be labor costs.<sup>14</sup>

An interesting observation by Raymond Vernon, in his presentation of the product cycle hypothesis, supports the discussion in Chapter I of the decision-making process of managers. It reads as follows:

Any hypotheses based on the assumption that the United States entrepreneur will react rationally when offered the possibility of a lower-cost location abroad is, of course, somewhat suspect. The decision-making sequence that is used in connection with international investments, according to various empirical studies, is not a model of the rational process.<sup>15</sup> But there is one theme that emerges again and again in such studies. Any threat to the established position of an enterprise is a powerful galvanizing force to action; in fact, if I interpret the empirical work correctly, threat in general is a more reliable stimulus to action than opportunity is likely to be.<sup>16</sup>

Such threats may come when local manufacturers begin to lose market power to imported goods, for instance, or when local governments become concerned with promoting employment and balancing their trade accounts. Thus, the decision to invest internationally may be based primarily on loss of market share, or possibly on loss of a market.

In the final stage of Vernon's product cycle hypothesis, the standardized product may be exported by less developed countries because of the comparative cost advantage of their production location. The Hecksher-Ohlin theorem would not support this possibility, since it would predict that exports of the less developed countries would tend to be relatively more labor-intensive. Hecksher and Ohlin leave marketing costs out of their theorem because they regard market information as being instantaneously available. Market information is necessary, however, and costly.



If we can assume that highly standardized products tend to have a well-articulated, easily accessible international market and to sell largely on the basis of price [an assumption inherent in the definition], then it follows that such products will not pose the problem of market information quite so acutely for the less developed countries. This establishes a necessary if not a sufficient condition for investment.<sup>17</sup>

The uncertainty over the applicability of necessary external economies to the less developed countries diminishes the scope of the product cycle hypothesis. Such external economies should be applied to skilled labor, repairmen, reliable power, spare parts, raw materials, the processing of industrial material according to exacting specifications, and so on. In the automobile industry the necessary external economies may not be practicable even though the production process may be highly standardized.

#### Applicability of the Product Cycle Hypothesis to the North American Automobile Industry

In speculating about the product cycle hypothesis and its applicability to the automobile industry, fairly clear-cut set of economic characteristics will be assumed. The local production process must require significantly less expensive inputs of labor; otherwise there is no reason to expect a lower production cost in less developed countries. The products should have a high price elasticity of demand; and their production process should not rely heavily upon external economies.

Products which could be precisely described by standardized specifications and which could be produced for inventory without fear of obsolescence would be more relevant than those which had less precise specifications and which could not easily be ordered from remote locations. Moreover, high-value items capable of absorbing

significant freight costs would be more likely to appear than bulky items low in value by weight. Standardized textile products are, of course, the illustration par excellence of the sort of product that meets the criteria. But other products come to mind such as crude steel, simple fertilizers, newsprint and so on.<sup>18</sup>

The first criteria of high labor content would not seem to apply to automobile manufacture. Even though the labor input is highly significant, it is balanced by a capital input of almost equal significance. Moreover, even if the capital were readily available, the external economies necessary for the production of motor vehicle parts and vehicles discourages subsidiary manufactures in less developed countries.

The absence of adequate marketing and manufacturing knowledge necessary for success in the automobile market has thwarted many attempts by entrepreneurs to enter into the U.S.-Canadian market. In 1974, the Big Four automobile manufacturers (American Motors Corporation, Chrysler, Ford, and General Motors) represented 99.9 percent of the total United States production by manufacturers,<sup>19</sup> and 100 percent of the total Canadian production.<sup>20</sup> The U.S. Canadian automobile market has also been dominated by sales of domestic rather than foreign automobile types. In 1975, imports represented 15.7 percent of the total United States consumption of passenger automobiles and 16.2 percent of the total Canadian consumption of passenger automobiles.<sup>21</sup> In the United States this represents an increase of 7.9 percent since 1960. In Canada, however, there has been a 13.9 percent decrease in imports during the same period. One could argue that the increase in the percentage of United States imports is evidence in support of the product cycle hypothesis. It may well be more reflective of a high income elasticity of demand for imports. This, along with the rise in affluence among U.S. consumers, had

meant that U.S.-based automobile manufacturers have become less and less able to meet the increased demand for small economical passenger cars. The principle that a market is better served from within is supported in this case by the success overseas of United States multinationals and, more recently, by the production of Volkswagen automobiles in the United States. The U.S.-Canadian automobile market is best served by firms producing in the U.S. and Canada. There may be shifts in dominance among these firms, especially if such corporations as American Motors and Chrysler capture less of the total automobile market while foreign firms producing in the United States gain a greater market share.

The product cycle hypothesis of international trade is insightful and provides a more precise explanation for world trade than did earlier theoretical efforts. Nonetheless, its applicability to the automobile industry of the United States and Canada is minimal,<sup>\*</sup> and we must look to other models for more exact and usable correspondences.

#### Economic Integration and the Automotive Agreement

The Automotive Agreement of 1965 is an initial step in the cooperation

This perspective is shared with Dr. Paul Wonnacott of the University of Maryland and Dr. Donald Daly of York University. Their insights were provided in personal interviews while the author was in Washington, D.C. in May, 1978.

of two nation-states for common economic benefits through the efficient use of the resources. It represents the first stage in the process of economic integration between nations. The following section will elaborate on this process to more fully understand the Agreement as a possible precursor to further economic cooperation between the United States and Canada.

Charles P. Kindleberger and Peter H. Lindert propose five stages of economic integration.<sup>22</sup> The first stage concerns the establishment of a free trade area and is of primary importance to the U.S.-Canadian Automotive Agreement. In this stage an agreement is reached between two or more countries to eliminate tariffs in one or more industries. In the case of the United States and Canada, both countries agreed to eliminate tariffs on restrictions, which are outlined in Chapter II, impose some limits on the scope of free trade between the two nations and will be addressed in more detail in a later chapter. The point to be emphasized here is that the 1965 Agreement represented a "freer" trade agreement than existed previously however not explicitly free trade.

In the second stage of economic integration a customs union must be agreed upon. Similar in most respects to a free trade area, a customs union differs in that it is necessary for those contracting countries to have common external tariffs. The implementation of these first two stages of integration can affect trade and welfare in two possible ways. It can result in the creation of more trade, when the demand for each country's goods increases as more goods are traded between the partners and fewer with the outside world not covered in the free trade area. However, the terms of the new agreement may specify a shift from a low-cost outside supplier to a high-



cost supplier. In this case, the result would be a trade diversion. The net effect must be considered, taking into account the magnitude of the differences between costs to the participating countries before and after the free-trade agreement or customs union. It has been recognized that the more countries there are that join the customs union, and the lower the common external tariff is, the less will be the trade diversion, and the more nearly will the customs union approach the free trade ideal.<sup>23</sup> The ideal objective of free trade is trade creation, which exercises a positive effect on the welfare of all members of the trading world.

The next three stages of economic integration are the common market, economic union, and complete economic integration. A common market covers free movement of goods as well as the factors of production, labor, and capital. Economic union goes further and provides for the harmonizing of national economic policies. Complete economic integration would require the establishment of common monetary and fiscal policies and other commonalities in the macroeconomic area.

#### A Test of the Hecksher-Ohlin Model

Intra-industry Trade. Now it is necessary to return to the Hecksher-Ohlin model of international trade and consider its relation to economic integration. The case under consideration will be the European Economic Community (Common Market) which was formed in 1957. Before the agreement to form the community was reached, some countries feared that entire industries might fail because of their lack of comparative advantage. What in fact occurred,



however, was an increase in intraindustry trade.<sup>24</sup> It was found that the expansion of trade in the Economic Community did not take the form the Hecksher-Ohlin model had predicted--that is for example, the exchange of German cars for French wines--but instead resulted in the exchange of German cars for French cars and German wines for French wines.

While the basic Hecksher-Ohlin model explains trade between industries, which we call interindustry trade, the studies of economic integration in Europe revealed the importance of trade involving commodities belonging to the same industry...known as the intraindustry trade.<sup>25</sup>

In an effort to measure this situation more precisely, Herbert G. Grubel and P.J. Lloyd developed the following index:

$$B = 1.0 - \frac{X - M}{X + M}$$

It implies that for a given industry the index of intraindustry trade (B) is at its maximum of 1.0 when exports equal imports, and the ratios in this equation is zero. On the other extreme, when an industry either has exports but no imports or vice versa, the index becomes zero because the ratio is 1.0.<sup>26</sup>

In the European Economic Community, this index of all industries on the average increased from 0.54 in 1959 to 0.67 in 1967. L.N. Willmore found that trade in manufactures among countries of the Central American Common Market showed an intraindustry index of 0.22 in 1961 and 0.40 in 1967.<sup>27</sup>

Intra-industry trade and the Auto Agreement. When the intraindustry trade index was applied to the United States and Canadian automobile industry, the

following results were determined:\*

	<u>1960</u>	<u>1965</u>	<u>1967</u>	<u>1971</u>	<u>1974</u>
Calculated "B"	.05	.41	.85	.97	.89

It is apparent from the above calculations that the degree of intradustry integration was quite significant for the U.S.-Canadian automotive market. These results will be analyzed in greater detail in the following chapter where the economic integration that has taken place in the U.S.-Canadian automobile industry will be evaluated.

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\*This index was calculated for Canada and U.S. trade in automotive products. The statistics were derived from: Review of the North American Automotive Industry, Automotive Task Force, Ottawa, Canada, 1977.

## FOOTNOTES

## Chapter III

<sup>1</sup>P.T. Ellsworth and J. Clark Leith, The International Economy (Macmillan Publishing Co. Inc., 1975) pp. 11, 12.

<sup>2</sup>August Hecksher, Mercantilism (London: George Allen, University Ltd., 1936), pp. 25-26.

<sup>3</sup>Ellsworth and Leith, The International Economy, pp. 28-30.

<sup>4</sup>James W. Angell, The Theory of International Prices (Cambridge, Massachusetts: Harvard University Press, 1926), pp. 16-18.

<sup>5</sup>Ellsworth and Leith, The International Economy, p. 33. also see David Hume "Essay on the Balance of Trade" cited in Arthur Eli Monroe, Early Economic Thought, (Cambridge, Massachusetts: Harvard University Press, 1927).

<sup>6</sup>Adam Smith, The Wealth of Nations, (New York: Modern Library, Inc., 1937), pp. 424-26.

<sup>7</sup>Ellsworth and Leith, The International Economy, pp. 46-47.

<sup>8</sup>David Ricardo, Principles of Political Economy and Taxation (London: J.M. Dent and Sons, Ltd., 1962), p. 83.

<sup>9</sup>Charles P. Kindleberger and Peter H. Lindert, International Economics, (Homewood, Illinois: Richard D. Irwin, Inc., 1978), pp.30-33.

<sup>10</sup>Raymond Vernon, "International Investment and International Trade in the Product Cycle," Quarterly Journal of Economics, May, 1966, pp. 190-207.

<sup>11</sup>Vernon, *Ibid.*, p. 190.

<sup>12</sup>Vernon, *Ibid.*, p. 195.

<sup>13</sup>Mordecai Kreinin, "The Leontief Scarce - Factor Paradox," The American Economic Review, March 1965. Kreinin finds that the higher cost of labor in the United States is not explained by a higher rate of labor productivity in this country.

<sup>14</sup>Vernon, op.cit., pp. 198-200.

<sup>15</sup>Yari Ahoroni, "The Foreign Investment Decision Process" (Boston: Harvard University Division of Research, Graduate School of Business Administration, 1966.)

<sup>16</sup>Vernon, op. cit., p. 200

<sup>17</sup>Vernon, Ibid., pp. 202-203.

<sup>18</sup>Vernon, Ibid., pp. 203-204

<sup>19</sup>Canadian Automobile Agreement, (op. cit., Chapter 2), p. 237.

<sup>20</sup>Canadian Automobile Agreement, Ibid., p. 241.

<sup>21</sup>See Tables 10 and 11 in Chapter 2.

<sup>22</sup>Kindleberger and Lindert, op. cit., pp. 172-185.

<sup>23</sup>Kindleberger and Lindert, Ibid, p. 176.

<sup>24</sup>See Herbert G. Grubel and P. J. Lloyd, Intraindustry Trade: The Theory and Measurement of International Trade in Differentiated Products, (New York: John Wiley and Sons, 1975).

<sup>25</sup>Herber H. Grubel, International Economics, (Homewood, Illinois: Richard D. Irwin, Inc. 1977), p. 71.

<sup>26</sup>Grubel, Ibid., p. 72.

<sup>27</sup>Willmore, L.N., "Free Trade in Manufactures Among Developing Countries: The Central American Experience." Journal of Economic Development and Cultural Change, July 1972.

## C H A P T E R I V

THE MEASUREMENT OF THE EFFICIENCY  
OF THE AUTOMOTIVE AGREEMENTGeneral Hypothesis Development and Procedure

Origins of the hypotheses. The foundation of this study is international economics and specifically free trade theory. The theories upon which these hypotheses were developed have been described in Chapter III. The literature was exhaustively reviewed in attempts to come up with specific measures for evaluating the efficiency of the Agreement. The most helpful source was an unpublished study by Dr. Paul Wonnacott of the University of Maryland.<sup>1</sup>

Dr. Wonnacott considered the Canadian consumer-taxpayer and automotive hourly wage earner to be the most affected by any efficiency gains that may have occurred in the U.S.-Canadian automobile market due to the Agreement. This perspective is based on the relative inefficiency of the protected Canadian automobile industry previous to the signing of the Agreement in 1965. As product and plant specific economies of scale<sup>\*</sup> are achieved, the Canadian-consumer-taxpayer and automotive hourly wage earner would be expected to gain through increased automotive wages, increased automotive profits, or lower relative prices. This chapter attempts to isolate the effects the Automotive Agreement has had on Canadian automotive prices and

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<sup>\*</sup> See discussion in Chapter V under Hypothesis #2.



wages and the degree to which integration has occurred in automobile production between the United States and Canada.

Technique of analysis. (See Appendix B). The limitations of available data restricts the choice of alternative methods of evaluation of the Agreement. Therefore, given the small sample size of 16 years (1960-1976), the standard test for significance will be the Students' t-test. The significance level of .05 for the two tailed test (0.25 in each tail) has been chosen based on the compromise between the low control conditions of the data which suggests a smaller level of significance (e.g. .001) and the support of the hypotheses by theory which suggests a larger level of significance (e.g. .10).<sup>2</sup> An additional test of significance is used to extract any significant change in the slope and/or intercept of an ordinary least squares line predicting the variables individually. These results are presented in Table 29 at the end of this section. Data for the Canadian statistics is provided by Statistics Canada and data for the United States comes from the U.S. Bureau of Census and U.S. Department of Commerce.

In all cases, the data has been evaluated with 1965 serving as the watershed or statistically stated treatment year. When the data is broken into two separate groups, 1960-1966 and 1966-1976 periods provide the before and after treatment distinction. The assumption is made that 1965 is part of the before treatment group due to the necessary litigation procedures of both countries following the signing of the Agreement which is taken to be one year.

Procedure for hypothesis evaluation. Each hypothesis is first stated as it appears in the dissertation proposal. Following each hypothesis is: (1) a discussion of how the hypothesis is tested; (2) evaluation and conclusion of the statistical result; and (3) the statistical results. .

### Hypotheses

#### Hypothesis #1

Hypothesis. Integration of automobile production has occurred more significantly than if the Agreement were not signed, as measured by the changes in imports of the United States and Canada from one another.

Evaluation procedure. Prior to 1965, Canadian automobile producers operated with a 2% cost advantage over U.S. producers in the Canadian market. This cost advantage was the residual advantage after the 17-1/2% import duty.<sup>3</sup> Canadian producers were competitive in their own market, however, subject to competition from the efficiently produced U.S. automobiles. One could expect U.S. exports to be significant in the Canadian market but Canadian exports insignificant in the U.S. market prior to 1966. But one would expect U.S. imports from Canada to grow significantly after 1965 due to model and plant specialization after the implementation of the Agreement.

In terms of the specific data, Canadian and U.S. automobile imports should grow significantly after 1965 as model specialization occurs in both countries and plant specialization occurs in Canada. The economies of scale that one would expect to occur in Canada after the Agreement should result in there being a significant difference between pre 1966 and post 1966 U.S.

imports. In order to account for what would have occurred in absence of the Agreement, the pre 1966 relationship between the U.S. and Canadian imports is shown. It is hypothesized that if the Agreement had a significant effect on integration of the U.S.-Canadian automobile industry, the post 1965 relationship of the import statistics should be significantly different from the pre 1966 period. This result should show up in the change in U.S. imports pre to post 1966 (inclusive) as Canada gains in its share of the market. This hypothesis is tested in the following section.

Evaluation and Conclusion. U.S. automobile imports increased significantly after 1965 (see Table 18 and 19). The results lead one to conclude that the Agreement had a significant effect on the degree of integration in the U.S. and Canadian automobile industry.

One must also observe the results of what would have occurred in the absence of the Agreement presuming that the assumptions are correct as to what constitutes "in the absence" of the Agreement for this hypothesis. The data in Table 29 for variables  $\hat{Y}_1$ ,  $\hat{Y}_2$ ,  $\hat{Y}_3$ , and  $\hat{Y}_4$  shows a significant change in the slope of the line after 1965. There is also a significant intercept change for Canadian automobile unit ( $\hat{Y}_2$ ) and dollar ( $\hat{Y}_4$ ) imports, and U.S. automobile dollar imports ( $\hat{Y}_3$ ). These results indicate the Agreement has had a significant positive effect on both U.S. and Canadian imports of automobiles. Therefore, the results in Table 28 for variables  $\hat{Y}_1$ ,  $\hat{Y}_2$ ,  $\hat{Y}_3$  and  $\hat{Y}_4$  indicate the positive results would not have occurred in absence of the Agreement.

Table 18

U.S. Imports and Canadian Automobile Imports  
(thousands of units)  
1960-1966 vs. 1966-1976

Variable	Years	No. of Cases	Mean	Standard Deviation	Standard Error	Separate Variances Estimates		
						T Value	Degrees of Freedom	2-Tail Probability
U.S. Auto-mobile Imports	1960-1966	6	8.33	12.83	5.72	8.36	9.09	.000
	1966-1976	10	626.1	233.08	73.70			
						Ho: Rejected at .000 level of confidence		
Canadian Auto-mobile Imports	1960-1966	6	21.59	14.02	5.72	8.11	9.40	.000
	1966-1976	10	336.90	121.59	38.45			
						Ho: Rejected at .000 level of significance		

Table 19

U.S. Automobile Imports and Canadian Automobile Imports  
(in thousands of U.S. Dollars)

1960-1966 vs. 1966-1976

Variables	Years	No. of Cases	Separate Variance Estimate				2-Tail Probability	
			Mean	Standard Deviation	Standard Error	T Value		Degrees of Freedom
U.S. Auto-mobile Imports	1960-1966	6	68.16	96.05	49.21	6.71	9.10	.000
	1966-1976	10	3666.00	1691.95	535.04			
Ho: Rejected at .000 level of confidence								
Canadian Auto-mobile Imports	1960-1966	6	561.16	217.84	88.93	5.47	9.34	.000
	1966-1976	10	4142.70	2051.49	648.74			
Ho: Rejected at .000 of level of confidence								

\*Differences in exchange rates between Canadian and U.S. dollar included.



## Hypothesis #2.

Hypothesis. Efficiency in Canadian automobile production has increased significantly following the Agreement as measured by the increase in Canada's share of North American automobile production compared to its increase in automobile employment and also as measured by the degree of effective protection which should show a decrease in excess costs of production in Canada versus the United States.

Evaluation Process. The Canadian automobile manufacturers were committed to Canadian \$260 million increase in automotive production facilities by the end of model year 1968. This requirement in the short run transferred production from the efficient U.S. producers to the inefficient Canadian producer in attempts to achieve economies of scale. After the tooling up of production facilities occurred, economies of scale would begin to appear in the form of increased output with lower labor per unit of output as compared to the pre 1966 levels. A more precise measure would be the labor input per unit of output of the pre 1966 period versus the post 1968 level. However, for the purposes of consistency of results between each hypotheses, the 1960-1966 period is compared to the 1966-1976 period.

In order to determine the efficiency of the Canadian automotive industry, three distinct measures are used. The first of the three measures compares total Canadian shares of U.S.-Canadian automotive employment. The pre 1966 period will serve as the measure in absence of the Agreement. The relationship of the pre 1966 period with the post 1966 period is also shown to clarify the changes of the two periods.

The second measure estimates the efficiency per unit of Canadian value added with the use of the formula derived for effective protection:<sup>4</sup>

$$X = \frac{T - UV}{C(1 + T - UV) - (T - UV)}$$

Here, X stands for the excess cost per unit of Canadian value added, with T representing the Canadian-U.S. price differential for cars (average), C the percentage of Canadian content and UV the percentage of the value of the car paid in tariffs on parts. The excess cost of Canadian value added should decrease over the period, as the Canadian industry develops economies of scale. General inflationary pressures are considered in evaluating these results, however a more thorough investigation of price changes relative to other industries will be considered under the third hypothesis. Data was available only for the years 1964 through 1975 with 1970 data not available. Therefore, the issue of "in the absence" of the Agreement is not specifically evaluated for this measure of efficiency.

The third measure uses an ordinary least squares line to predict each of the variables over the 1960-1976 period. Slope and intercept changes are sought to infer a causal relationship between the Agreement and Canadian automobile production and employment.

Evaluation and conclusion. According to the first measure, efficiency did occur in the Canadian automotive industry after the Agreement. This conclusion is supported by the significant change in the relationship of the pre vs. the post 1966 (inclusive) data for both the Canadian shares of total U.S.-Canadian automotive production and total employment (See Tables 20 and

21). Additional insight is also provided by the pre 1966 versus the post 1966 data for each variable (See Tables 20 and 21).

The results for the second measure of the excess cost of Canadian value added are not as conclusive. These results show excess costs decreasing from 12.9% in 1964 to 8.5% in 1969 to 7.9% in 1975 (See Table 22). However, the significance of these results are less pronounced considering after 1965 there was a 3% reduction in costs due to the elimination of the tariff on original equipment parts. Inflationary pressures were strong in Canada during this period, however, these pressures were greater in the United States in the same period. This insight is gained from looking at the Canadian industrial selling price\* index for automotive and household furniture and fixture industries and the U.S. wholesale price indexes for automotive and household furniture and fixture industries (see Table 26). Further insight is given to the inflationary pressures operating on the Canadian automotive industry in the following section on the welfare of the Canadian consumer-taxpayer.

The third measure of efficiency shows an insignificant change over the pre and post period for Canadian shares of automobile production ( $\hat{Y}_5$ ) and employment ( $\hat{Y}_6$ ), and Canadian total automobile production ( $\hat{Y}_7$ ) and employment ( $\hat{Y}_8$ ). These results clearly outweigh the positive results of the first measure (See Table 29).

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\*The Canadian Industrial Selling Price Index is comparable to the U.S. Wholesale Price Index.

In conclusion, improved efficiency of the Canadian automobile industry has not occurred after the Agreement. An additional statistical test was used, suggesting further the statistical inconclusiveness of the results (see Chapter 5, hypothesis #2 for further elaboration of this test).

Table 20

Canadian Shares of U.S.-Canadian Automotive  
Production and Employment  
(Percentages)

1960-1966 vs. 1966-1976

Variable	Years	No. of Cases	Mean	Standard Deviation	Standard Error	Pooled Variance Estimate		
						T-Value	Degrees of Freedom	2-Tail Probability
Canadian Share of Total U.S.- Canadian Employment	1960-1966 1966-1976	6 10	6.03 11.12	.882 2.413	.360 .763	4.91	14	.000
Ho: Rejected at .000 level of confidence								
Canadian Shares of Total Canadian Automotive Production	1960-1966 1966-1976	6 10	4.53 6.52	.493 .885	.201 .280	5.01	14	.000
Ho: Rejected at .000 level of confidence								



Table 21  
Canadian Total Production and Employment  
(thousands of units)

<u>Variable</u>	<u>Year</u>	<u>No. of Cases</u>	<u>Mean</u>	<u>Standard Deviation</u>	<u>Standard Error</u>	<u>T-Value</u>	<u>Degrees of Freedom</u>	<u>2-Tail Probability</u>
Total Canadian Automobile Production	1960-1966	6	489.75	148.75	60.72	5.68	14	.000
	1966-1976	10	990.72	186.94	59.11			
Ho: Rejected at .000 level of confidence								
Total Canadian Automobile Employment	1960-1966	6	25.93	5.10	2.08	8.69	14	.000
	1966-1976	10	43.49	3.05	.96			
Ho: Rejected at .000 level of confidence								

Table 22  
Excess Cost of Canadian Value Added\*

Year	T	c	uv	x
1964	.094	.6	.03	12.9%
1965	.094	.6	0	12.7%
1966	.069	.6	0	12.1%
1967	.065	.6	0	11.4%
1968	.058	.6	0	10.1%
1969	.049	.6	0	8.5%
1970 (not available)				
1971	.103	.6	0	18.5%
1972	.123	.6	0	22.0%
1973	.113	.6	0	20.4%
1974	.123	.6	0	22.0%
1975	.046	.6	0	7.9%
1965-1970 average				11.0%
1971-1976 average				19.2%
1965-1976 average				15.1%

$$*x = \frac{T-uv}{C(1+T-uv)} - (T-uv)$$

where

x = the excess cost per unit of Canada value added

T = the Canadian-U.S. price differential for cars. (average of factory list of two door six

cylinder coupe and four door eight cylinder sedan.

Exchange rate differences accounted for in calculations)

c = percentage of Canadian content

(The minimum content requirement of 60% was used for the entire period as specified by pre and post Agreement Canadian legislator. Actual Canadian content has been shown to be as high as 78%. See Paul Wonnacott, "The U.S.-Canadian Automotive Agreement of 1965: The Early Effects: p. 335 op. cit.).

uv = percentage of the value of the car paid in tariffs on parts. Paul Wonnacott found tariffs collected on original equipment parts to be about \$30 million in 1962 or approximately \$60 per vehicle. At 1962 prices this represented about 3% of the factory price of vehicles. The Agreement eliminated the tariffs on original equipment parts. Ibid. p. 310.

### Hypothesis #3.

Hypothesis. The consumer-taxpayer of Canada is "better off" following the Agreement as measured by the benefits of lower relative prices offsetting the tariff revenues lost.\*

Evluation Process. The Canadian consumer-taxpayer economic position may be judged to have improved if the fall in automotive prices has more than offset the decline in tariff revenues. The author assumes the tariff revenues lost to be 3% of the factory price of vehicles as indicated in the previous section on Canadian excess cost. If the price differential between Canadian and U.S. made cars has been reduced below the 3% loss in tariff revenues, the consumer taxpayer is judged to be better off after the Agreement. The significance of a slight versus a large dispersion in the two figures is left to the reader's interpretation.

Canadian and U.S. automotive prices are subject to inflationary pressures present in the prospective economies. Therefore, inflationary pressures should be considered in determining the effects of the Agreement on automotive prices. If the inflationary pressures are evidenced to be less significant in the automotive industry relative to other durable good industries, stronger support may be given to Agreement associated benefits to the Canadian consumer-taxpayer. Specifically, if the pre and post 1966 differentials of industrial selling price indexes are shown to have increased the consumer-taxpayer has benefited.

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\*The author would like to emphasize the normative nature of such a measure consistent with the literature on consumer welfare.

The author has selected the furniture and fixture industry in Canada and the United States for comparison to the automotive industry in order to show the inflationary pressures operating on another durable good industry. The author recognizes the difference in capital intensity between the two industries which may confound the results. However, classification of available government statistics limits the choice of comparable durable good industries. Also, the statistics of the furniture and fixture, industry are consistent with the overall durable good industry statistics reinforcing the author's choice.

The Canadian industrial selling price price indexes of each of the two durable good industries are subtracted and compared for the pre 1966 with the post 1966 period. The United States wholesale price indexes (comparable to Canadian industrial selling price index) of the two industries are treated the same as the Canadian statistics. The U.S. differentials are used as the case of "in absence of" the Agreement because of the insignificance of the Agreement on the efficiency of the U.S. automotive industry. An additional test is used to test for significant changes in the slope and intercept of an ordinary least squares line for the furniture and fixture and motor vehicle industrial selling price indices individually to extract any causal effects the Agreement may have had on the motor vehicle industry wholesale price structures.

Evaluation and Conclusion. The average differential for the two automobiles produced in Canada and the U.S. after 1965 of 8.2% and 8.4% is not large enough to cover the 3% loss of tariff revenues (see Table 23). Compared to the average of 1964 and 1965 price differentials of 9.6% and

9.2%, the benefits of lower relative prices shows only a 1.4% and 1.2% reduction in the price differential (see Table 23). The results for the imported automobile are even less significant considering an average differential of 14.5% after 1965 compared to the average differential of 30.5 for 1964 and 1965. The 16% reduction in the price reduction in the price differential is not large enough to account for the 17-1/2% price reduction attributed to the elimination of the Canadian pre-Agreement tariff. Thus, the first test of the relative position of the Canadian consumer taxpayer as measured by lower relative auto prices versus tariff revenues lost indicates the Canadian consumer-taxpayers is not "better off."

The second measure of the welfare of the Canadian consumer taxpayer indicates a significant improvement after 1965. The automotive products industry has resisted inflationary pressures significantly better than the other durable good industry, the household furniture and fixture industry. The results show a significant difference for the pre and post 1966 years significant at the .006 level of confidence (see Table 24).

The additional test for slope and intercept changes for the two industries shows a high degree of significance for the pre versus the post Agreement period. However, these results indicate that one cannot conclusively say that the Agreement was the cause of the change in the motor vehicle industrial selling price index. (See Table 29, variables  $\hat{Y}_9$  and  $\hat{Y}_{10}$ ).

In summary, the consumer-taxpayer of Canada has not improved his/her position as measured by lower relative prices versus tariff revenues lost. To further test this hypothesis, a regression equation was developed for the



1961-1976 period based on a 1952 U.S. Department of Commerce model for predicting automobile registrations in the U.S. The new model attempted to predict Canadian consumption of U.S.-Canadian automobiles. The results further indicate statistically, the inconclusiveness of a positive causal relationship the Agreement has had on consumer welfare. The results are further elaborated on under Hypothesis #3 in Chapter 5.

The welfare of the Canadian automotive worker is considered in the following section.

Table 23

Canadian Price Differential Over (Under) U.S. Price  
For Three Popular Automobiles\* (Percentages)

	2 door** 6 cylinder <u>coupe</u>	4 door** 8 cylindar <u>sedan</u>	2 door*** 8 cylinder <u>hardtop</u>
1960 - 1964	(N.A.)		
1964	9.6	9.2	30.4
1965	9.6	9.2	30.6
1966	7.2	6.6	24.7
1967	6.8	6.3	8.7
1968	5.7	5.9	8.7
1969	4.2	5.6	10.0
1970	(N.A.)		
1971	10.1	10.6	13.0
1972	12.1	12.5	15.2
1973	11.2	11.5	14.1
1974	12.4	12.2	14.7
1975	<u>4.6</u>	<u>4.6</u>	<u>6.3</u>
Average 1966-1975	<u>8.2</u>	<u>8.4</u>	<u>14.5</u>

\*Converted to U.S. dollars at official exchange rate.

\*\*Produced both in U.S. and Canada.

\*\*\*Produced in U.S., imported into Canada.

Table 24  
Canadian Differential of Industrial Selling Price  
Indicies for Household Furniture  
and Fixtures and Automotive Products Industry

and  
U.S. Differential of Wholesale Price Indicies  
for Household Furniture and Fixtures  
Industry and Automotive Products Industry

Variable	Years	No. of Cases	Mean	Standard Deviation	Standard Error	Separate Variance Estimate		2-Tail Probability
						T-Value	Degrees of Freedom	
(Canadian) Household fix- tures indust- rial Selling Price Index	1961-1966	5	-12.34	.74	.33	3.63	9.06	.006
minus Automotive Pro- ducts Industrial Sel- ling Price Index	1966-1976	10	+ 7.9	17.65	5.58			
Ho: Rejected at .006 level of confidence								
(U.S.) Household Fur- niture & Fix- tures Wholesale Price Index	1961-1966	5	-.08	.27	.11	5.14	9.75	.000
minus Automotive Pro- ducts Wholesale Price Index	1966-1976	10	2.82	1.74	.55			
Ho: Rejected at .000 level of confidence								

#### Hypothesis #4

Hypothesis. The wage earner in the Canadian automobile industry is better off following the agreement as measured by the gains in wages in Canada, and also gains in economic rents as compared to similar employment in the durable goods labor market.

Evaluation Process. As a result of the Agreement, the Big Four automotive manufacturers (Ford, General Motors, Chrysler and American Motors) increased Canadian value added of \$260 million (Canadian) by the end of 1968 model year, plus 60% increased in content requirement for each successive year above the base year 1964. Associated with these increases in production were increases in Canadian automotive employment. It may be deduced that the Canadian automotive workers gained by these additional employment opportunities. However, it is assumed that the automotive workers would have been employed in absence of the Agreement. Therefore, gains to the automotive worker would appear in the form of economic rents which exclude factors other than differences in wage rates of the next best employment opportunity. This opportunity would logically be in other durable good industry employment. Thus, differences in wage rates between the durable good manufacturing wage and the automotive wage represents the benefits to the Canadian wage earner associated with the Agreement.

The author has sought to find a significant change in automotive wages from before 1966 to after 1966 along with the relative differences between durable good wages and automotive wages over the 1960-1976 period. In addition, the differentials between the general manufacturing wage and the

automotive wage of both U.S. and Canada are tested for significance before and after 1966. These results are presented to show how the wage earner in the automotive industry fared relative to general manufacturing industries before and after the Agreement and also in relation to the United States. One would expect the pre and post 1966 differentials to be significantly different for Canada and the post 1966 differentials to be closer in line with the U.S. differentials. These expected results are supported by the success of the United Automobile Workers Union (UAW) at achieving wage parity for the Canadian automotive workers with the U.S. automotive worker in 1970. Theoretically, these results are supported by the factor equalization theorem of Paul Samuelson which states that free trade will equalize not only commodity prices but also factor prices regardless of the factor supplies or demand patterns in the two countries.<sup>5</sup> The following section will distinguish the benefits to the Canadian automotive wage earner.

Evaluation and Conclusion. Economic rents for the Canadian automotive wage earner has increased from \$.47 (U.S.) in 1960 to \$.64 (U.S.) in 1966 to a high of \$1.06 in 1973. Wage "parity" was achieved with the U.S. auto worker in 1970 with slight variations accounting for exchange rate fluctuations. Based on the results in Table 26, a significant change is observed between the pre 1966 and post 1966 period for Canadian motor vehicle hourly wages based on a 95% degree of confidence. The significance of these results are somewhat lessened when one considers that the pre and post 1966 hourly wages for the durable goods industry also were significantly different. There also was not a change in significance in the pre and post 1966 relationship of the motor vehicle hourly wage compared to the durable good wage (see Table 27).



The lack of significance in these later measures may be confounded by the inability to extract the automotive industry wage from the average durable good wage.

The differentials in the Canadian and the U.S. market inspires a high level of confidence for the pre vs. post 1966 data (see Table 27). However, the evaluation of slope and intercept changes in the ordinary least squares line for the manufacturing, durable good and automotive wage rates shows a significant change in both the slope and intercept for U.S. and Canadian wage rates. This would lessen the ability to infer a positive causal effect of the Agreement on the wage structure of the automotive industry (see Table 29, variables  $\hat{Y}_{11}$ ,  $\hat{Y}_{12}$ ,  $\hat{Y}_{13}$ ,  $\hat{Y}_{14}$ ,  $\hat{Y}_{15}$  and  $\hat{Y}_{16}$ ).

In summary, the hourly automotive wage earner of Canada has benefitted after 1965. The wage earners in general manufacturing and durable good industries have also improved their position after 1965. Therefore, one cannot conclusively say the Agreement has caused the improvement in wage rates.

Table 25

Average Hourly Earnings for  
Canadian Motor Vehicle Production &  
Related Workers Durable Good Manufacturing Workers\*  
(U.S. Dollars)

<u>Year</u>	<u>(A) Avg. M.V. Hourly Wage</u>	<u>(B) Avg. Durable Good Wage</u>	<u>Difference (A-B)</u>
1960	2.27	1.80	.47
1961	2.27	1.84	.43
1962	2.31	1.89	.42
1963	2.43	1.96	.47
1964	2.50	2.04	.46
1965	2.66	2.06	.60
1966	2.72	2.08	.64
1967	2.87	2.39	.48
1968	3.26	2.58	.68
1969	3.47	2.78	.69
1970	4.02	3.04	.98
1971	4.45	3.51	.94
1972	4.91	3.86	1.05
1973	5.23	3.17	1.06
1974	5.69	4.79	.90
1975	6.10	5.29	.81

\* Adjustments were made for differences in exchange rates over the entire period.

Table 26  
Average Canadian Motor Vehicle Hourly Earnings and Average  
Canadian Durable Good Hourly Earnings  
(in U.S. Dollars)

1960-1966 vs. 1966-1976

Variable	Years	No. of Cases	Mean	Std. Dev.	Std. Error	Separate Variance Estimate	
						T Value	Degree of Freedom
Average Motor Vehicle Hourly Earnings	1960-1966	6	2.40	.15	.37		
	1966-1976	10	4.27	1.19	.06	4.98	.95
Ho: Rejected at .001 level of confidence							
Avg. Durable Good Hourly Earnings	1960-1966	6	1.93	.10	.33		
	1966-1976	10	3.44	1.06	.04	4.46	9.3
Ho: Rejected at .002 level of confidence							

Table 27

Differentials Between Avg. General Manufacturing Hourly Wages and  
Motor Vehicle Hourly Wages of United States and Canada  
(U.S. Dollars)

1960-1966 vs. 1966-1976

Separate Variance Estimates

Variable (U.S.)	Years	No. of Cases	Mean	Std. Deviation	Std. Error	T Value	Degrees of Freedom	2 Tail Probability
General Manu- facturing	1960-1966	6	-.71	.08	.03	-4.41	10.34	.001
minus Motor Vehicle hourly wage	1976-1976	10	-1.20	.37	.11			
(Canada)								
General Manu- facturing	1960-1966	6	-.62	.04	.01	-4.92	9.88	.001
minus Motor Vehicle hourly wage	1966-1976	10	-1.04	.26	.08			

Ho: Rejected at .001 level of confidence

Ho: Rejected at .001 level of confidence

### Hypothesis #5

Hypothesis. The wage earner in the United States automobile industry is worse off following the Agreement, as measured by the loss in employment which shifted to Canada in the form of lost economic rents. These workers would have to seek employment in lower wage industries.

Evaluation Process. The assumed loss to U.S. automotive labor as a result of the Agreement is difficult to quantify because of the impact of the monetary and fiscal measures taken by the U.S. Government. Therefore, the quantity change in U.S. automotive employment is excluded from consideration. The significant issue is the amount of loss in economic rents as the potential wage earners of the automotive industry must presumably seek employment in the next best alternative. This alternative is the durable goods industries excluding the automotive industry. The economic rents are considered purely in the differences in hourly wage rates between general durable good industries and automotive industry. Also, durable good hourly wages are compared to automotive hourly wages pre and post 1966; as well as each separately over the pre and post 1966 periods; no hypothesis of expected outcome of these later results is proposed. If significance appears, observations will follow.

Evaluation and Conclusion. The automotive wage earners of the United States that would have been employed in the absence of the Agreement have lost increasingly in the terms of economic rents. The hourly wages of the next best suitable employment in the general durable good industry shows an increase in the differential with the motor vehicle hourly wages over the sixteen year period. This gap has increased from a \$.46 (U.S.) difference in



1960 of the automotive wage earner over the general durable good wage earner to \$1.02 in 1968 to a high of \$1.48 in 1974. These differences appear as a weekly wage loss (40 hours) of \$18.40 in 1960, \$40.80 in 1968 and \$59.20 in 1974.

Thus, if the assumption of employment loss to the U.S. automotive wage earner due to the Agreement is correct, the loss in economic rents loss increased to put the U.S. wage earner in a "worse off" position after the Agreement.

The following Chapter integrates the results from this hypothesis and other hypotheses to determine if the expected benefits and gains to the automotive industry of the United States and Canada have been achieved. Along with this assessment, suggestions are provided for modifications and alterations in the Agreement and the implications for continued free trade between the U.S. and Canada.

Table 28  
Average U.S. Motor Vehicle Hourly Earnings and Average U.S.  
Durable Good Earnings  
(U.S. Dollars)

Variable	Years	# of Cases	Mean	Std. Deviation	Std. Error	Pre 1966 vs Post 1966		
						T Value	Separate Variance Estimate Degrees of Freedom	2-Tail Probability
Avg. M.V. hourly earnings	1960-1966	6	3.14	.21	.08	5.31	10.28	.000
	1966-1976	10	4.89	1.00	.31			
Ho: Rejected at .000 level of confidence								
Avg. Durable Goods Hourly earnings	1960-1966	6	2.60	.13	.05	4.97	9.97	.001
	1966-1976	10	3.80	.74	.23			
Ho: Rejected at .001 level of confidence								

Table 29

Ordinary Least Squares Regressions of Agreement Variables  
To Test for Slope and Intercept Changes, 1960-1966 vs. 1966-1976\*

$$\text{General Model: } Y = \beta_0 X_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_1 X_2 + \varepsilon$$

where  $Y$  = Agreement Variable

$X_0 = 1$  for the 1960-1976 period

$X_1 = 1$  for 1960-1966 period; 0 for 1966-1976 period

$X_2 = 1-16$  for 1960-1976 period where  $X_2 = 1$  in 1960,  $X_2 = 2$  for 1961, ...,  $X_2 = 16$  for 1975.

$X_1 X_2$  = interaction term

$\varepsilon$  = error term

If  $\beta_1, \beta_3 \neq 0$ , slope and intercept varies pre vs. post Agreement (1965) and the model is:

$$y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_1 X_2 + \varepsilon$$

If  $\beta_1 = \beta_3 = 0$ , neither slope nor intercept varies, therefore:

$$y = \beta_0 + \beta_2 X_2 + \varepsilon$$

If  $\beta_1 = 0, \beta_3 \neq 0$ , only the slope varies, therefore:

$$y = \beta_0 + \beta_2 X_2 + \beta_3 X_1 X_2 + \varepsilon$$

If  $\beta_1 \neq 0, \beta_3 = 0$ , only the intercept varies, therefore:

$$y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

(continued)

Table 29 (continued)

Variable	Predicting Equation	Change	R <sup>2</sup>
Hypothesis #1			
U.S. automobile unit imports	$\hat{Y}_1 = -88.7 + 62.2X_1 - 56.7X_1X_2 + \epsilon$	Slope	.91
Canadian automobile unit imports	$\hat{Y}_2 = -96.7 + 109.7X_1 + 37.8X_2 - 35.3X_1X_2 + \epsilon$	Slope, intercept	.97
U.S. automobile dollar imports	$\hat{Y}_3 = -2689.9 + 2607.8X_1 + 552.6X_2 - 509.9X_1X_2 + \epsilon$	Slope, intercept	.99
Canadian automobile dollar imports	$\hat{Y}_4 = -3406.2 + 3601.2X_1 + 656.4X_2 - 551.7X_1X_2 + \epsilon$	Slope, intercept	.97
Hypothesis #2			
Canadian shares of Canadian U.S. automobile production	$\hat{Y}_5 = 2.88 + 71X_2 + \epsilon$	no change	.93
Canadian shares of Canadian U.S. automobile employment	$\hat{Y}_6 = 4.3 + .19X_2 + \epsilon$	no change	.82
Canadian total automobile production	$\hat{Y}_7 = 386.5 + 52.5X_2 + \epsilon$	no change	.93
Canadian total automobile employment	$\hat{Y}_8 = 38.3 - 21.5X_1 + \epsilon$	intercept X <sub>2</sub> not significant	.30
Hypothesis #3			
Canadian furniture and fixture industrial selling price index (1971 = 100)	$\hat{Y}_9 = 20.3 + 59.0X_1 + 82.X_2 - 7.2X_1X_2 + \epsilon$	slope, intercept	.89
Canadian motor vehicle industrial selling price index (1971 = 100)	$\hat{Y}_{10} = 74.3 + 19.2X_1 + 2.4X_2 - 2.1X_1X_2 + \epsilon$	slope, intercept	.87
Hypothesis #4 and 5			
U.S. manufacturing hourly wages	$\hat{Y}_{11} = .98 + 1.2X_1 + .22X_2 - 15X_1X_2 + \epsilon$	slope, intercept	.98
U.S. automobile hourly wages	$\hat{Y}_{12} = .83 + 1.9X_1 + .34X_2 - .23X_1X_2 + \epsilon$	slope, intercept	.98
Canadian manufacturing hourly wages	$\hat{Y}_{13} = -.41 + 1.9X_1 + .31X_2 - .25X_1X_2 + \epsilon$	slope, intercept	.98
Canadian automobile hourly wages	$\hat{Y}_{14} = -.24 + 2.3X_1 + .39X_2 - .31X_1X_2 + \epsilon$	slope, intercept	.99
Canadian durable goods hourly wages	$\hat{Y}_{15} = -.54 + 2.2X_1 + .34X_2 - .29X_1X_2 + \epsilon$	slope, intercept	.98
U.S. durable goods hourly wages	$\hat{Y}_{16} = 1.02 + 1.3X_1 + .24X_2 - .17X_1X_2 + \epsilon$	slope, intercept	.98

\* These regression equations were developed through the assistance of Dr. D. Frederick and Dr. Dillon of the University of Massachusetts, Marketing Department and Dr. Rodney Thompson of Bentley College, Economics Department.

## FOOTNOTES

<sup>1</sup>Paul Wonnacott, "The U.S.-Canadian Automobile Agreement of 1965: The Early Effects," Working Paper Series, Bureau of Business and Economic Research, University of Maryland, August 1968.

<sup>2</sup>Sanford Labovitz, "Criteria for Selecting a Significance Level: A Note on the Sacredness of .05". The American Sociologist, Vol. 3 (1968), 220-22.

<sup>3</sup>See Paul Wonnacott and Ronald J. Wonnacott, Free Trade Between the United States and Canada: The Potential Effects, (Cambridge, Massachusetts: Harvard University Press, 1967).

<sup>4</sup>Paul Wonnacott, op. cit., p. 3.34. It is an elaboration of the formula for effective protection presented in Harry Johnson, "The Bladen Plan for Increased Protection for the Canadian Automotive Industry," Canadian Journal of Economics and Political Science, May 1963, p. 142. When the price differential,  $X$  becomes effective protection rather than excess cost.

<sup>5</sup>Kindleberger and Lindert, International Economics, op. cit., p. 86.



## C H A P T E R V

## SUMMARY AND CONCLUSIONS

The Effectiveness of Rationalization of Canadian-U.S.  
Automotive Production

Objectives of the Agreement

Restatement of the Objectives. The objectives of the 1965 Automotive Trade Agreement as stated in Chapter I of this study and as written in Article 1 of the Agreement:

- (A) The creation of a broader market for automotive products within which the full benefits of specialization and large scale production can be achieved;
- (B) The liberalization of the United States and Canadian automotive trade in respect to trade barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries;
- (C) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade.

These objectives are now evaluated in relation to the results from the hypothesis tests of the preceding chapter.

### Summary of the Hypothesis Results.

Hypothesis #1. Integration of the U.S.-Canadian automobile market has changed from the 1960-1966 levels. Integration was measured by the changes in automobile imports for the pre and post 1966 period.

These results may be confounded in the future by the greater increase in Canadian automotive demand for North American vehicles (Big Four) relative to U.S. demand resulting in a long-term deterioration in the Canadian automotive trade balance with the U.S. This stronger demand growth is expected to persist until 1985. If Canada retains its 1976 share of North American production through 1985, the indications are that the automotive trade deficit with the United States would be about 2.4 billion (1976 Canadian dollars) in 1985. In 1976, Canada's share of North American production was 12.5% for motor vehicles and 6.6% for independent and captive automotive parts producers. The present (1977) deficit in automotive trade with the U.S. is \$1 billion (Canadian) with a \$2 billion deficit in automotive parts.<sup>1</sup>

Automotive investment in Canada has been in the labor intensive sector of the industry (i.e. assembly and independent parts manufacture), where prior to 1970 the Canadian wage rates were lower than in the U.S. Since the early 1970's however, there has been a drastic reduction in overall investment due primarily to the loss of this cost advantage as wage parity was achieved resulting in the use of U.S. production facilities of automobile assembly of amounts over the "floor" requirements in the "Letters of

Undertaking."<sup>\*</sup> This cost advantage does again appear with the Canadian dollar weakening relative to the U.S. dollar.<sup>2</sup>

Hypothesis #2. The efficiency of the Canadian automotive market has not significantly improved since the 1965 automotive agreement. There is, however, an improvement in the output per automotive worker in Canada in the 1966-1976 period. This has occurred through plant and product specific economies of scale (mentioned briefly in Chapters I and IV).

Plant specific economies refer to the reduction of per unit manufacturing or production costs through the effect of different plant sizes (for a given state of technology). This effect on per unit costs has been recognized for many decades. Product specific scale economies however, have only been recognized since the Second World War. Generally, this notion refers to changes in cost per unit of output with longer lengths of production run. Different factors can operate to reduce total costs per unit. Overhead costs are spread over longer runs, leading to lower costs per unit of output. Learning curves rise as employees evolve better methods of carrying out the same tasks, so lower variable costs on wages occur. Cost of materials decline with large volume purchases. Finally, at a certain level of production, efficiency may indicate a major change in the production line or assembly operation, involving larger and different machinery and production techniques which would lower per unit costs.<sup>3</sup>

The result of the hypothesis tests however, remain statistically in-

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<sup>\*</sup>See Appendix A.

conclusive especially after a regression was run for the 1961-1976 period.

The regression equation is as follows:

$$y = \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \varepsilon$$

where:

$y$  = Change in Production of U.S.-Canadian type automobiles in  
units

$x_1$  = Constant (y-intercept)

$x_2$  = Change in investment for Canadian automobile plant and  
equipment in millions of 1971 Canadian dollars

$x_3$  = Change in Canadian automobile employment

$x_4$  = Dummy variable with value of "0" for 1961-1966 and  
"1" for 1966-1976

The regression explained 39% of the variation both with and without the dummy variable ( $x_4$ ). Although this is not a high regression coefficient, the insignificance of the dummy variable and slight change in the "y intercept" in the regression reflects the non-causal effect of the Agreement on the efficiency of the automobile industry.

Product and plant specific economies of scale occurred in the Canadian automotive industry through the significant increase of investment in production facilities to meet the \$260 million required increase by 1968. Also, Canada is now producing fewer models for both the U.S. and Canadian market eliminating the need for fewer line changes and also increasing the length of production runs.

Donald W. McEwan, Chief of Motor Vehicles Division of the Department of Industry, Trade and Commerce in Ottawa, however informed the author of the

continued presence of model changeovers. These changeovers may be for two similar car models, however, inefficiencies were present due to downtime in specific assembly line changes.

Also confounding the efficiency of the Canadian automotive industry is the presence of a maximum 48 hour workweek in the Province of Ontario. This factor lends to inefficiency through the need to retain more workers on the payroll to meet the peak demand periods rather than the use of overtime. This is a problem the author terms as structural and beyond the capabilities of the Agreement as it is presently written.

Hypothesis #3. The Canadian consumer-taxpayer's relative position has not improved after the Agreement as measured by lower relative prices of comparable automobiles produced in Canada and the U.S. However, at the wholesale price level, there has been relatively lower increases in automotive prices versus those of another durable good industry. This indicates improved efficiency at the production level, however, these efficiencies are not passed along to the consumer as indicated by the insignificant decrease in automobile prices.

Some of the factors tending to increase prices of automobiles are included in the following list:<sup>4</sup>

#### Taxes

1. Capital tax on assets (e.g. Ontario rate of 1/5 of 1%);
2. Federal sales tax on building materials;
3. Federal sales tax on auxiliary production machinery and equipment.



### Duties

#### Custom duties:

1. Paid on imported materials used in the original equipment of automobile parts;
2. Paid on the imported materials used in the manufacture of automobiles;
3. Paid on imported building materials and components;
4. Paid on imported machinery, equipment and auxiliary capital items.

### Manufacturing Costs

1. Cost of imported components from parent companies in U.S. (transfer pricing);
2. Cost of Canadian "vendor" items (e.g. tires, trim, etc.);
3. Assembly plant production mix penalty (product specific diseconomies of scale).

### Marketing Costs

1. Advertising: the result of
  - a) broad range of product;
  - b) geographically widespread market (i.e. 100 miles by 3000 miles);
  - c) two official languages.
2. Support of regional sales offices;
3. Support of regional parts distribution centers;
4. Average Canadian dealer markup higher than average U.S. dealer markups.

### Warranty

1. Climatic conditions;
2. Servicing limited market on broad base;
3. Other cost factors resulting in higher Canadian warranty costs over those experienced in the U.S.

### Canadian Buyer Behavior

1. Preferences of Canadian buyer: a) Tendency of Canadian purchaser to specify not only fewer options per vehicle but less expensive options per vehicle, (e.g. lower Canadian rate of original equipment manufacturers installation of air conditioning); b) Tendency of Canadian purchaser to buy fewer deluxe models within a range.

This list comprises the more significant factors lending to higher relative prices of automobiles in Canada. It is interesting to note that preliminary statistics for the wholesale price of 1978 cars shows Canadian prices below U.S. prices by 1.3%. These results reflect the dynamics of the freely fluctuating exchange with the Canadian dollar 12%-15% below the value of the U.S. dollar. (see Table 39) A further measure was used as discussed in Chapter 4 under this hypothesis. The regression equation for the 1961-1976 period is as follows:

$$y = \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 - \beta_5 x_5 + \beta_6 x_6 + \varepsilon$$

where:

$y$  = Canadian Consumption of U.S.-Canadian type automobiles in units

$x_1$  = Constant (y intercept)

$x_2$  = Canadian disposable personal income in 1971 Canadian dollars

$x_3$  = % change in disposable personal income to preceding year in 1971 Canadian dollars

$x_4$  = Canadian consumer price index for automobiles to consumer price index for all items

$x_5$  = Non U.S.-Canadian type automobiles consumed in Canada

$x_6$  = Dummy variable with a value of "0" for 1961-1966 and "1" for 1966-1976

The regression was run with and without the dummy variable ( $x_6$ ). The regression coefficient ( $R^2$ ) remained at 71.3% in each regression equation. The F-test was significant at 95% in each equation. The T-test for the dummy

variables, however, was insignificant and the regression coefficient was also insignificant. These results suggest that the treatment (Agreement) had little effect on Canadian consumption of U.S.-Canadian type automobiles.

A "Chow test" was considered to test for a significant change in the regression coefficients for the pre and post Agreement period. However, the lack of degrees of freedom for the pre 1966 period would not allow the test.

The results for this regression represent a significant area for future research in the U.S.-Canadian automobile industry. However, it remains outside the research question of this study.

Hypothesis #4 and #5. Canada's gain in automotive employment and earnings does not reflect Pareto optimal results and thus a loss to U.S. automotive workers. There was an increase in Canada's percentage of total Canadian-U.S. automotive employment from 8.9% in 1965 to 11.2% in 1976. This represents a 2.3% loss in employment to the U.S. automotive workers.

The increased proportion of Canada's share of Canadian-U.S. automotive employment can be attributed partially to Canadian automotive activities being concentrated in labor intensive assembly operations. Also, the employment is less skilled than comparative automotive employment in both vehicle assembly and parts manufacture. The distribution of employment in these sectors of the automotive industry of both countries for 1976 in percentages is as follows:<sup>5</sup>

Table 30

	<u>Vehicle Assembly</u>		<u>Parts Manufacture</u>	
	<u>Canada</u>	<u>U.S.</u>	<u>Canada</u>	<u>U.S.</u>
Non-Skilled	73%	49%	51%	33%
Semi-Skilled	23%	42%	34%	57%
Skilled	4%	9%	15%	10%

This data reflects a growing inequity in the distribution of total investment towards labor intensive rather than capital intensive sectors in the Canadian automotive industry. This inequity may cause the Canadian automotive industry to become less competitive in world automotive trade as Canada's comparative advantage has been lost due to nominal wage parity. This comparative advantage may again appear as the Canadian dollar is depressed on world markets. The most significant question, however, is whether the lower value of the Canadian dollar is perceived as long-term condition and thus a factor in corporate decision making.

The following table shows a more drastic decrease in investment in parts manufacturing versus vehicle assembly.

Table 31

## Canadian New Investment as Percentage Shipments

<u>Year</u>	<u>Vehicle Assembly</u>	<u>Parts Man.</u>
1965	4.1	14.2
1967	3.0	7.9
1969	1.1	6.9
1971	0.7	4.3
1973	1.2	3.4
1975	1.1	2.8
1976	0.9	1.9

Source: Statistics Canada 31-001

The above table shows the level of investment in Canadian vehicle assembly has remained relatively stable since 1969 and the level of investment in parts manufacture is trending downwards. This decrease reflects a shift in investment into the U.S. and a reliance on foreign suppliers of automotive parts by U.S. auto manufacturers. Automotive parts produced outside the U.S. and Canada are allowed to enter duty free if the vehicle contains at least 50% North American content. This situation of a decrease in investment in capital intensive sectors and its effect on the future competitiveness of the Canadian automotive industry is addressed briefly in the following section and comprehensively in the following final chapter.

### Conclusion

The Agreement has lent to improved efficiency in the automotive industry of Canada and thus the U.S.-Canadian automotive market. The benefits appear in the form of a significant increase in employment, wages and lower relative wholesale prices of automotive parts. The objectives of the Agreement, based on the rationalization of automotive production, have been achieved to a significant degree.

However, shortcomings in the agreement as it is written indicate the need for modifications to better fit today's priorities of U.S. and Canadian consumers, taxpayers, laborers, and stockholders. One modification would include some guarantee of continued investment in Canada above the 60% Canadian value added commitment by the automobile manufacturers in the letters of undertaking.



This added clause would also specify the type of investment in order to assure Canada of its fair share of both the labor and capital intensive investments. Guarantees, such as this reflect other than primarily economic considerations. These other considerations are addressed in the following chapter.

Table 32  
The Exchange Rate's Effect on the Average Price Differential of Cars  
Between Canada and United States

a) Exchange Rate

In calculating the differential in price between Canadian and United States cars at the whole-sale level, the prices are evaluated on the common basis of the Canadian dollar. It is therefore apparent that any variation from parity in the exchange rate will offset the differential in price. For every percentage point the Canadian dollar falls below the U.S. dollar, the differential will narrow by a similar amount and will widen for every percentage point the Canadian dollar exceeds the U.S. dollar.

b) Average Price Differential at Factory Level

Exchange Rate	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978 (p)	1979
1. Fixed	8%	5%	4%	4%	3.8%	3.5%	2.3%	1.7%	1.7%	nil	-1.4%	-1.4%	-1.2%	+1.2%	
2. Par	16%	13%	12%	12%	11.8%	11.5%	10.3%	9.6%	9.6%	7.7%	6.5%	6.5%	6.7%	+9.3%	
3. Actual	8%	5%	4%	4%	3.8%	3.5%	9.3%	8.5%	9.6%	9.3%	6.4%	6.4%	4.5%	-1.3%	(p)

The above table shows the differential samples in trade computed on the basis of 1) the rate of exchange which was in effect prior to the floating of the dollar in June 1970 (i.e. \$1.00 U.S. = \$1.08 Canadian), 2) computed on the basis of both currencies being at par, and 3) on the basis of average 11 month rate of exchange of U.S. \$1.00 = \$1.10684 Canadian.

p - preliminary  
r - revised

Source: Transportation Division, Department of Industry, Trade and Commerce. Government of Canada, July 26, 1978.

Footnotes

<sup>1</sup>"The Automotive Industry in Canada," Sector Profile. Government of Canada, Department of Industry, Trade and Commerce, 1977, p. 8.

<sup>2</sup>"The Automotive Industry in Canada," Ibid., p. 3.

<sup>3</sup>Donald J. Daly, "Economies of Scale and Canadian Manufacturing" (Downview, Ontario: Prepared for Seminar, "Appropriate Scale for Canadian Industry," October 19-21, 1977), pp. 3-10. Also see D.J. Daly, "Empirical Applicability of the Alchian-Hirshleifer Modern Cost Theory" (York University, mimeo, 1975).

<sup>4</sup>Summer of 1978 Memorandum, Motor Vehicles Division, Department of Industry, Trade and Commerce, Government of Canada.

<sup>5</sup>"The Automotive Industry in Canada," Op. Cit., p. 4.

## C H A P T E R VI

## NEW PERSPECTIVES FOR U.S.-CANADIAN TRADE

Humanistic Paradigm

Introduction. The basic premise of the Agreement is one of freer trade with the desired outcome of rationalized automotive production across the United States/Canadian border. The guiding principle has been the theory of comparative advantage with certain guarantees insuring Canada of its fair share. However, Canadian labor has achieved nominal wage parity thus losing its cost advantage in wages. And as observed by Mr. John Kotyk (International Government Relations, The Ford Motor Company), the Ford Motor Company would prefer to produce in the U.S. due to lower capital costs and the presence of the "Knowledge Center" in Dearborn. The decreased value of the Canadian dollar does uncover cost advantages for production in Canadian facilities over the U.S. However, the impact of the Canadian exchange rate on the investment decisions of the Big Four automakers has yet to be determined.

As a result of the previous analysis in this research paper, the author believes in the need for other criteria for decision making in the U.S.-Canadian automotive market. These criteria follow from the perspective of all the participants, and not only the decision makers in the multinational firms.

Definition. The humanistic approach to rule making and evaluation centers around man-created rules developed through observable individual and collective behavior. These rules are a "set of instructions or a body of knowledge which provide that under certain identifiable circumstances, the individual is to respond in a particular fashion if he expects to achieve a certain result."<sup>1</sup> The problem of the researcher in the social sciences is to determine the outcomes of a specific rule or rules and based on this evaluation suggest changes so as to better serve the participants in the system.<sup>2</sup>

The structure for rule making and evaluation lies in the paradigm (e.g. humanistic paradigm). "A paradigm can be defined descriptively as a set of initial perceptual assumptions as to what the nature of the fundamental entities of the social world are and how they interact with one another; normatively, it postulates a set of values or preferred human end states to human existence and how these might appropriately be achieved individually or collectively."<sup>3</sup>

The Humanistic approach and the Agreement. The Agreement serves as the logical means/ends relationship between the government of the United States and Canada. The objectives of the Agreement represent the criteria for evaluation as appears in Chapter IV. The results show some benefits to the Canadian consumer/taxpayer in the form of lower relative price increases in the automotive sector compared to the general manufacturing sector. The Canadian automotive wage earner has gained through the significant increase in employment and wages.



However, as a result of the Agreement investments have been increasing at a decreasing rate in Canada and these investments have been in labor intensive sectors, i.e. assembly operations versus capital intensive parts manufacturing. This outcome will minimize the benefits to the Canadian side of the automotive industry as cost efficiency dictates production in the lowest cost centers, the U.S. automotive plants. In order to improve the overall operations of the U.S.-Canadian automotive industry, criteria must arise to insure a continued overall balance in the benefits to all participants.

Comparative advantage is a guiding principle in world trade, developed in a world with many economic participants as explained by Adam Smith's principle of atomism. However, today's world of fewer and more powerful entities requires other considerations beyond comparative cost theory in order to insure the benefits for the whole. The force and power of the multinational corporations must be clearly understood.

### The New World System of Multinational Corporations

Introduction. So far, no theory whether political, social or economic exists to account for the world economy and therefore, for the behavior of the multinational corporation.<sup>4</sup> Therefore, any serious attempt to understand the behavior of the multinational corporation or explain its behavior involves consideration of sociology, politics, psychology, and culture as well as economics. The allocation of scarce resources, through the operation of comparative advantage is only part of the world system. Consideration

must be given to the effect the multinational corporation has on the total world system and its accountability to a sovereign power.

Definition of multinational. Jack W. Behrman, a former Assistant Secretary of Commerce, and a leading academic analyst of global corporation, suggests that the most important criterion for determining whether a corporation should be called multinational is centralization of policy and the integration of key operations among affiliates. The world corporation has taken the eighteenth century economic dicta about comparative cost advantages and division of labor and applied them on a global scale for the maximization of profits.<sup>5</sup>

Different perspectives of the multinational enterprise. Kari Levitt believes that in order for a multinational firm to be most effective, attempts have been made to make foreign cultures as similar to the U.S. culture in the form of capitalistic values and norms. She believes "homogenization" of the free world value structures is a major objective of the multinational firm. There would be less need for the tailoring of products to meet the diversified world markets having different cultural, technological, political and economic values. She believes that the new colonialism of the multinational corporation is coined by the ideology of materialism, liberalism and anti-nationalism. She further states, "If the nation state is a barrier to the efficient production of material goods by international corporations then, in this liberal view, the nation state is regressive reactionary and obsolete."<sup>7</sup>

In an article by Heather Dean<sup>8</sup> she states the economic allocation of scarce resources, which is a major conflict between multinational firms and host governments would be best served by a supernational body. This body would centralize prices and allocation of scarce resources with a consideration for the total free world market. Anthony Sampson believes however that "for the great part of the welfare of individuals must continue to reside with the nation around which the whole apparatus of taxation and the welfare state has been constructed. Nationalism in this function, is far from outdated...the nation is the only institution strong enough to stand up to the multinationals, and to instill comparable loyalties, for the foreseeable future, and it is only the nation that can redress the present imbalance. The concept of sovereignty may seem an old fashioned and misleading one, but it expresses well enough the basic conflict and political question, 'Who is going to provide the context and shape of men's lives?'"<sup>9</sup> Jean Jacques Servan-Shreiber clearly states, "The multinational corporation will be disruptive if a political power does not develop to put the economy at the service of man, and not put man at its service."<sup>10</sup> (humanistic perspective)

Barnet and Müller make some interesting statements with regard to the multinational corporation:

The global corporation is the first institution in human history dedicated to centralized planning on a world scale. Because its primary purpose is to organize and to integrate economic activity around the world in such a way as to maximize global profit, the global corporation is an organic structure in which each part is expected to serve as the whole. Thus in the end it measures its successes and its failures not only by the balance sheet of an individual subsidiary, or the suitability of particular products, or its social impact in a particular country, but by the growth in global profits and global market shares. Its

fundamental assumption is that the growth of the whole enhances the welfare of all the parts. Its fundamental claim is efficiency.<sup>11</sup>

Charles P. Kindleberger, one of the U.S. authorities on international economics, states, "The international corporation has no country to which it owes more loyalty than any other, nor any country where it feels completely at home."

Barnet and Müller point out the managerial dilemma of the nation-state:

Large corporations plan centrally and act globally, and nation-states do not. It is this difference that puts governments at a disadvantage in trying to keep up with and control the activities of global corporations. As individual business units become more powerful and mobile, as their balance sheets become less and less accurate, reflective of real economic activity, government finds itself handicapped, administratively and politically, in regulating the economy with traditional Keynesian methods. The ease with which global corporations can conceal or distort information vital for the management of the economy is creating the same sort of administrative nightmare for the advanced industrial state that underdeveloped countries have lived with for years.<sup>12</sup>

And further present a humanistic perspective:

The success of a social system ultimately depends upon the achievement of balance. It needs social balance, which avoids the dangerous concentration of wealth in a few hands. It needs ecological balance, which avoids the misuse of natural resources...Finally it needs psychological balance which avoids the human costs of alienation--a process of enslavement that takes place, as Marx wrote, when the power has given to things "sets itself against him as an alien and hostile force." We need a holistic perspective for evaluating the quality of growth. The impact of the peculiar system of growth associated with the global corporations on social, ecological and psychological balance must be examined together. The achievement of balance in one sphere at the sacrifice of another cannot produce a system that works in any lasting or human sense. The empirical evidence to date casts great doubt on the capacity of a global system to achieve such equilibrium.<sup>13</sup>

Multinational corporations have contributed to the shrinking of the world's geography. Through the media of multinational enterprise, goods,



capital, men, women, management and technology have spread internationally; unquestionably the multinational corporation contributes to a smaller world.<sup>14</sup> It is up to the individual to determine if this smaller world is a better world.

On the subject of destroying national sovereignty and creating dependent relationships, Mira Wilkins believes that economic strength and political sovereignty are linked, foreign investors that aid economic growth contribute a material basis for the enhancement of national sovereignty. She does believe, however, that foreign investment does provide a challenge to national sovereignty when it reaches a certain size or when it is in a vital industry (i.e. automobile industry), but nations do have the power to limit foreign investors.<sup>15</sup> The exercise of this power may, in the author's opinion, force a cutback in operations by the home corporation for the political risk index has now increased.

Peter F. Drucker believes that the multinational corporation satisfies the economic promise that demand creates supply; and since demand exerts the pull, the multinational business is in every case a marketing business. He believes that the multinational corporation has exposed, for the first time in three hundred years, that economy and sovereignty are becoming divorced from one another. What has emerged is an autonomous world economy which is not just the sum of national economies. And in a world that is threatened to be destroyed by nationalist passions, the multinational corporation is an important institution.<sup>16</sup>

These diverse perspectives provide timely insight critical to the issues of national sovereignty a critical issue in the development of a



humanistic perspective in which individual and collective behaviors and insights provide the basis for change.

Solutions to the issue of sovereignty and the power of multinational

corporations. The author believes in the opportunity of each country to determine their social, economic, and political directions and their level and speed of development in these areas. The multinational corporation has represented a change agent for many cultures toward a more similar political, economic and social world. This very change has been hailed and condemned, as was previously pointed out, depending on the perspective of the individual host country. The author further believes in the necessity of this institution's answerability to a governing body other than the economic forces of demand and supply and the theory of comparative costs.

The multinational corporation is not answerable to a sovereign power due to its worldly economic flexibility. Attempts to control multinational corporations in host countries are hardly achieved, especially due to the obscurity of distinct trade and control lives within them.<sup>17</sup> Expropriation may have served as a viable solution to this obscurity for certain frustrated countries. Thus, the self-determination of individual countries should not be frustrated and this sovereign right could be supported by a supranational governing body. This supranational authority would be knowledgeable of the national plans of individual countries. These plans would then serve as guidepoints for multinational corporations operating within a planned economy according to the humanistic plan of a country.

For example, the national plan would consider issues of employment, defense, environmental quality, fiscal and monetary policy, regional development, mass transportation, national resource development and allocation, cultural development, among many others.<sup>18</sup> These plans would then be supported and facilitated by the supranational organizations so as to regard national sovereignty with the highest priority and not as an obsolete state as a result of the economic power of multinational corporations.

Until such time as this agency is organized, the Agreement serves as an effective device to integrate national priorities with economic criteria. The Agreement previously served as this mechanism as exemplified by the commitments made by the Big Four automotive companies to the Government of Canada in the "Letters of Undertaking."

Canada's problems. In an article by Robert Fulford,<sup>19</sup> the Editor and Vice President of the Toronto magazine, Saturday Night, he observed the need for specialization in the Canadian economy, an economy with one of the lowest levels of investment in research and development among the OECD countries. Only 33% of the total spent on research and development is financed by industry. This figure runs as high as 65% in Japan. Part of the problem is that nearly sixty percent of the Canadian manufacturing sector is owned by foreign based multinational corporations.

The critical question posed by Robert Collison, Assistant Editor of Saturday Night, is if these multinational corporations in 1978 have the inclination or interest to make the investment and transfer the technology to restructure their businesses for Canada's economic benefits. It follows that

any talk about nationalization and technological sovereignty raises the problem of continentalism.\*<sup>20</sup>

In a recent study by the Alberta economist, Bruce Wilkinson, he observed that more than 60% of Canadian trade is with the United States and that 60% of that trade is in crude and semi-processed materials. He further states that Canada is like a developing nation in that about 50% of our total mineral exports are in crude rather than semi-processed forms. Canada is running a deficit for over \$10 million in manufactured goods comprised of the substantial \$1 billion in automotive trade with the U.S. for 1977.

Collison feels that Canada can't outperform Korea unless the country is willing to become a low-wage, labor intensive society. To become a high technology economy requires massive investment in research and development and the aggressive promotion of Canadian industry, along with government planning.<sup>21</sup> Dr. Donald Daly, an economist at York University, further elaborates: "Much more emphasis should be placed on diffusion of technology and on areas of research and development where the costs could be spread over large markets in which Canada is a potential exporter, rather than being spread widely over a variety of domestic manufacturing industries where Canada currently is experiencing serious cost disadvantages."<sup>22</sup>

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\*Continentalism is defined by Robert Collison as the word used to define the impact of the American economic, political and cultural influence over Canadian national life.

Northern Telecom, the manufacturing subsidiary of Canada Bell, has been quite successful in developing new communications technologies and capturing lucrative export markets. Robert Scrivener, chairman of Northern Telecom, says the company realized in the late 1960's that the Canadian market alone wouldn't be sufficient to support rising research and development costs. As a result of this insight, Northern Telecom, aggressively acquired firms in the U.S. with experienced sales and service force and an expanded product line. The irony of the success of this company, is that Western Electric was forced to divest itself of its Canadian branch plant then Northern Electric now Northern Telecom. The Science Council of Canada believes that the company picked up the challenge of developing its own technological base when the flow of technology from the U.S. based company was curtailed.<sup>23</sup>

The Agreement and the automotive industry. The previous section on the structure of Canada's manufacturing sector further reflects the necessity for some degree of national planning. The inconsistency between the increase in education and low levels of research and development reflects the inability of the market to uncover a national comparative advantage. Imperfections in the marketplace also appear as a result of decisions made in multinational headquarters. John Kenneth Galbrath notes the power of multinational corporations in his statement that the "only reasonable defense of the multinational corporation is now the truth. That it has power must be conceded...prices are set. Customers are persuaded. Cultural patterns are altered. Governments are persuaded...The only durable defense is to hold that such exercise of power is inevitable and, if subject to



proper guidance and restraint, socially useful."<sup>24</sup> The coordination of government planning and strategic corporate planning, would minimize the inefficiencies that now exist in the labor and manufacturing sector of the Canadian economy. The importance of these sectors is pivotal to the development and maturation of industrialized economies.

The Canadian automotive industry is characterized by an oligopolistic market with three major automobile manufacturers, the General Motors Corporation, the Ford Motor Company and the Chrysler Corporation. The American Motors Corporation is one of the Big Four however with only a 3.8% share of passenger car sales in Canada in 1975. The three major corporations possessed 40.4%, 21.9% and 20.1% shares of the total Canadian passenger car market respectively. Imports attained the remainder 13.8% share including foreign owned companies operating in Canada excluding the U.S. owned companies mentioned above.

The control of the Canadian automobile market by American multinationals indicates precisely the difficulty Canada has in developing the technological comparative advantage that it so desperately needs. The Agreement makes no specification of the type of investment that should be made in meeting the 60% Canadian value added by the U.S. auto manufacturers. This requirement has in the past met with increased assembly operations which as previously indicated is labor intensive and the necessary skill level is low.

On August 15, 1978 the Ford Motor Company made the decision to invest \$533 million in Windsor, Ontario. Roy Bennet, President of Ford of Canada indicated that "the decision to build this major facility in Canada is a



direct result of close co-operation between industry and government with respect to achieving national objectives including increased employment."<sup>25</sup>

This decision may indicate the precedent of mutual goal setting in the planning processes of the Canadian government and the U.S. multinationals operating in Canada. The expected benefits to the Canadian economy, as a result of the \$533 million Ford investment are:<sup>26</sup>

1. Employment at plant of 2,600.
2. \$50 million a year in new personal income and \$20.8 million in retail sales at current wage rates.
3. Increase in feeder industries employment of 1,200 to 1,400.
4. Increase in spinoff for commercial and service industries of 2,600.
5. 80% of the production will be exported.

The investment decision was also contingent on a \$68 million incentive offered by the Canadian government to Ford Motor Company which was supposed cost differential between building the plant in Lima, Ohio and Windsor, Ontario. This incentive was denounced by C. Fred Bergsten, the Assistant Secretary for International Affairs in the Treasury Department, as "interventionist practices" by the Government of Canada and Ontario.<sup>27</sup> The necessity of such incentives was given by the Canadian Ford President, Roy Bennet, "...to attract any new industry whether it be an automobile assembly plant or a shoe manufacturing plant, we in Canada must make ourselves competitive with many of the U.S. states which are seeking to attract new industry by offering a wide range of incentives."

The need for investment incentives indicates the imbalance that exists in costs between the Canadian and United States automotive industry. This imbalance is contrary to the supposed outcome of rationalization of automotive production which would indicate cost balance transcending the

borders. Costs of production are however confounded by government fiscal and monetary policies which in Canada's case may run contrary to cost efficiency in the automotive industry. Also indicated may be the inadequacy of the Agreement in resolving the imbalance in its present form.

The future effectiveness of the Agreement and the competitiveness of the U.S.-Canadian automotive industry in domestic and export markets is contingent upon the integration of policy setting of the U.S. multinationals and the governments of both the U.S. and Canada. This integration of policy setting in Canada would address the underlying problems in the economy of a deteriorating competitive position in manufacturing or world markets.

The humanistic paradigm necessitates individual and group insights in the rule making process or stated in another way, in the policy setting, procedure and implementation of all sectors. The first step, the government plan, would be composed of the insights and demands of individuals as taxpayers, consumers, laborers, and shareholders. This plan would address the short and long range problems of the Canadian economy, i.e. the need for increased spending in research and development by industry and objectives would be cited for use in negotiations with company officials of the U.S. automotive companies. The Auto Agreement should be updated to reflect the priorities of both governments and the strategic objectives for the Big Four auto companies who own 97% of automotive manufacturing industry in Canada.

The future of free trade between the U.S. and Canada. The overall effectiveness of the "freer trade" Automotive Agreement of 1965 serves as an excellent reference for free trade agreements in other sectors of the auto

industry and other industries. With free trade, specialization and economies of scale would raise Canadian real income:

- 1) by a reduction in prices of manufactured goods in Canada to the U.S. level; and
- 2) by an increase in nominal wages in manufacturing to the U.S. level.<sup>29</sup>

Both the results in fact occurred in the automotive industry; prices increased relatively less than other manufacturing sectors on the wholesale level and wage parity was achieved.

Free trade on a bilateral basis between the U.S. and Canada does however undermine the theme of multilateralism and most favorite nation treatment of the 1948 GATT. Mr. Rolfe Nordlie,<sup>30</sup> of the Transportation Equipment Division of the U.S. Department of Commerce, also speculates that future free trade agreements should be on a multilateral basis in line with the GATT objectives. He feels bilateral agreements give rise to sectionalism and constant evaluations of relative shares and benefits. In a situation of inequity of the degree and size of industrialization of the trading partners, there is constant fear of the smaller power being absorbed by the more powerful. He does however empathize with Canada's concerns.

Dr. Donald Daly<sup>31</sup> believes that future free trade between the U.S. and Canada should involve the "intermediaries" (i.e. steel, rubber, tin, plastic, etc.) in order to share the benefits of free trade with the entire automotive sector.

Conclusion. The benefits and shortcomings of free trade between the U.S. and Canada hopefully have been clarified in this study. The author believes in a general policy of trade liberalization exposing the gains to national income

and economic growth achieved through the more efficient use of a nation's labor, capital, land, management and other resources. However, national planning must be coincidental to the liberalization so as to ensure the competitiveness of the economy on world markets. Multilateralism is preferred to bilateralism in trade agreements, however implementation and evaluation of bilateral free trade agreements is crucial to the stages of economic integration.

Footnotes

<sup>1</sup>Stanley Young, The Social Sciences: A Humanistic Perspective, University of Massachusetts 1978, Chapter 1, p. 4.

<sup>2</sup>Stanley Young, Ibid., pp. 8 and 9.

<sup>3</sup>Thomas S. Kahn, The Structure of Scientific Revolutions, (Chicago: University of Chicago Press, 1970).

<sup>4</sup>Peter F. Drucker, Management: Tasks, Responsibilities, Practices, (New York: Harper and Row, 1974), p. 740.

<sup>5</sup>Richard J. Barnet and Ronald E. Miller, Global Reach, Simon and Shuster, (New York: Gemonard Shuster, 1974).

<sup>6</sup>Kari Levitt, Silent Surrender, MacMillan, Toronto, 1970.

<sup>7</sup>Kari Levitt, Ibid., p. 98.

<sup>8</sup>K. T. Fann and Donald C. Hodges, Readings in U.S. Imperialism. (Boston: Porter Sargent Publisher, 1971), p. 154.

<sup>9</sup>Anthony Sampon, The Sovereign State of ITT. (Greenwich, Connecticut: Fawcett Publishers, 1974), pp. 311-312.

<sup>10</sup>Jean-Jacques Seran-Schreiber, Business Week, November 14, 1972.

<sup>11</sup>Richard J. Barnet and Ronald E. Müller, Op. Cit., p. 14.

<sup>12</sup>Barnet and Müller, Ibid., p. 256.

<sup>13</sup>Barnet and Müller, Ibid., pp. 361-362.

<sup>14</sup>Mira Wilkins, The Maturing of the Multinational Enterprise: American Business from 1914 to 1970, (Cambridge, Massachusetts: Harvard University Press, 1974), p. 395.

<sup>15</sup>Mira Wilkins, Ibid., p. 401.

<sup>16</sup>Peter Drucker, Op. Cit., pp. 728-741.



<sup>17</sup>See Mira Wilkins, Op. Cit., for the model of development of the multinational enterprise.

<sup>18</sup>A. Elliott Carlisle and Stephen R. Michael, "National Planning in the United States," Long Range Planning, Volume 9, Number 3, June 1976, pp. 21-28.

<sup>19</sup>Robert Fulford, "Canadians, always lucky need to be smart as well," Saturday Night, July/August, 1978, p. 12.

<sup>20</sup>Robert Collison, "The unsentimental lovers. Our shaky liaison with the U.S. economy," Saturday Night, July/August, 1978, p. 18.

<sup>21</sup>Robert Collison, Ibid., p. 20.

<sup>22</sup>Donald J. Daly, "It's a bad combination: high costs and low productivity," The Financial Post, August 21, 1976.

<sup>23</sup>Georgette Jasen, "Bold Canadian Concern Raids the U.S. Market with Telephone Gear," The Wall Street Journal, October 2, 1978, pp. 1, 23.

<sup>24</sup>John Kenneth Galbrath, "The Defense of the Multinational Company," Harvard Business Review, March-April, 1978, pp. 87-88.

<sup>25</sup>"Ford Plant: Its Official," The Windsor Star, Tuesday, August 13, 1978, p. 1.

<sup>26</sup>"What new plant means to city," The Windsor Star, Tuesday, August 15, 1978, p. 1.

<sup>27</sup>Edmund Cowan, "Canada's Offer to Ford Draws Criticism in U.S.," New York Times, Wednesday, August 2, 1978, p. D1.

<sup>28</sup>Ken Romain, "Makers of auto parts told to use initiative, imagination, and ingenuity," Toronto Globe and Mail, April 26, 1978, p. 1.

<sup>29</sup>R. J. Wonnacott and P. Wonnacott, Free Trade between the United States and Canada: The Potential Effects, Harvard University Press, Cambridge, Massachusetts, 1967.

<sup>30</sup>Interview, U.S. Department of Commerce, May 24, 1978.

<sup>31</sup>Interview in Washington, DC, May 21-24, 1978.

<sup>32</sup>Ronald Wonnacott, Canada's Trade Options, Economic Council of Canada, 1975, p. 104.

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APPENDIX A

TEXT OF UNITED STATES-CANADIAN AGREEMENT

## APPENDIX A

## TEXT OF UNITED STATES-CANADIAN AGREEMENT

Agreement Concerning Automotive Products Between the Government of the United States of America and the Government of Canada

The Government of the United States of America and the Government of Canada,

Determined to strengthen the economic relations between their two countries;

Recognizing that this can best be achieved through the stimulation of economic growth and through the expansion of markets available to producers in both countries within the framework of the established policy of both countries of promoting multilateral trade;

Recognizing that an expansion of trade can best be achieved through the reduction or elimination of tariff and all other barriers to trade operating to impede or distort the full and efficient development of each country's trade and industrial potential;

Recognizing the important place that the automotive industry occupies in the industrial economy of the two countries and the interests of industry, labor and consumers in sustaining high levels of efficient production and continued growth in the automotive industry;

Agree as follows:

Article I

The Governments of the United States and Canada, pursuant to the above principles, shall seek the early achievement of the following objectives:

(a) The creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;

(b) The liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede on a fair and equitable basis in the expanding total market of the two countries;

(c) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production and trade.

It shall be the policy of each Government to avoid actions which would frustrate the achievement of these objectives.



## Article II

(a) The Government of Canada, not later than the entry into force of the legislation contemplated in paragraph (b) of this Article, shall accord duty-free treatment to imports of the products of the United States described in Annex A.

(b) The Government of the United States, during the session of the United States Congress commencing on January 4, 1965, shall seek enactment of legislation authorizing duty-free treatment of imports on the products of Canada described in Annex B. In seeking such legislation, the Government of the United States shall also seek authority permitting the implementation of such duty-free treatment retroactively to the earliest date administratively possible following the date upon which the Government of Canada has accorded duty-free treatment. Promptly after the entry into force of such legislation, the Government of the United States shall accord duty-free treatment to the products of Canada described in Annex B.

## Article III

The commitments made by the two Governments in this Agreement shall not preclude action by either Government consistent with its obligations under Part II of the General Agreement on Tariffs and Trade.

## Article IV

(a) At any time, at the request of either Government, the two Governments shall consult with respect to any matter relating to this Agreement.

(b) Without limiting the foregoing, the two Governments shall, at the request of either Government, consult with respect to any problems which may arise concerning automotive producers in the United States which do not at present have facilities in Canada for the manufacture of motor vehicles, and with respect to the implications for the operation of this Agreement of new automotive producers becoming established in Canada.

(c) No later than January 1, 1968, the two Governments shall jointly undertake a comprehensive review of the progress made towards achieving the objectives set forth in Article I. During this review the Governments shall consider such further steps as may be necessary or desirable for the full achievement of these objectives.

## Article V

Access to the United States and Canadian markets provided for under this Agreement may by agreement be accorded on similar terms to other countries.

Article VI

This Agreement shall enter into force provisionally on the date of signature and definitively on the date upon which notes are exchanged between the two Governments giving notice that appropriate action in their respective legislatures has been completed.

Article VII

This Agreement shall be of unlimited duration. Each Government shall however have the right to terminate this Agreement twelve months from the date on which that Government gives written notice to the other Government of its intention to terminate the Agreement.

In witness whereof the representatives of the two Governments have signed this Agreement.

Done in duplicate at Johnson City, Texas, this 16th day of January 1965, in English and French, the two texts being equally authentic.

For the Government of the United States of America:

- (S) Lyndon B. Johnson
- (S) Dean Rusk

For the Government of Canada:

- (S) Lester B. Pearson
- (S) Paul Martin

Annex A

1.
  - (1) Automobiles, when imported by a manufacturer of automobiles.
  - (2) All parts, and accessories and parts thereof, except tires and tubes, when imported for use as original equipment in automobiles to be produced in Canada by a manufacturer of automobiles.
  - (3) Buses, when imported by a manufacturer of buses.
  - (4) All parts, and accessories and parts thereof, except tires and tubes, when imported for use as original equipment in buses to be produced in Canada by a manufacturer of buses.
  - (5) Specified commercial vehicles, when imported by a manufacturer of specified commercial vehicles.
  - (6) All parts, and accessories and parts thereof, except tires, tubes and any machines or other articles required under Canadian tariff item 438a to be valued separately under the tariff items regularly

applicable thereto, when imported for use as original equipment in specified commercial vehicles to be produced in Canada by a manufacturer of specified commercial vehicles.

2. (1) "Automobile" means a four-wheeled passenger automobile having a seating capacity for not more than ten persons;
- (2) "Base year" means the period of twelve months commencing on the 1st day of August, 1963 and ending on the 31st day of July, 1964;
- (3) "Bus" means a passenger motor vehicle having a seating capacity for more than 10 persons, or a chassis therefor, but does not include any following vehicle or chassis therefor, namely an electric trackless trolley bus, amphibious vehicle, tracked or half-tracked vehicle or motor vehicle designed primarily for off-highway use;
- (4) "Canadian value added" has the meaning assigned by regulations made under section 273 of the Canadian Customs Act;
- (5) "Manufacturer" of vehicles of any following class, namely automobiles, buses or specified commercial vehicles, means, in relation to any importation of goods in respect of which the description is relevant, a manufacturer that
- (i) produced vehicles of that class in Canada in each of the four consecutive three months' periods in the base year, and
- (ii) produced vehicles of that class in Canada in the period of twelve months ending on the 31st day of July in which the importation is made,
- (A) the ratio of the net sales value of which to the net sales value of all vehicles of that class sold for consumption in Canada by the manufacturer in that period is equal to or higher than the ratio of the net sales value of all vehicles of that class produced in Canada by the manufacturer in the base year to the net sales value of all vehicles of that class sold for consumption in Canada by the manufacturer in the base year, and is not in any case lower than seventy-five to one hundred; and
- (B) the Canadian value added of which is equal to or greater than the Canadian value added of all vehicles of that class produced in Canada by the manufacturer in the base year;
- (6) "Net sales value" has the meaning assigned by regulations made under section 273 of the Canadian Customs Act; and
- (7) "Specified commercial vehicle" means a motor truck, motor truck chassis, ambulance or chassis therefor, or hearse or chassis therefor, but does not include:
- (a) any following vehicle or a chassis designed primarily therefor, namely a bus, electric trackless trolley bus, amphibious vehicle, tracked or half-tracked vehicle, golf or invalid cart, straddle carrier, motor vehicle designed primarily for off-highway use, or motor vehicle specially constructed and equipped to perform special services or functions, such as, but not limited to, a fire engine, mobile crane, wrecker, concrete mixer or mobile clinic; or

(b) any machine or other article required under Canadian tariff item 438a to be valued separately under the tariff item regularly applicable thereto.

3. The Government of Canada may designate a manufacturer not falling within the categories set out above as being entitled to the benefit of duty-free treatment in respect of the goods described in this Annex.

#### Annex B

(1) Motor vehicles for the transport of persons or articles as provided for in items 692.05 and 692.10 of the Tariff Schedules of the United States and chassis therefor, but not including electric trolley buses, three-wheeled vehicles, or trailers accompanying truck tractors, or chassis therefor.

(2) Fabricated components, not including trailers, tires, or tubes for tires, for use as original equipment in the manufacture of motor vehicles of the kinds described in paragraph (1) above.

(3) Articles of the kinds described in paragraphs (1) and (2) above include such articles whether finished or unfinished but do not include any article produced with the use of materials imported into Canada which are products of any foreign country (except materials produced within the customs territory of the United States), if the aggregate value of such imported materials when landed at the Canadian port of entry, exclusive of any landing cost and Canadian duty, was -

(a) with regard to articles of the kinds described in paragraph (1), not including chassis, more than 60 per cent until January 1, 1968, and thereafter more than 50 per cent of the appraised customs value of the article imported into the customs territory of the United States; and

(b) with regard to chassis of the kinds described in paragraph (1), and articles of the kinds described in paragraph (2), more than 50 per cent of the appraised customs value of the article imported into the customs territory of the United States.



## LETTERS OF UNDERTAKING

Hon. C. M. Drury,  
Minister of Industry,  
Parliament Buildings,  
Ottawa, Ontario.

General Motors of Canada, Ltd.,  
Oshawa, Ontario, January 13, 1965.

Dear Mr. Minister: This letter is in response to your request for a statement with respect to the proposed agreement between the Governments of Canada and the United States concerning trade and production in automotive products, as you have described it to us. The following comments assume that the proposed agreement for duty-free treatment has the full support of the respective Governments, and that the program may be expected to continue for a considerable period of time.

It is our understanding that the important objectives of the inter-governmental agreement are as follows: (a) the creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved; (b) the liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries; (c) the development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, productions, and trade. We subscribe to these objectives and agree with the suggested approach of removing tariff barriers and moving in the direction of free trade even in this limited area. Such an approach is fully compatible with General Motors' expressed position with respect to the desirability of free trade in automotive vehicles and components, not only in Canada, but in all other countries in the free world.

It is noted that under the proposed agreement the right to import vehicles and certain automotive parts, free of duty, into Canada will be available to Canadian vehicle manufacturers who (1) maintain Canadian value added in the production of motor vehicles in ensuing model years at not less than the Canadian value added in motor vehicle production in the 1964 model year; (2) produce motor vehicles in Canada having a net factory sales value in a ratio to total net factory sales value of their motor vehicle sales in Canada and those of their affiliated companies in Canada of not less than the ratio prevailing during the 1964 model year; (3) increase in each ensuing model year over the base year, Canadian value added in the production of vehicles and original equipment parts by an amount equal to 60 per cent of the growth in their market for automobiles sold for consumption in Canada and by an amount equal to 50 per cent of the growth in their market for commercial vehicles sold for consumption in Canada (for this purpose, growth in their market means the difference between the cost of vehicles sold in Canada during the ensuing model year and the cost of vehicles sold in Canada during the base model year net of Federal sales tax in both cases); and (4) undertake, in addition to meeting the above three conditions, to achieve a stipulated increase in the annual Canadian value added by the end of the model year 1968.



With respect to General Motors, in connection with the conditions outlined in the previous paragraph, it is our understanding, in the case of (1) that Canadian value added would be decreased in circumstances where the value of General Motors sales declined below that achieved in the base year, and in the case of (3) that in the event of a decline in General Motors net value of vehicle sales for consumption in Canada, a decrease in Canadian value added of 60 and 50 per cent in cars and trucks, respectively, is acceptable. In addition, it is our understanding, with respect to (4), that for General Motors the stipulated annual increase in the Canadian value added by the end of the model year 1968 is \$121 million.

We understand that certain changes are proposed in the regulations pertaining to the determination of Canadian value added. We believe that several of these changes require further review and consideration as in our opinion they tend to impede rather than aid in the attainment of the objectives of the agreement.

In particular, these are (a) the elimination of the profit on components purchased from affiliated Canadian companies; (b) the elimination of profit on sales of vehicles and parts by General Motors of Canada or by Canadian affiliated companies to affiliated companies outside of Canada; and (c) the elimination of depreciation on non-Canadian facilities used in the manufacturing process both in our plants and in those of our Canadian suppliers.

(a) We believe that the elimination of the profit element on purchases of components purchased by General Motors of Canada from affiliated Canadian companies is discriminatory. McKinnon Industries, a major supplier of components, has been an affiliate of ours since 1929. McKinnon prices to us are competitive with those for similar components manufactured by other manufacturers. It is a policy of General Motors that pricing between affiliated operations be competitive and the purchasing unit has the obligation of negotiating the best possible price with the supplying unit. McKinnon and other affiliated Canadian parts manufacturers supply parts to other Canadian vehicle manufacturers and the profit on these transactions is not required to be eliminated by those manufacturers. We feel that at most any elimination of profit from value added should be confined to the elimination of profit above the percentage level in the base period.

(b) It is our opinion that the elimination of the profit on sales of vehicles and parts produced in Canada by General Motors of Canada and affiliated Canadian companies to affiliated General Motors companies in the United States and other countries is also discriminatory and should be given added consideration. It is recognized in the tariff regulations of most countries that the value of imported goods includes a "reasonable" rate of profit. Further, on sales by nonaffiliated Canadian suppliers to General Motors Corp. in the United States and its overseas subsidiaries the profit in such sales would be considered as Canadian value added.

(c) On the matter of exclusion of depreciation on non-Canadian machinery and equipment used in the production of automotive products in Canada, it seems that this only hinders the attainment of the objectives of the plan. In order to increase production in Canada, additional capacity is a necessity either in our plants or those of our suppliers. As much of this required equipment is either unavailable or more costly in Canada, it appears

that no allowing depreciation on such equipment as Canadian value added discourages rather than encourages the enthusiasm required to effect the desired increase in Canadian value added. It should be noted, however, that it is our intention to maintain our present policy of obtaining any additional machinery and equipment in Canada whenever economically feasible.

You have requested that we should increase Canadian value added in our products by \$141 million between 1964 and the end of the model year 1968, as outlined under condition (4). Also you have requested that the amount should be further increased to the extent required under condition (3) stated above. We think that this objective in that time is extremely ambitious, particularly in view of the fact that one-half of the first model year has already passed.

We have carefully reviewed our situation in the light of your proposals and requests and have asked that our affiliates do the same. We can see areas where we can and will achieve a significant portion of your suggested objective of \$121 million increase in Canadian value added in 1968. This is possible because General Motors of Canada and our affiliated Canadian companies have recently engaged in the Canadian manufacture of certain automotive components heretofore imported. These include the fabrication and assembly of automatic transmissions at McKinnon Industries Windsor plant not only for Canadian requirements but for export to assembly plants in other countries as well. In addition, in the 1964 model year the oversea market for North American-type passenger cars and commercial vehicles has been increasingly served by our plants in Canada. Of course, any slowing down in the rate of growth in the industry or any adverse developments in the economies of Canada, the United States, or other principal markets, or failure to achieve duty-free entry into the United States would make this achievement more difficult.

To attain your stated objective ratably over the 4 years of the plan amounts to an increase in Canadian value added of \$30 million a year plus growth. Our plans, which have been underway for more than a year, should accomplish about \$60 million of the total or, putting it another way, we can see our way clear to accomplish that portion applicable to the first 2 years of the plan.

Studies are underway of various steps we might take to accomplish that portion applicable to the last 2 years. However, we are and have been operating our facilities in Canada at full capacity, and so, I believe, have most of our suppliers. Therefore, the Canadian value added applicable to the last 2 years will probably require added facilities on our part, or on the part of our suppliers, or both. A further reappraisal of our present facilities and our capacity and those of our suppliers must be made. The extent and nature of any additional facilities can be determined only in the light of the plan as finally published. You can appreciate, I am sure, that all of this takes time.

Subject to the imponderables mentioned above, it is our intention and that of our affiliates to make every feasible effort to meet the objectives of the agreement to be made between the Governments of Canada and the United States, and to achieve the indicated goal as rapidly as possible.

Referring again to the items which appear to impede the program, we hope you will review your position further in the light of the information included earlier in this letter.

In conclusion, therefore, I am prepared to say at this time that, first, General Motors of Canada has plans underway to increase Canadian value added by about \$30 million in each of the first 2 years of the plan; and, second, we are continuing our studies of ways to accomplish the remainder of the program and will undertake to meet the full objective of \$121 million by the end of the model year 1968.

It is anticipated that these studies will take between 3 and 4 months to finish, and I will be prepared to discuss the results with you when they are completed. From time to time, as requested, we will be glad to discuss our current operations and our plans for future development with the Minister if Industry, and to receive and consider his suggestions.

Sincerely,

E. H. Walker.

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Ford Motor Co. of Canada, Ltd.,  
Oakville, Ontario, January 14, 1965.

Dear Mr. Minister: Enclosed are executed copies of our two letters to you of this date relative to the proposed agreement between the Governments of Canada and the United States concerning trade and production in automotive products under which it is proposed that the customs duty in each country on the importation from the other of automotive vehicles and original equipment parts therefore be eliminated.

We consider it essential that any substantial administrative interpretation or treatment that may be extended by you to any other motor vehicle manufacturer, the lack of which would place Ford Motor Co. in a noncompetitive position, also be extended to Ford.

You have provided us with a draft of the proposed order in council expected to be adopted in order to implement that agreement and with a draft of the regulations proposed to be adopted under that order in council.

Our undertakings are, of course, conditional upon the execution of that agreement, upon the adoption of an order in council, and regulations substantially in the form of the drafts that you have already delivered to us, and upon an acceptable response in respect of the enclosed supplementary letter.

Yours sincerely,

Ford Motor Co. of Canada, Ltd.,  
By Karl E. Scott, President.

Ford Motor Co. of Canada, Ltd.,  
Oakville, Ontario, January 14, 1965.

Dear Mr. Minister: We are writing with respect to the agreement between the Governments of Canada and the United States concerning production and trade in automotive products.



Ford Motor Co. of Canada, Ltd., welcomes the agreement and supports its objectives. In this regard, our company notes that the Governments of Canada and the United States have agreed "\*\*\* that any expansion of trade can best be achieved through the reduction or elimination of tariff and all other barriers to trade operating to impede or distort the full and efficient development of each country's trade and industrial potential\*\*\*." In addition, we note that the Governments of Canada and the United States shall seek the early achievement of the following objectives:

(a) The creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;

(b) The liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries; and

(c) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade.

Our company also notes that the right to import motor vehicles and original equipment parts into Canada under the agreement is available to vehicle manufacturers in Canada who meet the conditions stipulated in the Motor Vehicles Tariff Order 1965. These conditions are, in brief, that vehicle manufacturers shall maintain in each model year their production of motor vehicles in Canada in the same ratio to sales of motor vehicles for consumption in Canada and the same dollar value of Canadian value added in the production of motor vehicles in Canada, as in the period August 1, 1963 to July 31, 1964.

We understand that --

(i) in ascertaining whether Ford qualifies as a motor vehicle manufacturer and whether the requirements of paragraphs 1 and 2, below, are satisfied, production of automotive vehicles in Canada by Ford Motor Co. of Canada, Ltd., and by any person designated as associated with Ford Motor Co. of Canada, Ltd. ("an associated person") will be taken into account, whether sold in Canada or exported;

(ii) in determining whether the requirements of paragraphs 1 and 2, below, are satisfied, export sales of original equipment parts by Ford Motor Co. of Canada, Ltd., and by any associated person in Canada (as well as production of automotive vehicles in Canada by Ford Motor Co. of Canada, Ltd., and by any associated person, whether sold in Canada or exported), and purchases of original equipment parts by any affiliated Ford company outside of Canada from Canadian vendors, will be taken into account. An "affiliated Ford company" is one that controls, or is controlled by, or is under common control with, Ford Motor Co. of Canada, Ltd.

(iii) for the purpose of computing the ratios referred to in paragraph 2(1) (e) (ii) (A) of the order in council of the definition of manufacturer, the numerators of the fractions will consist of the net sales value of all passenger automobiles (or specified commercial vehicles or buses) produced by the motor vehicle manufacturer in Canada, including those sold in Canada and those sold in export, and the

denominators of the fractions will consist of the net sales value of all passenger automobiles (or of specified commercial vehicles or buses) sold by the motor vehicle manufacturer for consumption in Canada, including imported passenger cars (or specified commercial vehicles or buses) but excluding passenger cars (or specified commercial vehicles or buses) that are produced by the motor vehicle manufacturer in Canada and sold in export.

The undertakings in this letter are based on the definition of "Canadian value added" in your present regulations.

We understand that in the computation of Canadian value added for vehicle assembly in Canada, section 2(a) (i) of the regulations would prevent us from including the cost of parts produced in Canada that are exported from Canada and subsequently imported into Canada as components of original equipment parts; this provision reduced the incentive to source in Canada parts that would be incorporated in U.S. engines and other original equipment parts. Accordingly, we request that you give careful consideration to the revision of this clause.

In addition to meeting these stipulated conditions and in order to contribute to meeting the objectives of the agreement, Ford Motor Co. of Canada, Ltd., undertakes:

1. To increase in each model year over the preceding model year Canadian value added in the production of vehicles and original equipment parts by an amount equal to 60 per cent of the growth in the market for automobiles sold by our company for consumption in Canada and by an amount equal to 50 per cent of the growth in the market for the commercial vehicles specified in tariff item 950 sold by our company for consumption in Canada, it being understood that in the event of a decline in the market a decrease in Canadian value added based on the above percentages is acceptable. For this purpose, growth or decline in the market shall be measured as the difference between the cost to our company of vehicles sold in Canada during the current model year and the cost to our company of vehicles sold in Canada during the preceding model year net of Federal sales taxes in both cases.

We understand that in the event that the total passenger car and/or total truck sales of our company in any model year fall below the total passenger car and/or total truck sales of our company during the base period, Canadian value added requirements would be reduced below the base period amounts for the purpose of this section, and for the conditions stipulated in the Motor Vehicles Tariff Order 1965.

We believe that the definition of growth is unfair because it includes as growth the difference between the cost of vehicles produced in Canada and the cost to us of identical imported vehicles. In the event that we rationalize our vehicle production in Canada so as to concentrate our production in Canada on high volume models for the North American market with other models being imported, the difference in cost as defined above would result in a substantial growth even though there was no change in the number and models of vehicles sold in Canada. We request your careful consideration of a change in the definition that would eliminate this inequity. This inequity is compounded by the fact



that Ford Motor Co. of Canada, Ltd., is compelled by the Canadian antidumping law to import vehicles at dealer price, and we request that your Government also give careful consideration to a change in the antidumping law in respect of vehicles imported under the Motor Vehicles Tariff Order 1965.

2. To increase Canadian value added over and above the amount that we achieved in the period August 1, 1963, to July 31, 1964, and that which we undertake to achieve in (1) above, by an amount of \$74.2 million during the period August 1, 1967, to July 31, 1968.

The undertakings given in this letter are to be adjusted to the extent necessary for conditions not under the control of the Ford Motor Co. of Canada, Ltd., or of any affiliated Ford company, such as acts of God, fire, earthquake, strikes at any plant owned by Ford or by any of our suppliers, and war.

The Ford Motor Co. of Canada, Ltd., also agrees to report to the Minister of Industry, every 3 months beginning April 1, 1965, such information as the Minister of Industry requires pertaining to progress achieved by our company, as well as plans to fulfill our obligations under this letter. In addition, Ford Motor Co. of Canada, Ltd., understands that the Government will conduct an audit each year with respect to the matters described in this letter.

We understand that before the end of model year 1968 we will need to discuss together the prospects for the Canadian automotive industry and our company's program.

Yours sincerely,

Ford Motor Co. of Canada, Ltd.  
By K. E. Scott, President

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Ford Motor Co. of Canada, Ltd.,  
Oakville, Ontario, January 14, 1965.

Dear Mr. Minister: I wish to bring to your attention a matter of major importance to the Ford Motor Co., which will affect the ability of the company to participate under the Motor Vehicle Tariff Order 1965.

You will recall that our company and its parent, Ford Motor Co., have made commitments to spend in excess of \$50 million to increase production of a limited range of automotive engines in Canada for use in our Canadian plants and for export to the United States. This plan provides for greatly expanded production of engines in Canada, thus making possible substantial cost savings. The production of certain engines now produced in short high-cost runs will be discontinued in Canada but will be imported as required.

As a result of this plan, the contribution of engines to our Canadian value added in the production of motor vehicles in Canada in the 1966 model year and subsequent years, will be substantially reduced below the amount contributed by engines in the 1964 model year. The total Canadian value added of our engine operations for domestic use and for export will, however, be increased substantially over our actual value added of engine production

in the 1964 model year. For the purpose of the definition of a motor vehicle manufacturer, however, our value added in Canada in the production of motor vehicles in Canada in the base year may experience a short fall of approximately \$22 million. Regardless of this possibility, our total Canadian value added will be maintained at the level of our basic undertaking set forth in paragraph 2 of our letter of January 14, 1965.

Should the total Canadian value added in Ford's vehicle assembly in Canada in any model year fall below the level prevailing in model year 1964, Ford undertakes to purchase an additional amount over the amount purchased in the base year of automotive components from Canadian vendors who are not affiliated with a vehicle manufacturer, which is equal to the short fall in Canadian value added below the level achieved in model year 1964.

This undertaking is conditional upon the Ford Motor Co. of Canada, Ltd., being accorded the same tariff treatment it would receive as if it qualified under the Motor Vehicle Tariff Order 1965.

Yours sincerely,

Ford Motor Co. of Canada, Ltd.,  
By Karl E. Scott, President

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Chrysler Canada, Ltd.,  
January 13, 1965.

Hon. C. M. Drury,  
Minister of Industry,  
Ottawa, Canada.

Dear Mr. Minister: I am writing with respect to the agreement between the Governments of Canada and the United States concerning production and trade in automotive products.

Chrysler Canada, Ltd., welcomes the agreement and supports its objectives. In this regard, our company notes that the Governments of Canada and the United States have agreed "\*\*\*\*that any expansion of trade can best be achieved through the reduction or elimination of tariff and all other barriers to trade operating to impede or distort the full and efficient development of each country's trade and industrial potential \*\*\*." In addition, we note that the Governments of Canada and the United States shall seek the early achievement of the following objectives:

- (a) The creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;
- (b) The liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries; and
- (c) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade.

Our company also notes that the right to import motor vehicles and original equipment parts into Canada under the agreement is available to vehicle manufacturers in Canada who meet the conditions stipulated in the Motor Vehicles Tariff Order 1965.

These conditions are, in brief, that vehicle manufacturers shall maintain in each model year their domestic production of motor vehicles in the same ratio to their domestic sales of motor vehicles and the same dollar value of Canadian value added in the production of motor vehicles in Canada, as in the period August 1, 1963, to July 31, 1964.

In addition to meeting these stipulated conditions and in order to contribute to meeting the objectives of the agreement, Chrysler Canada, Ltd., undertakes --

1. To increase in each model year over the preceding model year, the dollar value of Canadian value added in the production of vehicles and original equipment parts by an amount equal to 60 per cent of the growth in the market for automobiles sold by our company for consumption in Canada and by an amount equal to 50 per cent of the growth in the market for the commercial vehicles specified in tariff item 950 sold by our company for consumption in Canada, it being understood that in the event of a decline in the market a decrease in such dollar value of Canadian value added in the above percentages is acceptable. For this purpose, growth or decline in the market shall be measured as the difference between the cost to our company of vehicles sold in Canada during the current model year and the cost to our company of vehicles sold in Canada during the preceding model year net of Federal sales taxes in both cases, and

2. to increase the dollar value of Canadian value added in the production of vehicles and original equipment parts over and above the amount that we achieved in the period August 1, 1963, to July 31, 1964, and that which we undertake to achieve in (1) above, by an amount of \$33 million during the period August 1, 1967, to July 31, 1968.

Chrysler Canada, Ltd., also agrees to report to the Minister of Industry, every 3 months beginning April 1, 1965, such information as the Minister of Industry requires pertaining to progress achieved by our company, as well as plans to fulfill our obligations under this letter. In addition, Chrysler Canada, Ltd., understands that the Government will conduct an audit each year with respect to the matters described in this letter.

I understand that before the end of model year 1968 we will need to discuss together the prospects for the Canadian automotive industry and our company's program.

Yours sincerely,

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Pro Forma Letter Respecting Company Commitments

January 14, 1965.



Hon. C. M. Drury,  
Minister of Industry,  
Parliament Building,  
Ottawa, Canada.

Dear Mr. Minister: I am writing with respect to the agreement between the Governments of Canada and the United States concerning production and trade in automotive products.

The American Motors (Canada), Ltd., welcomes the agreement and supports its objectives. In this regard, our company notes that the Governments of Canada and the United States have agreed "\*\*\* that any expansion of trade can best be achieved through the reduction or elimination of tariff and all other barriers to trade operating to impede or distort the full and efficient development of each country's trade and industrial potential \*\*". In addition, we note that the Governments of Canada and the United States shall seek the early achievement of the following objectives:

(a) The creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;

(b) The liberalization of United States and Canadian automotive trade in respect to tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries: and

(c) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade.

Our company also notes that the right to import motor vehicles and original equipment parts into Canada under the agreement is available to vehicle manufacturers in Canada who meet the conditions stipulated in the Motor Vehicles Tariff Order 1965. These conditions are, in brief, that vehicle manufacturers shall maintain in each model year their domestic production of motor vehicles in the same ratio to sales of motor vehicles and the same dollar value of Canadian value added in the production of motor vehicles in Canada, as in the period August 1, 1963, to July 31, 1964.

In addition to meeting these stipulated conditions and in order to contribute to meeting the objectives of the agreement, the American Motors (Canada) Ltd., undertakes:

1. To increase in each model year over the preceding model year, Canadian value added in the production of vehicles and original equipment parts by an amount equal to 60 per cent of the growth in the market for automobiles specified in tariff item 950 sold by our company for consumption in Canada, it being understood that in the event of a decline in the market a decrease in Canadian value added in the above percentages is acceptable. For this purpose, growth or decline in the market shall be measured as the difference between the cost to our company of vehicles sold in Canada during the current model year and the cost to our company of vehicles sold in Canada during the preceding model year net of Federal sales taxes in both cases; and
2. To increase Canadian value added over and above the amount that we achieved in the period August 1, 1963, to July 31, 1964, and that which

we undertake to achieve in (1) above, by an amount of \$11,200,000 during the period August 1, 1967, to July 31, 1968.

The American Motors (Canada), Ltd., also agrees to report to the Minister of Industry, every 3 months beginning April 1, 1965, such information as the Minister of Industry requires pertaining to progress achieved by our company, as well as to fulfill our obligations under this letter. In addition, the American Motors (Canada), Ltd., understands that the Government will conduct an audit each year with respect to the matters described in this letter.

I understand that before the end of model year 1968 we will need to discuss together the prospects for the Canadian automotive industry and our company's program.

Yours sincerely,

Earl K. Brownridge,  
President, American Motors  
(Canada), Ltd.



Summary of Excerpts from Schedule "A" of Canadian  
Customs Tariff Pertaining to Tariff Items 438a thru 438f

- 438a This item establishes the rate on motor vehicles: free under the British Preferential Tariff, 17 1/2 per cent under the Most-Favoured-Nation Tariff.
- 438b This item covers a list of products generally used by the parts industry in the manufacture of motor vehicle parts. These products are free of duty if of a class or kind not made in Canada, and they are subject to a 17 1/2 per cent rate of duty under the Most-Favoured-Nation Tariff if of a class or kind made in Canada. In either case, they are free under the British Preferential Tariff.
- 438c This item covers a long list of parts generally used by the automobile manufacturers. For this item, the double condition must be met if entry is to be duty-free; the part must be of a class or kind not made in Canada and a content requirement must be met: 40 per cent of the factory cost of passenger automobiles if production is less than 10,000 units, 50 per cent if the production is more than 10,000 units but does not exceed 20,000, and 60 per cent if production exceeds 20,000 units. If these conditions are not met, these parts are subject to the 17 1/2 per cent rate of the Most-Favoured-Nation Tariff. Again, parts are free of duty under the British Preferential Tariff.
- 438d This item covers a list of parts used in the manufacture of commercial vehicles. Again the double condition must be met in order to qualify for duty-free entry under the Most-Favoured-Nation Tariff but the Commonwealth content requirement is 40 per cent, whatever the scale of production. Parts are duty-free under the British Preferential Tariff.
- 438f This item covers all the parts not specifically provided for under the above items. The rates are free under the British Preferential Tariff and 25 per cent under the Most-Favoured-Nation Tariff.

## APPENDIX B

STATISTICAL MODELLING IN THE U.S.-CANADIAN AUTOMOTIVE INDUSTRY

## APPENDIX B

Statistical Modelling in the U.S.-Canadian Automotive Industry

Use of statistical modelling for this study was carefully considered and researched and contact was made with experts on U.S./Canadian trade. A summary follows:

1. Charles R. Weaver, Director of Transportation Equipment Programs, U.S. Department of Commerce.  
Mr. Weaver was a principal consultant in the preliminary evaluations of the proposed Automotive Agreement prior to 1965 and presently heads the division responsible for the continued evaluations and logistics of the 1965 Agreement.

In a conversation on February 27, 1978, Mr. Weaver queried "how management's decision to invest large sums of money in auto facilities can be considered in any statistical model." He further described the Agreement as being based more on political than economic considerations.

2. Rolfe Nordlie, Assistant Director of Transportation Equipment, U.S. Department of Commerce.  
Mr. Nordlie's specific assignment is as operations director of the Auto Agreement.

In an interview on May 24, 1978, Mr. Nordlie stated that there "... are too many variables to account for..., and the inputs are not substantially precise to use in an econometric model." In his capacity, Mr. Nordlie has access to unlimited statistical and economic capability and resources.

3. Carl Beigie, President of the National Planning Association, as a private organization comprised of business, government and academic leaders working for the Canadian and United States government. Mr. Beigie has researched extensively on the Auto Agreement.

In a conversation on February 28, 1978, Mr. Beigie viewed attempts at modelling as being inappropriate as he sees the Agreement largely as "... a political animal."

4. Dr. Paul Wonnacott, Department of Economics, University of Maryland.

Dr. Wonnacott individually and with his brother, Dr. Ronald Wonnacott, has extensively researched the topic of free trade between the United States and Canada.

Dr. Wonnacott reviewed the preliminary proposal for this study and his insights are included in the final proposal. He views modelling as ineffective in the evaluation of the Agreement for the similar reasons as did Mr. Beigie. In fact, it was Dr. Wonnacott who referred me to Mr. Beigie at the National Planning Association.

5. Dr. Donald Daly, an economic theorist and statistician currently Professor of Economics at York University, Toronto, Canada, reviewed the research proposal and made several suggestions, including further explanations of tariffs and their effects which he has not seen researched at all to date. His ideas and suggestions have been included in the study. He discouraged any attempts to introduce modelling in the research design.

After having reviewed the literature to date on international trade in free trade areas, classical and neo-classical theories of international economics and heard insights from industry and academic experts, I reluctantly conclude that model building would add little to an understanding and effective evaluation of the United States and Canadian automobile industry. Evaluation of the effectiveness of the Agreement will be based largely on comparisons between the non-free trade manufacturing industries and the free trade automobile industry.





