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Evaluating free trade how the experts assess the deal.

Peter Morici

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The Institute for U.S.-Canada Business Studies

Links with Canada constitute our nation's single most important economic and financial relationship. Moreover, as U.S.-Canada relations enter a new phase, the business communities of both countries face an increased need to understand the wide range of trade, investment and financial ties which link the two economies.

The Institute for U.S.-Canada Business Studies was created to facilitate access to resources -- human and documentary -- to enhance knowledge and understanding of this critical relationship. Our particular, though not exclusive, emphasis is on designing and providing materials and services for business school programs.

Such materials and services include course modules, brief case studies using U.S.-Canada examples to illustrate generic business transactions, consultations with faculty to integrate U.S.-Canada examples into course content, availability of Institute staff as guest lecturers, and assistance to students working on Canada-related projects. New materials are constantly evolving as new contacts are made, custom-tailored services are made generic, and collaboration with students generates new case studies. **- Stephen Blank, Director**

Evaluating Free Trade

How the Experts Assess the Deal

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About the Module

Canada and the United States, which together preside over the largest bilateral trading relationship in the world, have negotiated a free trade agreement. The agreement, while not particularly controversial in the United States, triggered one of the most controversial campaigns in Canadian history. For, while most economists foresaw substantial material benefits flowing to Canada, a great many Canadians feared that closer relations with the United States would overwhelm Canadian culture and institutions.

This set of readings allows students to assess the agreement. The selections will be of particular interest to students in a first year international business course, a course in international relations or trade policy.

Some questions students might consider: Were the negotiations successful? Did the resulting deal fulfill its initial promise? What fresh opportunities does the FTA create? Does it create any country-specific advantages for Canada or for the U.S.? The readings will allow students to come to conclusions about these questions.

The first reading, "The Canada-U.S. Free Trade Agreement: Origins, Contents and Prospects," by Peter Morici, provides a comprehensive assessment of the deal including a comparison of results and negotiating objectives.

The next reading, "U.S. Trade Pact a Two-Edged Sword," *Financial Times*, surveys Canadian hopes and fears.

The boxes on security of access to U.S. markets and "Concerns of [Canada's] Cultural Community," focus on specific provisions of the FTA. A more detailed assessment of the impact on Canadian industry, produced by Canada's Trade Negotiator's Office, follows. Finally, an assessment

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The Institute for U.S.-Canada Business Studies

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Prof. Stephen Blank Director | **Guy Stanley** Director, Publications | **Peter Morici** Senior Fellow | **Susan Sorrell** Program Manager

About the Module, cont'd..

opposing the deal is included. This selection, the introduction from *The Free Trade Deal,* Duncan Cameron, ed., (James Lorimer & Company, 1988) provides an overview of the best arguments against the deal, from a Canadian perspective. This last selection raises some themes and questions that were popular a decade ago - the costs and benefits of foreign investment, the impact on domestic policy of increasing interdependence, the effects of international competition on domestic social programs - in short, the impact of high levels of trade on "sovereignty." Especially noteworthy is the article's criticism of "bilateralism" as opposed to a strategy of "multilateralism" for liberalizing international trade. Should the U.S. and Canada have pursued these gains through the GATT? How successful would that likely have been?

Other questions students might consider: what are the opportunities created by the agreement? Is there any longer a good reason to locate in Canada? Can students suggest three industries specifically advantaged under the deal? What about the energy provisions - are they understood?

Finally, students might like to consider what steps the new Canadian government would have to take in order to deliver some quick success under the FTA in order to weaken lingering opposition to the deal.

Teaching the Canada-U.S. Trade Agreement

Not often does an instructor in a subject have presented an actual event that illustrates most of the salient points to be covered in a one semester course and which can be studied in detail. For instructors in international business, trade policy, negotiation and business strategy, the trade agreement that comes into effect this year between Canada and the United States is such an event.

The Institute for U.S. - Canada Business Studies, Pace University, is able to make available topical readings on all aspects of the FTA for classroom use. Using this material can help instructors ground the insights of trade theorists and text books of international business in the reality of the institutional framework that is now in place to shape the largest bilateral trading relationship in the world.

What follows is intended to suggest just some of the ways this material might be of use. Backing up this discussion is a selection of readings and notes on the FTA, on Canada's strategic options, on the FTA negotiating process, on evaluating the FTA and on the dispute resolving mechanism.

Canada's Strategic Options

To start with, there is the question why a country lagging in productivity and yet with an affluent living standard should choose a free trade strategy. True, economists generally counsel such a course of action. But that in no way guarantees such advice will be taken. Yet it appears that Canada - far more than the United States, despite its rhetoric - actually chose such a course.

Related to that is a strategic issue: what other strategic choice did Canada have to guarantee access to a so-called "triad" power?

On the U.S. side, there are other compelling strategic choices. Why pursue a trade liberalizing agreement bilaterally? What, if any, are the advantages of a "two-track" process of concluding a bilateral deal while pursuing trade liberalization in the GATT? What about the danger of encouraging the development of exclusive trade blocs?

Evaluating Free Trade

From the company perspective, there are some other issues: given the volume of bilateral trade, most of which is duty free already, what difference will this deal actually make? Will it alter Canada's role in the provision of goods and services for the North American or even the global market?

What are some of the risks as well as the benefits? For instance, what degree of "ensured access" to the U.S. market would be required to offset the advantages of locating in the United States and shipping to Canada?

The foreign exchange risk - as international investment moves the C$ upward - is something else to consider. Will this affect the competitiveness of Canadian plant? Indeed, can students

Continued overleaf...

explain why conclusion of the FTA would move the C$ upwards?

Having examined how a country like Canada readies itself for undertaking this course of action, students can move on to examine the negotiating process itself.

Negotiating Free Trade

Canada and the U.S. followed very different strategies. In fact the differences in approach were so great that the professional negotiators failed to secure the agreeement - they had to be rescued by the political side of the respective governments. Understanding how these divergences arose, why differences were so hard to reconcile and, finally, how a deal came to be concluded anyway, provides a detailed picture of what managing large scale negotiations involves.

Ratification of the FTA was not especially controversial in the United States. But in Canada the agreement was the focus of the most emotional and divisive election campaign in generations. Why? What was the impact of the deal that sparked such anxiety on the part of opponents and proponents alike?

Dispute Settlement

One of the most intriguing outcomes in the FTA is the development of a new, bilateral institution, the dispute resolving mechanism. Opinion is divided about this application of binational "judicial review". But the principle - that major trading partners have a voice in the case by case application of each other's trade law - is pathbreaking. A precondition for learning how this mechanism works is an understanding of the structure of trade law in the GATT and its implementation in the U.S., especially.

Finally, there are the big questions: the FTA and its effect on trade relations with the Japanese, on the management of the U.S. merchandise trade deficit, and the implications of a federal spending deficit as well.

There is also the question of the development of trading blocs in the "triad" regions of North America, Europe and Asia-Pacific. How will FTA likely affect these developments and what should companies do to take advantage of the trends.

The Canada-U.S. Free Trade Agreement: Origin, Contents, Prospects

This selection, by Peter Morici, is from *Economic Aspects of Regional Trading Arrangements*, New York University Press, (1989) New York. Reprinted with permission.

Discussion Note

This reading summarizes the history of Canada's trade policy, including the earlier attempts at negotiating free trade, then summarizes the main points of the FTA and makes clear that its successful implementation will depend on political will in both countries.

Key Questions

Mr. Morici's article sets out the key questions "always close at hand" in any consideration of Canada-U.S. relations:

- How much should market forces be permitted to determine patterns of trade, ownership and specialization?
- How much should governments intervene in the process?
- How do costs and benefits compare for Canadian measures designed to reinforce national institutions?
- What costs are there for Canadian cultural and political sovereignty in closer ties with the U.S.?

Canada's Trade Policy

Particularly interesting is Morici's discussion of the trade policies of the Trudeau years (in essence the decade of the 1970s). A period of economic nationalism, the Trudeau years saw Canada pursue an ambivalent policy of trade liberalization abroad and protectionism at home--by pursuing tariff reduction in multilateral trade talks and, at the same time, pursuing a national industrial policy by means of non-tariff barriers. These included screening foreign direct investment through the Foreign Investment Review Agency (FIRA), the urging of performance requirements-including local sourcing requirements--on the multinational sector and concluding with a National Energy Program (in 1980) that

sought to isolate Canada from world economic pressures on oil supply.

These were accompanied by cautious attempts at expanding trade with the U.S. through "sector by sector" agreements, an approach which came to nothing.

Then in less than four years Canada turned its back on its previous ambivalence about markets and trade liberalization and has now put together a path-breaking trade liberalizing agreement with its largest trading partner. What explains this turn-around?

U.S. Trade Policy

Throughout the same period, there is also U.S. trade policy to consider. Of particular concern to Canadians were the changes in application of trade remedy laws as offshore imports began to surge into the United States, transforming its traditional merchandise trade surplus into a chronic deficit.

How realistic were Canadian fears that U.S. protectionism could exclude them from their main export market? How successful will the FTA be in enhancing access to the U.S. market?

The Canada-U.S. FTA as a Prototype

Finally, there is the question of the usefulness of the FTA as a prototype agreement: good as it is, it failed to make progress in some noteworthy ways, such as government procurement, transportation and,perhaps most seriously, a common approach to subsidies. Do the limitations on Canada-U.S. progress suggest the existence of absolute barriers to trade liberalization that neither bilateral nor multilateral talks can resolve?

Mr. Morici's article enables us to begin to formulate informed answers to these questions.

THE CANADA-U.S. FREE TRADE AGREEMENT: ORIGINS, CONTENTS AND PROSPECTS

By Peter Morici

INTRODUCTION 1/

The idea of a U.S.-Canadian free trade area has a long history. Since 1846, when Great Britain abandoned Imperial Preferences for its colonies in favor of universal free trade, Canadians have been attracted to the idea of free access to the U.S. market. From 1854 to 1866, under the provisions of the Reciprocal Free Trade Agreement, Canada enjoyed limited duty-free access — the agreement covered mostly resource products and only a few manufactures.2/

Since that time, there have been several attempts to revive the concept, including a sweeping agreement proposed in 1911. Approved by the Congress, the agreement was stillborn in Canada as the Conservatives defeated the Liberals in part on the slogan of 'No Truck nor Trade with the Yanks.' The next major initiative did not come until after World War II. During 1946 and 1947, Canada encountered serious balance of payments problems, compelling it to borrow from the U.S. Export- Import Bank and in commercial capital markets. One long-term solution considered was a bilateral free trade arrangement that would encourage Canadian patterns of economic development along lines complementary to that of the United States. Secret negotiations followed, and the concept of a free trade area emerged in 1948 as the likely outcome. However, as Canada's balance of payments problems abated with its participation in Marshall Plan procurement, Prime Minister Mackenzie King developed second thoughts about establishing such close ties with the United States. Subsequently, both countries turned their attention to the newly established GATT, where they became strong partners working for a liberal multilateral system.

The only major bilateral initiative prior to the recently completed negotiations was the 1965 Automotive Agreement, which, as discussed below, established managed duty-free trade in new vehicles and original equipment parts. Nevertheless, during the 1960s and 1970s, the concept of a comprehensive free trade arrangement continued to be discussed. The endurance of this subject among Canadians reflects the attraction of preferential free access to the large U.S. market as a means for achieving greater economies of scale and improving productivity in Canadian industry. Yet, Canadians approach their commercial relationship with the United States cautiously, reflecting their strong concerns about the pervasive influence of U.S. investment, culture and politics on the Canadian economy and identity. Indeed, the free trade issue has been part of a broader debate in Canada about how Canadians can maximize their benefits from the most extensive bilateral trade and investment relationship in the world through trade and industrial policies, diplomacy and negotiations. Always close at hand are these key questions: How much should market forces be permitted to determine patterns of trade, ownership and specialization between the United States and Canada? How much should federal and provincial governments intervene in market processes? What costs do Canadians bear for measures that seek to reinforce separate or distinctive Canadian economic and

cultural institutions? How do the benefits and costs compare? What costs in terms of Canadian cultural and political sovereignty would be imposed by closer commercial ties with the United States? The decision to negotiate a comprehensive bilateral agreement encompassing tariff and nontariff barriers to trade in goods and services, as well as important aspects of foreign investment policy, was an historic step for Canada.

For the United States it was a bold step too. The basic thrust of U.S. post-war foreign economic policy has been multilateralism. Admittedly, new competitive realities and the limitations of the GATT system have impelled the United States to increasingly pursue bilateral solutions to trade and investment issues. The means have included orderly marketing agreements and voluntary restraint agreements to limit imports in trade-sensitive mature industries, a series of bilateral investment treaties, and efforts to negotiate improved access to the Japanese market in products ranging from automobile parts to semiconductors to construction engineering services. The United States entered into a more limited free trade agreement with Israel in 1985. However, a comprehensive agreement covering goods, services and investment with its largest trading partner considerably extends the scope of present and prospective U.S. involvement in bilateral arrangements.

The purposes of this paper are: to examine both countries' motivations for seeking an agreement and their negotiating goals; to describe the contents of the agreement; and to evaluate how effectively the FTA address U.S. and Canadian objectives.

> ***"How much should market forces be permitted to determine patterns of trade, ownership and specialization between the United States and Canada?"***

CANADIAN AND U.S. MOTIVATION AND GOALS

Canadian Objectives

Several factors have governed the evolution of U.S.-Canadian commercial relations. First, Canadian natural resources, being located further from principal North American markets and in more hostile climates, were generally developed after U.S. resources. This, coupled with Canada's less extensive domestic market, encouraged Canadian specialization in resource-based products for export. Second, many natural resource industries are particularly capital-intensive, and their development in Canada required substantial foreign investments. Third, for 100 years starting in 1879, Canada maintained high tariffs. This limited U.S. exports, and many U.S. manufacturers jumped the tariff wall to establish branch plants in Canada to service customers there. While U.S.-Canadian trade has generally reflected underlying patterns of comparative advantage, bilateral trade and specialization have been reduced to some degree by the tariff. Capital flows have substituted for trade flows but at a price. As of 1970, Canadian manufacturing productivity stood at about 70 percent of U.S. levels.3/ The significance of the free trade agreement for Canada is best appreciated in the context of post-war Canadian trade, investment and industrial policy. Following the termination of the 1947-48 negotiations, Canadian foreign economic policy embarked on a period of what might be characterized as easygoing internationalism. During the 1950s, Canada and the United States worked together to encourage the multilateral liberalization of trade and capital flows through the GATT, IMF and World Bank. Canada was open to — indeed welcomed — foreign investment, and Canada had a minimum of institutions to encourage or regulate industrial development. From 1951 to 1972, the U.S. share of Canadian exports grew from 59 percent to 69 percent; by 1970, foreign ownership of Canadian mining and manufacturing stood at 59 and 53 percent, respectively, with about three-fourths in U.S. hands.

Starting in the late 1950s and early 1960s, though, several internal and external trends precipitated a reevaluation of Canada's basic approaches to trade and industrial policy and, importantly, of its relationship with the United States. Among these developments three warrant mentioning here.

First, the emergence of the European Community (EC) and the European Free Trade Association left Canada as one of the few advanced industrialized economies (AICs) without tariff- free access to a market

of 100 million people. It became apparent that Canadian industry would benefit from rationalization and greater economies of scale if free access to a broader market could be obtained. The consequences of establishing a free trade area with the United States attracted interest, as evidenced by the publication of several important academic studies,4/ and the discussion of bilateral free trade among private sector leaders.5/

Second, the liberalization of trade and capital flows helped create a favorable environment for the growth of multinational corporations. MNCs became important vehicles for expanding trade and disseminating capital and technology. Some in Canada perceived MNCs, especially U.S.-based companies, as exerting considerable influence over the location and structure of production and employment, and over the character and content of trade. Whether high levels of foreign ownership best served Canada's national interest emerged as a critical public policy question.6/

"Some in Canada perceived MNCs, especially U.S.--based companies, as exerting considerable influence over the location and structure of production and employment and over the character and content of trade."

Third, Canadians were becoming increasingly concerned that economic integration with the United States was fostering cultural and social integration in which U.S. institutions would dominate. In discussing expanding commercial ties, the 1970 Canadian White Paper on foreign policy stated: "while such developments should be beneficial for Canada's economic growth, the constant danger that sovereignty, independence and cultural identity may be impaired will require a conscious effort on Canada's part to keep the whole situation under control".7/

In retrospect, the policies that ultimately emerged during the Trudeau years (1968-1984) became apparent during the early and mid-1960s. Canadians grappled with approaches that might be taken to encourage foreign MNCs to operate in ways consistent with Canada's industrial development aspirations, and the federal government spawned a number of industrial and regional development programs. In particular, Canadian policies toward the automobile industry became an important precursor of future policy directions.

During the 1950s and early 1960s, the North American automobile industry underwent consolidation. The scope for economies of scale greatly widened, and only four major North American automakers survived. The potential for making cars in Canada for the Canadian market behind a 17.5 percent tariff became quite limited and increasingly uncompetitive. Duty-free trade with the United States, permitting rationalization of the four major automakers' Canadian operations, emerged as the only viable option. In negotiating duty-free trade, Canadians were concerned that the industry would flee to the United States, supplying the Canadian market from more efficient plants there, even though Canadian locations might prove more cost effective in the long run. Consequently, in the body of the Agreement and in side letters with the major manufacturers, Canada sought and obtained production safeguards. Essentially, in exchange for duty-free access to the Canadian market, the major manufacturers agree to achieve value added in Canada equal to 60 percent of their sales there and to assemble approximately one vehicle in Canada for each vehicle sold there.8/ The United States admitted duty-free all Canadian made cars and original equipment parts (excluding tires) with at least 50 percent U.S. and/or Canadian content, while Canada afforded duty-free entry only to the products of North American manufacturers meeting its strict production and investment goals. However, Canada, unlike the United States, also permitted the qualifying automakers to import cars and parts duty-free from Asia, Europe and Latin America. When the agreement was signed, the U.S. negotiators understood that these safeguards were to be temporary, but they have become permanent.

The Automotive Agreement is contrary to the most-favored- nation requirements of the GATT. The United States requested and received a GATT waiver. Canada did not seek one; instead, it offered the benefits of the agreement to offshore producers that would meet the safeguards. Volvo and a number of truck and specialty vehicle manufacturers have qualified but, importantly, the Japanese, Korean and other European suppliers of passenger cars in North America never did. Consequently, Asian firms producing in the United States, such as Honda, do not qualify for duty-free access to Canada or their American made cars unless they choose to participate in Canada's duty remission program (discussed below).

This approach proved to be a precursor of future Canadian policies in the sense that Canada sought efficiencies that could be gained through the reduction of tariffs (in this case to zero), while at the same time seeking to manage the patterns of trade and specializa-

tion that would follow. In this case, the industrial policy tool was performance requirements for foreign companies seeking duty-free market access.9/

Indeed, Canadian policy may be characterized as having moved on two tracks during the Trudeau years. First, throughout the postwar era, Canada has recognized the benefits of market entry it received through the GATT. Through the first five rounds, it participated fully in item-by-item negotiated tariff cuts. However, Canada did not view the across-the-board tariff reductions agreed to in the Kennedy Round as serving its interests and did not fully participate in these cuts. When tariff cuts were completed in 1972, Canada still had much higher tariffs than the other AICs, and these permitted many Canadian industries to remain much less productive than their American counterparts. Under Prime Minister Trudeau, Canada agreed to full participation in the Tokyo Round across-the-board tariff reductions. Implemented from 1980 to 1987, these reductions are imposing much new competition on Canadian industry and encouraging significant industrial restructuring. Second, Trudeau sought to lessen Canada's dependence on the United States, the so-called Third Option, and to manage the structure of industrial development through an aggressive industrial policy. Among the goals of this policy were: increased processing in Canada of natural resources and more secondary manufacturing; rationalization of manufacturing to improve its international competitiveness; greater Canadian participation in R&D and high technology industries; increased Canadian ownership and control over the means of production; and better balance in employment opportunities and growth among Canada's regions. The tools of this industrial policy included extensive financial incentives to promote industrial adjustment, regional development, and technology-intensive activities; performance requirements for foreign investors, enforced through stringent monitoring and screening of new investments by the Foreign Investment Review Agency; the National Energy Program; aggressive federal and provincial procurement policies; duty remission programs to encourage Asian and European automakers to source or produce in Canada; and establishment of the quasi- public Canada Development Corporation (a holding company) to ensure adequate capital for high-technology activities. During the 1970s, Canadian optimism about these strategies was buoyed by strong markets for its energy and other resource-based exports. The October 1980 federal budget, introducing the National Energy Program, and the November 1981 federal budget included plans to use the rents from high energy prices to provide increased industrial, regional and R&D incentives. Similar policies were discussed for the minerals sector but never implemented. During the final Trudeau years, as the global economy became gripped in a major recession and the outlook for Canada's resource exports weakened, these policies were curtailed.

Despite these efforts, Canada's economic future continues to be linked to American prosperity and policies. U.S. ownership of Canadian enterprises has declined but remains high, and the U.S. share of Canadian trade has not fallen. More important, the industrial policies failed to appreciably improve Canadian competitiveness — in 1986, Canadian manufacturing productivity stood at 70 percent of U.S. productivity, the same as in 1970. Meanwhile, competitiveness problems in the United States gave impetus to protectionist sentiments there. U.S. actions in sectors important to Canada raised concerns among Canadians about their continued access to the U.S. market. They began to search for alternative approaches to economic policy, and the federal government undertook two important investigations — the Trade Policy Review and the Royal Commission on the Economic Union and Development Prospects for Canada (the Macdonald Royal Commission).10/ These reports ultimately established a new agenda for Canada's trade policy, centered around negotiating a free trade agreement with the United States.

> ***"Canada did not view the across-the-board tariff reductions agreed to in the Kennedy Round as serving its interests and did not fully participate in these cuts."***

The consensus that emerged among Canadian advocates of free trade was that Canada's global market opportunities in natural resources were no longer sufficient to generate rapid export-led growth, and consequently Canada would have to become more competitive in world markets in manufacturing. Further, with the Tokyo Round tariff cuts in place, Canada's tariffs are no longer sufficient to shield its manufacturing

from foreign competition, and foreign tariffs are no longer the major impediment to Canadian export success. The principal impediments to export- oriented investment and the restructuring of Canadian manufacturing are foreign nontariff barriers and the threat of new barriers emerging, particularly in the United States. With respect to the latter, the recent U.S. safeguard actions, such as in specialty and carbon steel, and countervailing duties, such as in lumber and fish products, galvanized a Canadian view that the threat of such U.S. contingent protection is a principal impediment to investment in Canadian manufacturing.

As such, Canada's objectives in the negotiations were fairly straightforward. Canada sought to enhance its access to the U.S. market through the elimination of tariffs and quotas and the liberalization of other nontariff barriers. With respect to the latter, specifically cited by the Canadian government were: discrimination in U.S. federal and state procurement; and standards, licensing, patents, and copyrights. Frequently mentioned was the Jones Act, which limits the transport of goods between U.S. ports to U.S. ships. Also, Canada sought to secure its access to the U.S. market by limiting the effects of U.S. trade remedy laws on Canadian exports. This included exemption of Canadian exports from U.S. safeguard measures aimed at third countries (for example, U.S. import actions for specialty and carbon steel) and a clearer, bilaterally agreed upon definition of what constitutes a countervailable subsidy. Further, Canada sought to enshrine Canadian market access through a strong agreement that would include a dispute settlement mechanism that provided for fair, expeditious and conclusive solutions to differences of view and practice. Finally, Canada was seeking to maintain Canadian independence of action in areas of national endeavor — most notably, to maintain its discretion to support cultural industries and to limit foreign investment in some sensitive sectors.

> ***"U.S. actions in sectors important to Canada raised concerns among Canadians about their continued access to the U.S. market."***

It also warrants mentioning that an FTA with the United States was seen by many of its proponents in the Canadian government and the private sector as a means for reducing government intervention in the domestic economy. For example, Canadian negotiators expected to accept significant disciplines on various forms of domestic subsidies as part of a bilateral regime for subsidies and countervailing duties, thus limiting the future role of such subventions. Also, it was hoped that FTA disciplines on nontariff barriers, such as product standards, resource policies and government procurement, would limit present and prospective barriers to commerce within Canada imposed by provincial governments.

United States

The United States had strong motivations of its own for entering into the negotiations. During the late 1960s and 1970s, as U.S. competitive performance waned in a succession of mature labor-intensive and capital-intensive industries — textiles, footwear, consumer electronics, steel, and compact cars — and the cost of imported oil rose dramatically, many policymakers and economists expected that the United States would be able to pay for increased imports by emphasizing its comparative advantages in agriculture, high-technology manufactures and services. In the 1980s, these expectations have been frustrated by the confluence of several sets of trends. Of immediate concern, large budget deficits, capital inflows and the surge in the dollar from 1981 to 1985 impeded the competitive performance of even the most export-oriented American industries. Taking a longer-term view, fundamental shifts in comparative advantages have permanently weakened U.S. export prospects in some sectors and portend difficulties, even after fiscal and current account imbalances are resolved. In agriculture, technology-driven improvements in productivity in India, Indonesia and other middle-income developing countries have reduced the demand for U.S. farm exports, as has a shift away from policies in many developing countries that encouraged industry and penalized agriculture. In knowledge-based manufacturing and services, much more rapid expansion of commercial R&D efforts in Japan and northern Europe and lagging U.S. performance in primary and secondary education have reduced, though not eliminated, U.S. comparative advantage. Although U.S. comparative advantages in these industries are still significant, they are no longer commanding; therefore, foreign practices that limit U.S. market opportunities abroad have attracted increasing attention in Congress and among U.S. trade negotiators. This trend has brought to the foreground the limitations of GATT treatment — or nontreatment — of agriculture, industrial development subsidies, intellectual property issues, government procurement, trade- related investment performance requirements, and services. All of these issues were put on the agenda for the Uruguay

Round at Punta del Este.

In the multilateral context, the negotiations with Canada were a useful opportunity for the United States in at least two ways. First, many American policymakers and trade analysts believed an effective negotiating process, and a resulting comprehensive agreement with Canada, could provide models for multilateral efforts in the GATT in several of the areas listed above. Second, a bilateral agreement with Canada provides a big lever in the multilateral process. It serves notice on the European Community, Japan and other trading partners that although the United States remains committed to the GATT process and multilateralism, the United States is prepared to pursue other avenues if the Uruguay Round does not deliver on areas of major concern to the United States.

Focusing on bilateral objectives, the negotiations offered the United States an opportunity to assure the permanency of the substantial gains achieved during the final years of the Trudeau government and under Prime Minister Mulroney. For example, Canada has significantly liberalized its rules with respect to inward foreign investment, and is indeed encouraging U.S. investment, except in the cultural industries and energy sector.

"...large budget deficits, capital inflows and the surge of the dollar from 1981 to 1985 impeded the competitive performance of even the most export-oriented American industries."

In the energy trade, Canada has greatly loosened restrictions on exports to the United States and even permits some U.S. investment in the energy sector. The United States was seeking assurances that Canada would not again impose performance requirements on foreign investment, and the negotiations provided the United States with an opportunity to seek access to Canadian energy and other resources on the same basis as Canadian customers.

The United States was seeking elimination of higher Canadian tariffs. On dutiable items these average 9 to 10 percent, while the comparable figures for U.S. duties were only 4 to 5 percent. Also, the United States was seeking to eliminate Canadian seasonal tariffs on fresh fruits and vegetables.

In the nontariff area, the United States was seeking to eliminate measures imposed at both the federal and provincial levels. Important among these were: discriminatory federal and provincial government procurement practices; discriminatory mark-up and listing practices in liquor and wine, as well as problems in obtaining access to local distribution systems for U.S. liquor, wine and beer; barriers to U.S. exports of poultry, eggs, dairy products and meats; and Canadian technical standards, such as those limiting U.S. access in certain agricultural products and plywood.

The United States was seeking controls on Canadian subsidies for regional and industrial development purposes. The general awareness in the Congress about the impact of subsidies offered by all U.S. trading partners has made them an increasingly important issue for U.S. negotiators. Also, the Canadian practice of offering Asian and European automakers remission of duties, in exchange for sourcing or producing in Canada for export, was seen in the United States as compromising the Automotive Agreement.

The United States was seeking to liberalize trade in business services. Particular areas of interest were trucking,information and computer services, insurance, professional services and advertising. In addition, the United States set as a high priority improved access in financial services, including commercial and investment banking and brokerage services.

Finally, the United States was hoping to resolve a number of bilateral issues, including better protection for U.S. pharmaceutical patents and copyright protection for U.S. broadcasters whose signals are retransmitted in Canada.

MAJOR CONTENTS OF THE CANADA-U.S. FREE TRADE AGREEMENT 11/

The Canada-U.S. Free Trade Agreement (FTA) is the most sweeping agreement establishing a free trade area under the GATT. It provides for at least some liberalization in all major sectors of the economy. Unlike other free trade agreements, it includes binding commitments on trade in services and comprehensive rules limiting the

regulation of direct investment.

Objectives and Scope

In the Preamble and Chapters 1 and 2 of the FTA, the two countries state their political commitment to establish a free trade area that builds on and is consistent with their mutual obligations under the GATT. Their objectives in entering into the agreement are to:

-Eliminate barriers to bilateral trade in goods and services and facilitate conditions of fair compet ition within the free trade area;

-Significantly liberalize conditions for bilateral investment flows;

-Establish effective procedures for the joint administration of the FTA and for the resolution of disputes;

-Lay the foundation for further bilateral and multilateral cooperation to expand and en hance the benefits of the agreement. The two countries agree to seek observance of the FTA by the states and provinces, unless otherwise stated in the agreement.

> ***"The Canada-U.S. Free Trade Agreement (FTA) is the most sweeping agreement establishing a free trade area under the GATT."***

Trade in Goods

General Provisions

Canada and the United States have agreed to afford each other's goods national treatment — GATT Article III is incorporated into the agreement.

Tariffs will be eliminated in three groups — immediately (January 1989), five year staging, and ten year staging. Import-sensitive sectors were generally accorded ten-year staging to conclude by January 1998; these include most agricultural and fish products, most wood products, textiles and apparel, footwear, steel, lead, zinc, rail cars, tires, consumer appliances, and precision instruments. Customs user fees are prohibited, and the United States agrees to phase out its fees in five years.

Rules of origin define whether goods incorporating components or materials from third countries qualify for duty- free treatment. Generally, materials and components must be incorporated into other goods or transformed in ways that are physically or commercially significant. In most cases, this requirement is met if the production process results in a change in tariff classification or if the process results in 50 percent U.S. and/or Canadian value added. This 50 percent rule is required for automotive products, and the agreement limits the amount of apparel made from offshore fabric that qualifies for duty-free treatment.

Import quotas are specifically prohibited unless grandfathered into the agreement or in accordance with each party's rights under the GATT — the latter exception is particularly important for import actions taken as part of domestic agricultural support programs. The agreement ends Canadian embargoes on used aircraft and used automobiles and U.S. embargoes on lottery materials; it prohibits the reimposition of U.S. restrictions on imports of Canadian unprocessed uranium and eliminates Canada's requirement that uranium be processed before it is exported.

Again, unless grandfathered or GATT authorized, the FTA prohibits export controls, the dual pricing of exports, and export taxes. In situations of short supply, export controls may be used only to allocate available supplies between the two countries on the basis of consumption patterns established over the previous three years. These provisions will be particularly important in the energy sector where Canada has restricted exports in the past and charged higher prices for exports than for domestic consumption. Canada and the United States both reserve the right to restrict exports of logs, and Canada reserves the right of Quebec and the Atlanta Provinces to restrict exports of unprocessed fish. However, such activities remain subject to GATT disciplines.

Duty drawbacks — i.e., refunds of duties on imported goods from third countries that are incorporated into goods subsequently exported — will not be permitted on Canadian (U.S.) goods destined for the United States (Canada) after January 1994. Also, for goods made in a U.S. or Canadian Free Trade Zone and not exported to a third country, duties must be paid on third country components regardless of whether final products are sold in the United States or Canada. Finally, duty remission programs, outside the automotive sector, that refund tariffs as an incentive to meet domestic performance requirements — such as sourcing local products for export or establishing local production facilities — may not be expanded and will be phased out as they expire no later than January 1998. In the automotive sector, the 13 overseas manufacturers receiving remission of duties on their imports into Canada, in exchange for purchasing and exporting components from Canada, will not receive

benefits for exports to the United States effective immediately; all other export-based duty remission will be phased out by January 1998. Overseas firms receiving duty remissions for achieving production (value added) goals in Canada (notably Honda, Hyundai and Toyota) will lose those benefits when their existing arrangements expire, but no later than January 1996.

Standards

The agreement recognizes each country's right to establish product standards and technical regulations to protect human, animal, and plant life and health, and the environment. However, such regulations can become unnecessary barriers to trade, and the two countries have agreed to avoid measures that pose unnecessary obstacles to trade. Further, they agree to work towards harmonized standards, where appropriate, so that similar products do not have to work or be made in different ways in order to be sold in both countries.

The two countries have agreed to make standards-related measures and procedures for product approval compatible, and to promote harmonization of standards set by private standards setting bodies. Importantly, though, these private bodies are not bound by the standards provisions of the FTA. The United States and Canada have agreed to recognize each other's laboratories, testing facilities and certification bodies. The two countries have agreed to undertake negotiations, as appropriate, to achieve these objectives. The FTA provides for a 60-day comment period for new standards and regulations, as well as other efforts to improve transparency. These commitments do not apply to measures taken by the states and provinces.

"The United States and Canada have agreed to recognize each other's laboratories, testing facilities and certification bodies."

Government Procurement

The FTA deepens, but does not widen, the benefits each country receives under the GATT Procurement Code. The Code establishes rules of access for foreign vendors to a specified list of agencies in each signator country. It opens to foreign bidders purchases over U.S.$171,000 by these agencies. For the United States, 11 of 13 federal departments are covered (the Departments of Transportation and Energy are excluded, as are many purchases by the Department of Defense). A comparable list of Canadian federal departments is included.

The FTA lowers the threshold for purchases under the Code to U.S.$25,000. It also provides for greater transparency in bidding procedures to ensure better enforcement of the Code's commitments on a bilateral basis. According to the Canadian government, the lower threshold opens up important new opportunities for Canadian producers of motor vehicles; scientific apparatus; industrial machinery; aircraft equipment; mineral products; plastic, rubber and leather products; electrical machinery; power generating equipment; chemicals; and heating and lighting equipment. According to the U.S. Department of Commerce, the lower threshold more than doubles opportunities for U.S. suppliers in Canada.

Being built upon the GATT Code, the FTA chapter on procurement inherits its limitations. The Code covers purchases of goods — services are covered only to the extent that they are incidental to the purchase of goods. The FTA does not expand the list of covered federal agencies and has no impact on state, provincial and local purchasing practices. However, Canada and the United States in the FTA state their commitment to seeking further multilateral progress as quickly as possible.

Sectoral Provisions

In ***agriculture***, support programs in Europe, North America and Japan — and the plethora of other trade restrictions they necessitate to insulate domestic markets — require a multilateral solution if the agriculture sector is to be brought into adjustment. Nevertheless, the two countries have agreed to take steps to liberalize bilateral trade. All tariffs will be eliminated within 10 years. The sector most affected will be fresh fruits and vegetables — in these products, tariffs may be temporarily reinstated for the next 20 years during periods of depressed market conditions.

The FTA prohibits the use of export subsidies in

bilateral trade, and both countries agree to consult and take into account the export interests of the other in offering export subsidies in third markets. Canada has agreed to eliminate import restrictions on U.S. wheat, oats and barley when U.S. government support levels for these products are reduced to Canadian levels. The FTA excludes each country from the other's quantitative restrictions on red meats. Canadian quotas on poultry and eggs have been slightly increased, and U.S. quotas on sugar-containing products have been moderated. The two countries have agreed to semi-annual meetings to discuss agricultural issues.

Also, the two countries have agreed to work closely to harmonize technical regulations affecting agricultural products, food, beverages and certain related products, and thereby pursue an open border policy. Areas that will be addressed include feeds, fertilizers, seeds, animal health, animal drugs, plant health, pesticides, food additives, packaging and labeling, meat and poultry inspection, dairy inspection, and fruit and vegetable inspection. Eight working groups, which will meet at least once each year, have been established to achieve these goals.

"The FTA prohibits the use of export subsidies in bilateral trade, and both countries agree to consult and take into account the export interests of the other in offering export subsidies in third markets."

U.S. ***wine and liquor*** producers will receive national treatment in Canada. Discriminatory listing will be eliminated and discriminatory pricing practices will be phased out by January 1995. Generally, U.S. producers are guaranteed full and equal access to provincial distribution systems. Canadian practices with respect to beer remain unchanged under the agreement.

The ***energy*** chapter covers petroleum, natural gas, coal, electricity, uranium, and other nuclear fuels. The FTA guarantees the United States access to Canadian energy supplies at prices equal to those paid by Canadians under comparable commercial circumstances. With respect to market access issues, the regulation of the energy sector in both countries is too complex to be brought into alignment. However, in the FTA, each country recognizes that its regulations could discriminate against the energy products of the other; if Canada (the United States) believes its products are placed at a disadvantage by actions taken by the Federal Energy Regulatory Commission or the Economic Regulatory Commission (National Energy Board) it is entitled to consultations to resolve the issue.

The ***automobile industry*** proved one of the most challenging areas for the negotiators. As discussed above, Canada only permits those automakers meeting strict goals for vehicle assembly and value added in Canada to import cars duty-free. The two incentives for the three major North American automakers to meet the Canadian safeguards are: (1) tariff-free access for their U.S. produced cars and (2) tariff-free access for their captive imports. (It is important to remember that among the major Japanese and European vehicle producers only Volvo has qualified for these privileges.)

This arrangement worked fairly well for Canada until Volkswagen, followed by several Japanese manufacturers, began establishing plants in North America in the late 1970s and early 1980s. Decisions to produce in North America were in part a response to protectionist sentiments in the Congress and the resulting voluntary restraint agreements which began in 1981. Consequently, Japanese choices between Canadian and U.S. plant locations were not merely the result of market forces. In 1985, 330,000 Japanese vehicles were produced in the United States but none in Canada. Canada responded by offering duty remission on imported vehicles when Asian automakers purchased parts in Canada for export or produced parts or vehicles in Canada for export. In 1978, Volkswagen received duty remission benefits for both its Canadian exports to the United States and to the rest of the world. When the United States objected, Canada dropped benefits for exports to the United States. In 1980, duty remission was offered to Japanese automakers but again excluded benefits for exports to the United States. In 1984 and 1985, as duty remission agreements were renewed, the exclusion for exports to the United States was dropped, greatly angering some U.S. trade policymakers. This program significantly shifted the incentives for Asian manu-facturers as to the choice of location among North American plant sites. Current estimates indicate that by 1990 some 15 percent of 2 million East Asian cars and trucks produced in North America will be produced in Canada. Under such circumstances, a U.S. countervailing duty suit — charging that duty remissions constitute an unfair subsidy — would be highly probable and would threaten the Automotive Agreement.12/

In negotiating the FTA, American officials might have liked to start all over: eliminating duties subject to rules of origin, and eliminating the Canadian safeguards. However, the three major North American manufacturers currently receive an important benefit: they may bring their captive imports into Canada without

paying a 9.2 percent duty by meeting the safeguards (this saves them Cdn.$300 million per year). In addition, the major automakers have long-term investments that already reflect the safeguards, and Canadian plant sites compare favorably with U.S. sites in terms of cost.
For the automotive sector, the FTA includes the following key provisions:

(1) A phased reduction of tariffs on bilateral trade that does not currently qualify for duty-free treatment under the Automotive Agreement.

(2) A tougher 50 percent U.S. and/or Canadian content requirement. Currently under the Automotive Agreement, the United States permits manufacturers to count overhead and indirect costs. By disallowing these costs, the new content requirement is the equivalent of a 70 percent requirement under the old rules.

(3) As discussed above, elimination of Canadian automotive duty remission programs.

(4) The three major manufacturers maintain the option of meeting the Canadian safeguards.

By doing so they may continue to bring captive imports into Canada duty-free. Canada has agreed not to extend these benefits to firms that do not currently qualify, in particular Asian producers locating production facilities in Canada. This arrangement removes the most important threat to the Automotive Agreement — the potential for U.S. countervailing duties on vehicles and parts made in Canada by Asian and European producers receiving duty remission benefits. At the same time, the privileged position of the three major automakers continues — they may continue to bring vehicles made offshore into Canada duty-free. For the first time, the United States accepts Canadian performance requirements, namely the safeguards, in the automotive sector.

> *"Current estimates indicate that by 1990 some 15 percent of 2 million east Asian cars and trucks produced in North America will be produced in Canada."*

Safeguard Actions

A traditional feature of most trade agreements is the ability of the participating countries to provide temporary relief from import competition to firms and workers substantially injured by the elimination of trade barriers. The FTA provides two sets of rules for these. The bilateral track defines actions that may be taken when an industry in one country is substantially injured as the result of the reduction or elimination of tariffs under the FTA. The global track defines how the United States (Canada) must treat imports from Canada (the United States) when domestic industries are injured by imports from third countries.

During the transition period, which ends December 31, 1998, either country may respond to serious injury to domestic producers resulting from the reduction of duties under the FTA by restoring tariffs for a period of no longer than three years. Such action may be taken only once in each industry, and the exporting country is entitled to compensation in the form of equivalent trade concessions. After the expiration of the transition period, neither country may continue or undertake a new import action without the consent of the other country.

The lone exception is the 20 year snapback provision for tariffs on fresh fruits and vegetables.

The United States and Canada continue their rights under GATT Article XIX. However, in taking global actions, they agree to exempt each other except in cases where imports from the other country are substantial (i.e., more than 5 to 10 percent of all imports) and are an important, though not necessarily the most important source of injury. If, however, the United States (Canada) determines that imports from Canada (the United States) meet these requirements, Canadian (U.S.) exports to the United States (Canada) may not be reduced below the trend of imports over a reasonable recent base period with allowance for growth.13/

In many industries where the United States is likely to take safeguard actions, Canada supplies more than 5 to 10 percent of U.S. imports. However, the global track does two things for Canada: it assures Canada that its industries will no longer be sideswiped in situations in which they are not an important source of injury to U.S. producers (as was the case in U.S. import actions in specialty steel commencing in 1983), and Canadian suppliers will still be given preferential market access in situations where they are found to be an important source of injury (for example under the current carbon steel program). Overall, the global track provides Canadian producers more certain and predictable access to the U.S. market. This may prove particularly important in many resource-based industries, such as nonfer-

rous metals and minerals, that could face continued contraction and restructuring during the next recession. However, this arrangement will impose costs on other U.S. trading partners, who will likely face greater reductions in their exports when the United States takes formal safeguard actions or negotiates orderly marketing agreements or voluntary restraint agreements. Disputes that arise from safeguard actions will be subject to binding arbitration.

Subsidies and Countervailing Duties

The negotiators could not agree to new bilateral rules for dumping and subsidies during the 20 month negotiating period. Given the priority attached by both sides to achieving a more orderly regime, the two countries are committed to negotiating common rules over the next 5 to 7 years.

In the interim, they have agree to continue to apply their existing laws and procedures for determining the presence of dumping and subsidies, for determining the presence and extent of injury and for imposing countervailing or antidumping duties. After the agreement comes into force, existing laws can be changed, as they apply on a bilateral basis, only after timely consultation, only if the new provisions specifically name Canada (the United States), and only if such provisions are consistent with the general intent of the FTA and the GATT. In applying domestic laws, after the U.S. International Trade Commission and the Department of Commerce (the Canadian Department of National Revenue and Import Tribunal) have issued findings, judicial review in the United States (Canada) will be replaced by a binding binational dispute settlement mechanism. The purpose of such review will be to ensure that agency findings are indeed consistent with domestic law.

> ***"It assures Canada that its industries will no longer be sideswiped in situations in which they are not an important source of injury to U.S. producers."***

Final determinations will be reviewed by five member binational panels. Each government will select two panelists from standing rosters and these four will in turn select the fifth panelist — a majority must be lawyers. These panels will examine whether the final determinations of the appropriate government agencies with respect to the presence of dumping or subsidies and injury were made 'in accordance with the antidumping or countervailing duty law of the importing Party.' For this purpose the 'law consists of the relevant statutes, legislative history, regulations, administrative practices, and judicial precedents to the extent a court of the importing Party would rely on such materials in reviewing a final determination of the competent investigating authority.'14/

The United States and Canada already have quite similar antidumping and subsidy/countervailing duty laws. The most significant Canadian complaints relate to subsidies. Many Canadians maintain: (1) that U.S. procedures for determining the presence of injury and whether Canadian exports are subsidized have become politicized and vulnerable to Congressional and regional pressures; (2) that the Department of Commerce (DOC) interprets the definition of a countervailable subsidy too broadly to include (a) what Canadians view as legitimate regional development aids and (b) natural resource pricing, an area where governments can reasonably disagree about what are optimal pricing policies for publicly-owned resources; (3) that the cost to Canadian exporters of mounting an adequate legal defense in countervailing duty cases is excessive and can impose significant burdens on smaller firms; (4) that judicial review of International Trade Commission (ITC) and DOC findings of the presence of injury subsidies can take years; and (5) that in levying countervailing duties on subsidized imports the United States does not consider the benefits received by U.S. industries from federal and state programs, so that only a differential rate of subsidy is calculated. The latter problem is particularly significant in agriculture and food products and was an issue when the United States applied countervailing duties on Atlantic groundfish in 1985 and hogs and porks in 1984.

The FTA bilateral dispute mechanism will provide relief for Canadians on several counts. The binational character of the review panels under the FTA should encourage impartiality on both sides of the border and encourage moderate, as opposed to extreme, interpretations of the laws of both countries. It should help restore confidence in the objectivity of the application of subsidy and dumping laws. Binational review will be faster, simpler and cheaper than the current systems of judicial review: binational review panels will review agency findings within 315 days, and small businesses wishing to challenge agency findings can ask their government to represent them before a binational review panel.15/ Problems with respect to the cost of mounting an adequate defense before the ITC and DOC remain,

although the bilateral review process should discourage frivolous cases.

The critical questions that remain are: In recent cases where Canadian exporters were found to benefit from subsidies, how often did political considerations actually tip the balance, not in the decision to bring suit but rather in findings that countervailable subsidies and injury were indeed present? Again in these cases, how often have affirmative findings reflected a broader American view of what constitutes a countervailable subsidy that is consistent with U.S. law? Rugman, citing the 1986 softwood lumber and 1985 Atlantic groundfish cases, argues that most of Canada's problems have emerged from the politicization of ITC and DOC decision making processes.16/ I suspect that although binational review will reduce the potential impacts of political pressures on ITC and DOC deliberations and reduce bilateral tensions, Canada and the United States will continue to have their differences about what should constitute a countervailable subsidy and that in the end these differences can only be comprehensively addressed through the negotiation of a new bilateral subsidies regime.

Trade in Services

The United States and Canada have essentially agreed to accord national treatment and to provide right of establishment to each other's providers of a list of over 150 commercial services. With the exception of doctors, lawyers, childcare, basic telecommunications, transportation, and government provided services, the FTA covers virtually all business services. The provisions of the services chapter apply to the insurance industry but do not apply to other financial services (discussed below).17/ The agreement also provides for access to domestic distribution systems. For example, providers of computer and enhanced telecommunications systems, which are on the covered list, are guaranteed access to the basic telephone systems, which are not on the list. The two governments agree that licensing and certification procedures should relate to competence and should not be structured with the intent of discriminating against providers from one country or the other. The two governments further agree to 'encourage the mutual recognition of licensing and certification requirements for the provision of covered services by nationals of the other Party.'18/

The national treatment requirement does not apply to existing nonconforming measures; therefore, most of the benefits are prospective. Sectoral annexes explain how these provisions apply to architecture, telecommunications and tourism. The two countries are committed to begin negotiations to remove the discriminatory effects of existing regulations in other sectors after the FTA is ratified.

Financial Services

The FTA does not provide the kind of overarching blueprint for the liberalization of financial services that it does for other business services. The FTA had to accommodate substantial differences in the regulatory structures and in the pace of deregulation underway in the two countries. At the federal level, the United States still maintains a rather strict separation between the activities of commercial banks, on the one hand, and investment banks and the brokerage houses, on the other, as enshrined in the Glass-Steagall Act. While the United States has afforded a significant measure of national treatment to foreign financial institutions, substantial though eroding barriers remain to nationwide interstate banking. In Canada until recently, foreign participation in the commercial banking and securities industries was limited. For example, subsidiaries of U.S. commercial banks (Schedule B Banks) were limited to 16 percent ownership of all Canadian bank assets; the Canadian subsidiaries of U.S. insurance companies were more constrained in their investment practices and in their ability to diversify into other financial services than their Canadian-based counterparts; and U.S. investment banking companies could not apply for membership on the Ontario stock exchange or underwrite public stock and bond issues for Canadian companies in Canada. Also, until recently, a rather strict separation was enforced between the Canadian commercial banking and securities industries. Starting in 1986, the Ontario and Canadian federal governments began substantial steps to afford U.S. financial services companies more equal treatment in Canada and to integrate Canada's commercial banking and securities industries. Reflecting these

> ***"The FTA does not provide the kind of overarching blueprint for the liberalization of financial services that it does for other business services."***

reforms, the FTA removes most discrimination against U.S. financial institutions operating in Canada. U.S. commercial banks will no longer be subject to the 16 percent rule, U.S. financial institutions will be free to purchase up to 100 percent of a Canadian securities company, and U.S. investment banking and securities companies will be able to participate in the Ontario and Quebec securities markets. Although the financial services provisions of the FTA do not apply to the actions of the states and provinces, current regulations in Ontario and Quebec — the principal financial centers — do not pose major difficulties. Subsidiaries of U.S. insurance companies will now be free to diversify into other financial services on the same basis as Canadian companies.

In return, the United States has made several concessions to Canada but these are not as sweeping as recent Canadian reforms. Most notable, though, should Glass-Steagall be repealed, the U.S. government is committed to affording Canadian banks the same treatment as U.S. banks. It is not required to do so for other foreign banks. As the two countries continue their respective processes of financial deregulation, they will continue to work together with the goal of assuring that benefits are shared by both U.S. and Canadian firms.

"Both countries have agreed not to screen the establishment of new businesses. Canada reserves the right to screen direct acquisitions of existing businesses."

Investment

In the FTA, the United States (Canada) agrees to accord national treatment to Canadian (U.S.) businesses, once established and operating in the United States (Canada). Both countries have agreed not to screen the establishment of new businesses. Canada reserves the right to screen direct acquisitions of existing businesses, but the threshold for screening direct acquisitions will rise to Cdn.$150 million by 1992. The threshold for screening indirect acquisitions in Canada will rise from Cdn.$100 million in 1989 to Cdn.$500 million in 1991; after 1991, indirect acquisitions will no longer be screened at all. Both countries agree not to impose minimum equity participation by local investors or to require the sale of an enterprise by reason of the owner's nationality.

The two countries agree not to impose certain performance requirements on each other's investors that may distort trade — specifically, requirements to export given shares of output, substitute imported goods and services with local goods and services, or achieve goals for domestic content. Further, the two countries have agreed not to impose such performance requirements on investors from third countries if such performance requirements would significantly distort bilateral trade. The United States and Canada remain free, though, to seek commitments from foreign investors relating to product mandates, R&D and technology transfers. Canada has sought such undertakings from U.S. and other foreign countries, and we may expect them to emerge in the future screening of acquisitions.

The FTA contains investor safeguards regarding expropriation and the transfer of proceeds from sales, dividends, royalties, and interest. As such, it is a rather comprehensive agreement.

The FTA investment chapter does not apply to financial services (these are discussed in a separate chapter — discussed above) or transportation services. Existing limitations on foreign ownership in specific sectors are grandfathered — in particular, U.S. restrictions in the communications and the atomic energy industries and Canadian restrictions in the communications, oil and gas, and uranium industries. The FTA codifies the substantially more liberal treatment U.S. investors have enjoyed under Prime Minister Mulroney. Moreover, although the United States has been generally open to Canadian investors, the FTA assures Canadian businesses that they will not be subject to screening or certain trade-related performance requirements should the United States adopt such policies in response to rapidly growing foreign direct investment in the United States.

Cultural Industries

Cultural industries are exempt from the nontariff provisions of the agreement — most notably, the provisions relating to services, foreign investment policies and subsidies. These industries are defined to include: the publication, distribution, sale or exhibition of books, magazines and newspapers; films, audio and video recordings; and radio, television and cable broadcasting. Where applicable, tariffs will be eliminated; however, Canada will be free to take most other actions to ensure the viability of its domestic industries. In this context, Canada has agreed to provide copyright protection to the owners of U.S. programs retransmitted in Canada

and not to require that newspapers and magazines be typeset and printed in Canada for advertisers to qualify for tax deductions. Also with regard to other Canadian actions to promote or protect cultural industries as defined in the FTA, the United States 'may take measures of equivalent commercial effect in response to actions that would have been inconsistent with the Agreement' but for the exemption of cultural industries.

Institutional Provisions and Dispute Settlement

A Canada-United States Trade Commission will supervise the implementation of the FTA and mediate any disputes that may arise, other than those relating to subsidies, dumping and financial services. 19/ The Commission shall be composed of representatives of both countries — the principal representative from each side will be the cabinet level officer or minister responsible for international trade or their designated representatives.

Either party may request consultations to resolve a dispute under the FTA. If consultations fail to resolve the dispute within 30 days, either party may request a meeting of the Commission or seek dispute settlement under the GATT. If the Commission fails to resolve that dispute within 30 days, either party may request that a panel of five qualified experts be formed to examine the issue and make recommendations to the Commission. Each government will select two panelists from standing rosters and these will in turn select the fifth panelist. Unless the Commission agrees otherwise, panel findings, along with dissenting opinions, will be published. After receiving the panel's findings, the Commission will seek to resolve the dispute. "Whenever possible, the resolution shall be non-implementation or removal of a measure not conforming with this Agreement or causing nullification or impairment ... or, failing such a resolution, compensation." If the Commission does not reach an agreement on a mutually satisfactory resolution and "a Party considers that its fundamental rights (under this Agreement) or benefits (anticipated under this Agreement) are or would be impaired by implementation or maintenance of the measure at issue, the Party shall be free to suspend the application to the other Party of benefits of equivalent effect until such time as the Parties have reached agreement on a resolution of the dispute". 20/

> ***"Either party may request consultations to resolve a dispute under the FTA."***

If both parties agree, binding arbitration may be selected at the point in the process where the panel of experts is established. Disputes involving dumping and subsidies (countervailing duties) and safeguard actions are subject to binding arbitration in all cases.

THE FTA'S PROSPECTS

When evaluated in terms of U.S. and Canadian negotiating objectives, as well as the broader goal of creating an integrated North American market for goods, capital and services articulated in chapter 1 of the FTA, the FTA makes a good start. It brings down many trade barriers, it ensures that many remaining barriers do not become more restrictive, and it establishes processes for achieving continued liberalization.

It eliminates all tariffs, a key goal of both countries, and the FTA's provisions about rules of origin, duty drawbacks, duty remission programs, and other export subsidies generally ensure that many of the potential efficiency benefits of a fully integrated duty-free market for goods will be realized. The combined effects of the provisions for foreign investment and financial services should ensure many of the benefits of a fully integrated U.S.-Canadian capital market. The chapters on foreign investment and energy resolve longstanding disagreements about the appropriate scope of national prerogatives in these areas. The comprehensive standstill agreement in business services is built on the principles of national treatment and right of establishment; it acknowledges the need for and commits the two countries to work toward compatible licensing and certification requirements; and it could prove to be a model for future pluralateral or multilateral arrangements.

With respect to nontariff barriers to imports, the FTA deals with several longstanding problems of interest

to one side or the other — market access issues in energy products, wine and liquor, red meats, grain products, fresh fruits and vegetables, and other food products, as well as more general concerns such as certain trade-related foreign investment performance requirements. Similarly, on the export side, the provisions dealing with export restrictions, the dual pricing of exports and export taxes should substantially contribute to the rationalization of markets, especially in the energy sector.

The global safeguards provisions should provide Canada with substantial relief from the U.S. use of safeguard actions as an instrument of contingent protection. The FTA provides a standstill on trade barriers imposed by standards. The FTA promises additional progress through negotiations and consultation in several areas including standards, trade in business and financial services, government procurement, and dumping and subsidies/countervailing duties. Although the negotiators were not able to include a chapter on intellectual property rights, U.S. concerns with respect to copyright protection for border broadcasters and patent protection for pharmaceutical patents have been addressed. The FTA contains a promising dispute settlement mechanism. It should provide for timely resolutions, although its ultimate effectiveness will become apparent only with experience. Canada achieved its goal of maintaining considerable latitude to encourage and promote autonomous cultural industries.

> ***"...both governments had to consider domestic political constraints and the prospects for ratification when deciding how far they could go."***

As in all negotiations, both governments had to consider domestic political constraints and the prospects for ratification when deciding how far they could go in removing barriers and establishing new rules. The agreement falls short of expectations in that important trade restrictions are grandfathered or their scope is only circumscribed — examples include Canadian practices with respect to poultry, dairy products, and beer; U.S. import quotas on sugar-containing products and the Jones Act; export embargoes on logs; and Canadian prerogatives with respect to the export of unprocessed fish caught off the Atlantic coast. However, in none of these areas did the agreement extend the scope of sectors vulnerable to controls. In the automotive sector, the new rules of origin perpetuate a measure of protection for U.S. and Canadian parts manufacturers. The opportunity offered the three major North American automakers to continue importing offshore vehicles duty-free into Canada by meeting the Canadian safeguards clearly discriminates against U.S. parts manufacturers, as well as European and Japanese firms selling parts and cars in Canada. However, the new provisions with respect to this sector extend the potential scope of duty-free trade and eliminate the distorting effects of Canada's duty remission programs. Also significant were the FTA's failure to include: new rules for subsidies and dumping; government purchases of services; and state and provincial procurement practices and product standards. However, the temporary procedures for dumping and subsidies should ensure that each countries' laws are applied without political prejudice, and these procedures should help moderate tensions until the two countries can negotiate common bilateral rules. The provisions for federal procurement are an improvement over current arrangements. The provisions with respect to national product standards are a major improvement, and the prospects for continued liberalization in this area are encouraging.

A great deal was achieved in just 20 months of negotiations. Yet it is clear that many of the benefits from the liberalization of nontariff barriers to trade in goods and services are prospective. These include: the benefits to be achieved through further negotiations and consultations in standards, business and financial services, procurement, and dumping and subsidy rules, as well as the avoidance of new disputes emanating from Article XIX actions and the application of countervailing duties. Among the key questions are:

—First, can the two governments negotiate meaningful new rules and disciplines for subsidies and develop concepts of dumping consistent with an integrated continental economy?

—Second, can the United States and Canada achieve meaningful interface of regulatory procedures and licensing requirements in services? Can they make steady progress towards harmonized product standards and technical requirements for goods. Can they persuade private bodies that set licensing requirements and product standards to meaningfully participate in these processes? Focusing on product standards, will the states and provinces be persuaded not to undermine this process with new requirements?

—Third, how effectively will the provisions relating to safeguards, subsidies and dumping constrain the use of trade remedy laws as a mechanism of contin-

gent protection?

—Fourth, how smoothly and effectively can the two governments implement the FTA? Will the Canada-U.S. Trade Commission prove to be an adequate institutional mechanism? How effectively and promptly will it mediate and resolve disputes?

Perhaps more than achieving a free trade agreement, the United States and Canada have embarked on a process of trade liberalization. The FTA is so broad and sweeping that good intentions must now be translated into earnest efforts. How much loophole seeking will occur on both sides by national, state and provincial governments, as well as by private groups that establish licensing requirements and set product standards? The first real tests will follow the national elections (due by Autumn 1989). The scope and pace of the work programs established in dumping and subsidies, standards, services and, perhaps, government procurement should provide a useful first indicator of the prospects for the agreement's success.

Notes

1. The historical background to the Canada-U.S. Free Trade Agreement present in the Introduction and Part I draws on material from my previous papers "U.S.-Canada Free Trade Negotiations: What Are the Issues?" *American Review of Canadian Studies* (Autumn 1985), pp. 311-323; "Impact on the United States," in Edward R. Fried, Frank Stone and Philip Trezise, eds., *Building A Canadian-American Free Trade Area* (Washington: The Brookings Institution, 1987), pp. 44-72; *Meeting the Competitive Challenge: Canada and the United States in the Global Economy* (Washington and Toronto: Canadian- American Committee, 1988) and "U.S.-Canadian Trade Relations," in Peter Kresl, ed., *Seen From the South* (Salt Lake City: Brigham Young University Press, forthcoming).

2. The Reciprocal Free Trade Agreement was part of the Elgin-Marcy Treaty of 1854. It established duty-free trade between the United States and the British North American Territories of Canada (present day Ontario and Quebec), New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland. The products covered were agricultural and forest products; ores and metals; dairy products; animal, fish and kindred products; and only a few manufactures (dyestuff and rags). From 1855 to 1863, about 55 percent of U.S. exports entered Canada duty- free, while about 90 percent of Canada's exports entered the United States duty-free. As provided for in the treaty, the United States abrogated the agreement in 1866 after giving one year's notice. Among the reasons cited by historians were increased Canadian duties (the Cayley-Galt tariff of 1858-1859), which Americans viewed as violating the spirit of the 1854 agreement, and Great Britain's preference for the Confederacy during the Civil War. For more detailed accounts of this agreement and the period from 1854 to 1948 see Anna Guthrie, "A Brief History of Canadian-American Reciprocity," in Sperry Lea, *A Canada-U.S. Free Trade Arrangement: Survey of Possible Characteristics* (Washington and Montreal: Canadian-American Committee, 1963) Appendix A, pp. 83-92; J.L. Granatstein, "Free Trade Between Canada and the United States: The Issue That Will Not Go Away", in Dennis Stairs and Gilbert R. Winham, eds.. *The Politics of Canada's Economic Relationship With the United States* (Toronto: University of Toronto Press for the Royal Commission on the Economic Development Prospects for Canada, 1985) pp. 11-54; and Peter Morici, "U.S.-Canada Free Trade Negotiations: What Are the Issues?"

3. D.J. Daly and D.C. MacCharles, *Focus on Real Wage Unemployment* (Vancouver: The Fraser Institute, 1986); and Peter Morici, *Meeting the Competitive Challenge: Canada and the United States in the Global Economy.*

4. Sperry Lea, *A Canada-U.S. Free Trade Agreement: A Survey of Possible Characteristics* (Washington and Montreal: Canadian-American Committee, 1963); and Paul and R.J. Wonnacott, *Free Trade Between the United States and Canada: The Possible Economic Effects* (Cambridge: Harvard University Press, 1967).

5. Sperry Lea, "A Historical Perspective" in Robert M. Stern, Philip H. Trezise and John Whalley, eds., *Perspectives on a U.S.-Canada Free Trade Agreement* (Washington: The Brookings Institution, 1987), pp. 11-29.

6. Peter Morici, Arthur J.P. Smith and Sperry Lea, *Canadian Industrial Policy* (Washington: National Planning Association, 1982).

7. Department of External Affairs, *Foreign Policy for Canadians* (Ottawa, 1970) p. 24.

8. Technically, the Canadian safeguards limited duty-free access to firms that: maintained their pre-agreement ratios of production to sales in Canada (in any case not less than 75 percent); maintained Canadian content (value added in Canada) equal to the level achieved in 1964 and increased their value added by at least 60 percent of the growth in their Canadian sales, plus an additional $260 by the 1968 model year. The essential long-term impact on the major automakers was to require the assembly of approximately one vehicle in Canada for each vehicle sold there, and to require value added in Canada equal to 60 percent of sales there.

9. Later in the 1970s, the Foreign Investment Review Agency imposed a variety of such requirements on many foreign companies seeking to establish new investments in Canada.

10. External Affairs, *Canadian Trade Policy for the 1980s: A Discussion Paper and A Review of Canadian Trade Policy: A Background Document to Canadian Trade Policy for the 1980s* (Ottawa: Minister of Supply and Services, 1983); Royal Commission on the Economic Union and Development Prospects for Canada (Ottawa: Ministry of Supply and Services 1985).

11. This review of the FTA is not intended to be exhaustive. The agreement in places makes references to existing statutes and other documents — reference to these is required to obtain the full meaning of the FTA in various Chapters. This review of the FTA is based on the following documents: The Canada-U.S. Free Trade Agreement, Canadian Edition, which includes the Government of Canada's annotations by chapter (Ottawa Department of External Affairs, October 1987); Summary of the U.S.-Canada Free Trade Agreement (Washington: Department of Commerce, February 1988), which provides the U.S. government's annotations by chapter; A Guide to the Canada-United States Free Trade Agreement (Toronto: Fraser & Beatty, Barristers & Solicitors, February 1988), The Canada-United States Free Trade Agreement: An Analysis (McCarthy & McCarthy, Barristers & Solicitors, January 1988); and The United States-Canada Trade Agreement: An Analysis (Washington: The Government Research Corporation, December 1987).

12. Paul Wonnacott, "The Canada-U.S. Free Trade Agreement and the Auto Pact," *Trade Monitor* (Toronto: C.D. Howe Institute, March 1988).

13. FTA Article 1102, paragraph 4.b.

14. FTA Article 1904, paragraph 2.

15. Gary Horlick, Geoffery D. Oliver and Debra P. Steger, "Dispute Resolution Mechanisms," in Jeffery J. Schott and Murray G. Smith, eds., The Canada-United States Free Trade Agreement: The Global Impact (Washington: Institute for International Economics, 1988), pp. 68-71; and Debra P. Steger, "Dispute Settlement," mimeo —Fraser & Beatty, Barristers & Solicitors (Ottawa: 1988).

16. Alan M. Rugman, Testimony before the House of Commons Standing Committee on External Affairs and International Trade, Thirty-third Parliament, December 7, 1987; and Alan M. Rugman and Samuel Porteous, "The Softwood Lumber Decision of 1986: Broadening the Nature of U.S. Administered Protection" (Chicago: presented at the Annual Meetings of the Academy of International Business, November 13, 1987).

17. The business services chapter applies to the sale of insurance policies and the investment of insurance company assets. The financial services chapter applies to insurance company diversification in commercial and investment banking and brokerage services.

18. FTA Article 1403, paragraph 3.

19. FTA Article 2005, paragraph 2.

20. Disputes concerning countervailing duties applied in response to subsidies and dumping are subject to a separate binding dispute settlement mechanism. Disputes relating to financial services will be resolved through consultations between the Ministry of Finance and the Department of the Treasury.

"The FTA is so broad and sweeping that good intentions must now be translated into earnest efforts."

"US Trade Pact a Two-Edged Sword "

This selection, by David Owen, taken from *The Financial Times*, January 18, 1988, discusses fears that the price of the trade pact would be too high.

Discussion Note

Fears that the price of free trade will be too high are the subject of this reading.

Some Economic Fears

The biggest fear was that U.S. branch plants would simply retreat back to the U.S., displacing thousands of Canadian workers. Yet interviews with CEOs (and the post-FTA experience) suggest instead that the FTA will enable Canadian operations to be integrated more tightly into a single North American production network.

Two major reasons for this behavior stand out: the sunk costs in plant and country specific advantages, like natural resources. No company is simply going to abandon plant in which they have invested a great deal without more inducements than the FTA provides. And no oil company, for example, is going to leave Canada as long as commercially recoverable oil remains in the ground. A third reason also cited by this reading is that in many sectors, such as autos and computers, production capacity is already fully rationalized, with Canadian plant having specific

Continued overleaf

global mandates that differentiate their product range from that of their parents.

The adjustment that is taking place thus involves increasing volumes of a narrower, more specialized product range for a global market. In short, the fears seem to have been groundless.

Adjustment and Theories of International Business

From a teaching viewpoint, this pattern of adjustment permits a review of various theories about international trade -why it takes place and what factors account for the existence of multinational firms.

Comparative Advantage

It would appear from looking at the composition of merchandise trade between Canada and the U.S. that Canada has a comparative advantage in natural resources and certain types of manufacturing, especially automotive. These are areas where tariffs between the two countries were ,generally speaking , quite low or nonexistent. The FTA would simply enhance confidence that these comparative advantages would continue to operate without distortion.

Product Life Cycle

Then there is the product life cycle theory. This suggests that as the market for manufactured products matures domestically, firms will seek new markets for those products abroad. And, as more advanced products follow domestically, that manufacture of the older products will also shift abroad. If you remove barriers like tariffs, then this process should occur more smoothly and without distortion. And, when you factor in geographic propinquity (Ontario and Quebec are within a day's truck ride of most major urban markets from Chicago to Washington D.C.), then the shift of production into Canada for export back into the U.S. is clearly encouraged.

Organization Cost Theory

Another, more general, theory encompassing both the insights of PLC theory and of comparative advantage is that of organization costs. This theory holds that multinational firms maximize gain by "internalizing" costs across areas where markets are inefficient (that is, using management to solve market failures) and "externalizing" activities where market forces operate efficiently. The use of administration (vertical and horizontal integration, etc.) resolves problems of high transaction costs (time to conclude agreements, capital shortage, proprietary knowledge, etc) and market uncertainty. The use of external markets allows cost reductions that are not possible to achieve in-house.

This model suggests that adjustment to the FTA will result in cutbacks in Canadian plant if that plant has been established for non-economic reasons. It also suggests that in all other cases, production will remain the same or grow in Canada. A decade of tariff cutting that preceded the FTA virtually ensured that most of the foreign investment hosted by Canada was there for mainly economic reasons. The fact that the U.S. market is 10 times that of the Canadian market suggests that, contrary to what the pessimists believed, the opportunities for cost saving (and thus profit-making) are actually higher in Canada: through extended production runs aimed at the U.S. market and lower cost inputs imported from the U.S. From the standpoint of the cost/benefit available to a multinational firm, it therefore follows that the FTA establishes conditions for "externalizing" production from U.S. plant to Canadian plant for production aimed at the northern U.S. and other markets.

What about Canada's traditional "market imperfections" in R&D and access to capital? Here is where the management power of the MNE can operate to advantage by overcoming these disadvantages: improving access to R&D and capital.

The same logic also suggests that continued trade liberalization to produce more competition would ensure this kind of rationalization takes place sooner rather than later.

The Dutch Disease

Yet is there not one fear that may be justified, even though it remains unspecified in the article -namely, the Dutch disease, whereby international interest bids up the price of some Canadian factors beyond the reach of Canadians themselves to compete for them, thus creating a two-tiered economy, one international, the other domestic.

In short, the point of this reading is to stimulate discussion of multinationals and international business.

David Owen examines Canadian fears over tariff-barrier removals

US trade pact a two-edged sword

"A FRIEND of mine works for a US company which is building a chocolate plant in Canada. I asked him if they would have built the plant if they had known there would be a free trade agreement. He said probably not."

Foreign direct investment is often viewed as a substitute for trade. Certainly the above example, recounted by a senior executive with a large US food processor in Canada, does nothing to undermine that contention.

Since before the turn of the century, US companies have been establishing operations in Canada, with the primary aim of circumventing tariff barriers.

The re-emergence since the late 1970s of contingent protectionism in the US has increasingly encouraged Canadian companies wishing to build sales south of the 49th parallel to adopt a similar approach.

The recent conclusion of a tentative free trade pact between the two countries, which sets the goal of essentially tariff-free bilateral trade within 10 years, has prompted concern in Canada that the removal of barriers will spark the reverse response – that free trade will prompt US companies to sell existing Canadian plants and supply their huge but sparsely populated neighbour from south of the border.

Conversations with executives from a wide range of Canadiansubsidiaries of US companies suggest, however, that an entirely different process will (and in some cases has already started to) take place. Rather than shut up shop in Canada, these conversations suggest, US companies will – where possible – integrate Canadian plants into a North American operations network.

Manufacturing facilities, in other words, will be rationalised to produce a much narrower range of products for a unified North American market rather than sold or mothballed.

While trade liberalisation may well produce, in the words of Professor Alan Rugman of the University of Toronto, "a gradual slowdown in the rate of increased direct investment," there appear to be at least two compelling reasons why most companies will not disinvest altogether.

The first is the matter of sunk costs. "Plant," in the words of Mr Jon Grant, Quaker Canada's president and chief executive, "is an expensive asset. Shutting down plant is a last resort."

The older the plant in question, of course, the less powerful the deterrent. Nevertheless, as Prof Rugman's studies indicate, there appear to be relatively few cases where overall exit costs would be low enough for out-and-out closure to be a viable option.

The second reason is Canada's many "country-specific" advantages, especially its resource base. Reduced tariffs will clearly have little bearing on investment decisions by the likes of Texaco while sufficient low-cost Canadian oil remains in the ground.

The number of US-controlled subsidiaries tied to Canada by such considerations is greater than might at first be imagined. "There's an advantage in producing near the feedstocks," says Mr Bob Seath, vice president in charge of commodity petrochemicals operations at Union Carbide Canada.

If closure is being rejected as too costly or otherwise undesirable, so too is the status quo, whereby Canadian plants have traditionally replicated US product lines without being able to benefit from the economies of scale available in the far bigger US market.

Hence, managers are hitting on cross-border integration as a means of maximising the efficiency of pre-existing Canadian assets.

Some industries and companies are further down the road than others.

Navistar International (formerly International Harvester), which has reaped the benefits of the "free-trade-with-strings" Auto Pact since 1965, believes that its North American plants – one in Ontario, one in Ohio – are already fully rationalised.

The heaviest trucks in the company's range, an official explained, are built in Canada; medium-sized vehicles and below are turned out in Ohio.

Integration is also at a relatively advanced stage in the computer sector, where duty averages only 3.9 per cent. Canadian subsidiaries have sometimes developed a degree of product range differentiation from their parents by winning global mandates to supply a given product, component or service to subsidiaries of the same group in other countries.

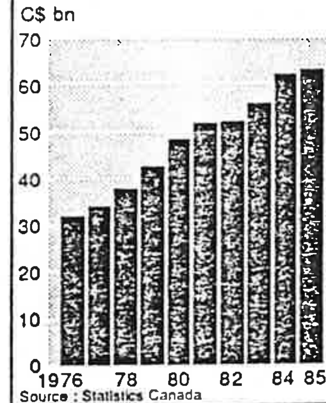
Digital Equipment's Canadian subsidiary has five such global mandates, including one top-of-the-line personal computer and the back panels of all Digital computers.

"We try to produce large volumes of few products," says Mr David Paolini, a Digital executive. "Free trade will make us more competitive, which could lead to more production mandates," he adds.

Several Canadian-based electrical products, appliance and components manufacturers have also secured such mandates from their parents: Westinghouse has 19; Honeywell about 20.

Essentially, companies are preparing to phase out production of such relatively low-tech products as valves and transistors, in favour of more sophisticated items.

Rockwell of Canada completed its abandonment of Canadian valve production about a year ago, according to Mr William Marks, director of Canadian operations.



Honeywell, meanwhile, has phased out production of some valves in favour of heat relays and electrical control equipment. General Electric Canada, similarly, has stated that it plans to focus on businesses "where value is added through knowledge."

It is in the area of food processing and consumer products that managers, while expressing the intention to rationalise, are probably furthest from achieving a meaningful degree of cross-border integration.

Procter & Gamble, which has trimmed its Canadian operations to five plants and between 3,000 and 3,500 employees in recent years, has just embarked on the process, in line with its June announcement that it plans to revamp its worldwide manufacturing operations.

At the time, the company noted that "the increased level of capital investment required today for new product introductions and changes in existing products further encourages reducing the number of production sites for individual products."

Mr Bob Anderson, Canada-based general counsel, elaborates. "The big costs in manufacturing are less ingredients than changeover time.

"If you can run your plant more hours per day than your competitor you are OK. It's harder up here to do that because the plants have been geared to supply the Canadian markets with all sizes (of a given product)."

The bulk of the US-controlled Canadian food processing sector, meanwhile, still consists of branch plants essentially replicating the parent's domestic market product line. As one executive of Kraft said: "The only business that we are in here that they aren't (in the US) is peanut butter."

While Nabisco Brands is selling more Peak Freans biscuits in the US, it is not allowed to market products made south of the border by its parent, RJR Nabisco, according to Mr Ron Adlam, the company's vice president for planning.

Even companies which do have a range of distinctive Canadian products, like Quaker Canada (pet foods, cereals, baking mixes) and Campbell Soup (apple juice, steak sauce, gravy mix), export very little to their parent company's home market.

Mr Grant of Quaker estimates that some 3 per cent of the Canadian subsidiary's sales are shipped to the US. "We export some Bisto to the US," adds Mr Tom Peddie, Campbell Soup's chief financial officer.

"They are basically riding on the coat-tails of products developed in the US," concludes Mr Jack Stacey, an analyst with Moss Lawson.

Nevertheless, most food sector executives project that free trade will lead to some cross-border rationalisation, in a bid to benefit from economies of scale and longer production runs.

However, they add, such restructuring may be less comprehensive than in other industries, due to freight considerations.

Food industry products are typically bulky and of low value. "The shipping costs might overcome any savings from rationalisation," speculates Mr Bruce Murray, an analyst with Nesbitt Thomson.

"We haven't been able to determine or identify any specific product lines where that sort of rationalisation will work," says Mr Bob Hurlbut, chairman of General Foods' Canadian operations. "There will be some dislocation, but in most instances, we are as cost-effective as our US plants."

"Concerns of the Cultural Community"

This reading is taken from *Evaluating the Free Trade Deal: A Guided Tour Through the Canada-U.S. Agreement*, by Richard G. Lipsey and Robert C. York, (1988) C.D. Howe Institute, Toronto. Reprinted with permission.

Discussion Note

The Culture Threat

What about culture? At stake is the ability of Canadians to talk to each other, in literature, film, theatre, etc., in a small, open economy that seems unable to sustain an appropriate number of artists without subsidies. True, as prosperity increases under the FTA, more money would be available for the arts. But artists contend that there is a set of subjects and values Canadians as a collectivity wish to see addressed that are of little interest to outsiders. The problem then, in the context of an FTA, is to find ways of facilitating Canada's "national conversations" that are not trade distorting or subject to erosion by the economic pressures of the country's giant southern neighbor.

The current critical and commercial success of Anglophone Canadian authors in the U.S. (parallelling similar success by Canada's Francophone writers in France) suggests that many of these fears are groundless. Notably, however, government subsidies early in their careers enabled these writers to develop their talent and reach the master category. Upsetting that pattern, critics of the FTA fear, could undermine the ability of many Canadian writers and artists to reach master class in the future. Compared to many European countries, Canada spends relatively little on its artists.

The U.S. position on culture is rather different. Cultural exports, like other "intellectual property" contribute significantly to the plus side of the U.S. merchandise trade account. The film and recording industries in particular have become multi-billion dollar global businesses. They view Canadian concerns as a potential trade irritant.

The question: who's right?

Box 8

Concerns of the Cultural Community

The case that Canada's cultural community has made against the Agreement seems to involve the following points.

1. U.S. arts and culture — television, movies, books, magazines — already dominate the Canadian market.
2. Over the years, Canada has employed a number of policies — some of them discriminatory against the United States — to preserve and support Canadian culture. That culture, nevertheless, remains fragile.
3. In spite of protests by foreign governments, particularly the United States, Canada has developed an array of policies that favor Canadian culture. No country has subsequently retaliated in a way harmful to the Canadian cultural community.
4. In future, U.S. interests will be able to use the Agreement *against Canada* in ways that constrain this country's ability to adopt discriminatory policies — film distribution is the best current example.
5. If the United States should retaliate under the terms of the Agreement, it may do so against noncultural industries, which could erode support for culture.

In total, this argument — whatever its flaws — expresses a set of widely asserted and deeply held beliefs of the Canadian cultural community. Points (1) and (3) seem not to be in dispute, but since the Agreement grandfathers most past discriminatory cultural policies, it has no bearing on them. The debt that Canadian culture owes to those cultural support programs which interfere with free trade is, however, in dispute.

As for the future, Canada has acknowledged in the Agreement its legal obligation to compensate the United States for future

Box 8 - continued

cultural policies that discriminate against, and commercially injure, U.S. residents. The United States has always had the option of retaliating against Canada for such discrimination — indeed, it has taken such action in the past. Enshrining this right in the Agreement, however, makes it more visible and enforceable. In that sense, this is a significant, if modest, change in the status quo.

The most important question the Agreement raises seems to be: should Canada's cultural community, and the general public, be concerned about formally acknowledging a right the United States already had?

The argument for answering no to this question is that Canada is still able to promote its cultural objectives without adopting discriminatory policies. The Agreement does not rule out preferential tax treatment and/or direct subsidies to Canadian artists or to Canadian cultural industries generally. It does not affect Canadian-content regulations for radio and television, although, in any free society, such regulations should be applied with prudence. It does not affect favorable tax treatment of personal or corporate cultural donations. Thus, there is no reason why Canadian culture cannot be even more generously promoted after the Agreement is implemented than it has been in the past. It certainly seems excessive to argue that Canada's culture has been traded away by an Agreement that preserves full policy independence, while only making explicit an already-existing U.S. right to retaliation.

What the Agreement does is to constrain — by the explicit threat of retaliation — the use of certain policy instruments. Canada can still use these policy instruments, and accept the risk of retaliation. More importantly, however, there are alternative instruments that Canada can use to meet any stated cultural support goal and that do not conflict with free trade.

"How the Agreement Increases Access"

This reading is taken from *Evaluating the Free Trade Deal: A Guided Tour Through the Canada-U.S. Agreement,* by Richard G. Lipsey and Robert C. York, (1988) C.D.Howe Institute, Toronto, Canada. Reprinted with permission.

Discussion Note

This reading summarizes important factual data to show that the FTA does indeed improve access of Canadian exports to the U.S. (Boxes 2 and 3).

The Importance of Access

Why are these issues important? Access to the U.S. market was the main goal Canadians wanted to achieve in these talks, for they were concerned that rising protectionism in the U.S. could exclude them from their best trading customer (The U.S. absorbs about 25 per cent of Canada's GNP!). Canada is also the U.S. 's best customer, taking about 25 per cent of all U.S. exports. But the U.S. is three times less export dependent than Canada (only about 10 per cent of U.S. production of goods and services is exported, compared with 30 per cent of Canada's GNP.) Canada therefore takes only 2.5 per cent of U.S. GNP-- more than western Europe or Japan, but clearly Canada is relatively much more dependent on the U.S. than vice versa. This selection suggests Canadians made significant gains, although not as much as they hoped. It should be compared to the situation facing the other U.S. trading partners in the light of the 1988 Omnibus Trade Bill. (The chart on the next page compares the salient features of the FTA and the 1988 Trade Bill).

A COMPARATIVE SUMMARY

1988 TRADE ACT	*FREE TRADE AGREEMENT*
Transfers from the President to the U.S. Trade Representative authority to decide on investigating and acting against foreign trade practices, subject to presidential discretion.	**Sets up binational commission to oversee working of the FTA. Establishes a dispute resolving mechanism permitting binational review of trade remedy action.**
Requires USTR to identify foreign trade practices whose elimination would most increase exports.	**Fixes explicit threshholds for U.S. emergency and other trade remedy laws.**
Toughens existing trade remedy provisions.	**Establishes rules of trade in automotive products and energy.**
Bans government dealing with foreign-owned securities firms unless its home country allows reciprocal access to its securities.	**Establishes rules for trade in services including financial services.**
Allows President to suspend or halt merger or acquisition of a U.S. firm by foreign citizens or firms if threat to national security.	**Grants national treatment to each other's new investment, preserving Canada's screening of M&As.**
Requires study of Canadian system of licensing wheat imports, intermediate export credits. Attacks subsidies to international consortia like Airbus.	**Sets up negotiations for a subsidies code.**
Requires the President to negotiate with other countries to achieve "more appropriate and sustainable..." current acount balances.	
Authorizes agricultural subsidies.	**Bans export subsidies on agricultural products exported to each other's country.**

Box 2

How the Agreement Increases Access

One can show how the Agreement allows Canadian exporters increased access to the U.S. market by working through it chapter by chapter, listing in the order in which they occur every measure, large and small, that has this effect. (All access-increasing measures are listed, whether or not a free trader would approve of them.)

1. Clear rules of origin remove all of the uncertainty currently associated with customs officers' *ad hoc* decisions as to what tariff is payable on specific items as they cross the border (Article 301).
2. All tariffs will be eliminated on all trade with the United States by 1998 (Article 401), although, in the case of fruits and vegetables, tariffs may be reinstated for a brief period at any time over a further ten years (Article 702).
3. By 1994, the United States will eliminate the use of customs user fees that are applied to all goods entering that country; currently, these amount to 0.17 percent of the value of the import transaction (Article 403).
4. The right of national treatment gives blanket assurance that the United States will not discriminate against Canadian producers in any activities covered by the Agreement, except where the treaty explicitly provides otherwise (Article 501).
5. Internal taxes, such as sales or excise taxes, no longer can be used as concealed trade barriers — for example, by levying rates on imports higher than those levied on domestic goods (Article 501).
6. The Agreement eliminates various nontariff barriers to trade, such as the common misuse of standards requirements (Article 603), and it addresses these barriers in a more comprehensive and obligatory way than does any other free trade area or agreement — including the provisions of EFTA, the EC, and the GATT.
7. The United States will recognize Canadian accreditation systems and product test data in an effort to reduce obstacles to trade (Articles 605-607).

Box 2 - continued

8. The Agreement will remove tariffs and quotas on all agricultural goods, except for quotas that are used to support supply management schemes — as in poultry and eggs (Articles 401 and 702).
9. The Agreement establishes free trade in red meats (Article 704).
10. The United States will allow unlimited access to its U.S. market for Canadian food products containing up to 10 percent sugar (Article 707).
11. The Agreement restrains the use of technical regulations as nontariff barriers to agricultural trade — for example, by relaxing U.S. meat inspection laws (Article 708).
12. The United States will recognize Canadian Whiskey as a distinct product and will not permit the sale of any product labeled as Canadian Whiskey unless it has been manufactured in Canada (Article 806).
13. Under the national treatment principle, the United States will allow British Columbia Hydro fair access to the distribution lines of the Bonneville Power Administration (Article 905.2).
14. The Agreement changes the rules of origin for automotive products to provide more protection against offshore parts producers and, thus, to increase the access of Canadian and U.S. parts producers to each other's markets (Article 1005).
15. The Agreement opens up some government procurement markets (Article 1304).
16. The Agreement protects free trade for a wide range of services industries by its inclusion of the right of establishment and the principle of national treatment (Articles 1401 and 1402).
17. Temporary entry for Canadian business people and service personnel (Article 1502) is to be easily granted, and an open and bilateral method for settling disputes over denied entry is to be established (Article 1504).
18. National treatment is extended to the establishment in the United States of Canadian business enterprises covered by the Agreement, thus increasing access for those businesses where a physical presence is needed if goods are to be sold (Article 1602).

Box 3

How the Agreement Increases Security of Access

The Agreement increases security of access to the U.S. market in a number of important ways. It also holds the promise of further increases in security of access in the future. Once again, one can allow the Agreement to speak for itself by working through it chapter by chapter and by listing these items as they appear.

Immediate Increases in Security of Access

1. The Agreement removes the threat of quantitative restrictions and the United States' ability to use them to force Canada to adopt VERs (Article 407, in combination with Articles 1101 and 1102).
2. The United States will give Canadian energy products increased security of access to its market. This is particularly important for oil and gas, uranium, and electricity (Articles 902 and 905).
3. The Agreement severely restricts the circumstances under which the United States can use national security to restrict imports of Canadian energy products (Article 907).
4. Because the Agreement strengthens the auto pact, free trade in automotive goods is made more secure and cannot be upset without abrogation of the entire Agreement (Article 1001).
5. Canada will no longer be hit by U.S. global safeguard actions aimed at others, thus removing the "sideswipe" problem that has arisen several times in the past (Article 1102).

Box 3 - continued

6. The Agreement reduces the uncertainty caused by escape clause action — which was used, for example, against shakes and shingles — to a minimal level by severely constraining both the circumstances under which such action can be taken and its severity (Article 1102).
7. The dispute settlement procedure outlined in Chapter 19 will make the application of U.S. trade laws less politically motivated; in the opinion of many U.S. trade lawyers, this would have altered the softwood lumber decision had it been in place.
8. By shortening the appeal process to less than a year, the dispute settlement mechanism makes it easier to redress bad decisions (Article 1904). At present, appeals through the U.S. courts often take years; in the meantime, the duty must be paid.

Future Increases in Security of Access

1. The United States has promised to accord national treatment to Canadian financial institutions operating in U.S. financial markets by amending U.S. laws governing financial institutions — in particular, the *Glass-Steagall Act* (Article 1702).
2. The Agreement improves the prospects for increasing future access by requiring consultations designed to revise antidumping and countervail laws over the next five to seven years. This provides for the maintenance of *a degree of close consultations that would have been highly unlikely without the Agreement* (Article 1907).

Industry and the FTA

Extracts from a study by the Government of Canada, Office of the Trade Negotiator

Discussion Note

The following reading is a discussion of the impact of the Free Trade Agreement on Canadian industry prepared by the Trade Negotiator's Office, Ottawa, Canada.

The reading surveys studies on trade liberalization and the Canadian economy and concludes that on balance the FTA will be beneficial. Interesting, too, are the tariff tables included in the selection. This shows that the tariff structure in both countries was broadly similar, which may help to explain the ease with which tariff elimination was agreed. Finally, the discussion of employment effects indicates how dynamic Canada's economy is — such that a large portion of the work force changes jobs each year through the normal course of events. So large is this number that displacements due to the FTA are unlikely to appear significant or to require new assistance programs, the TNO authors argue.

Canada-U.S. Free Trade and Canadian Industry

Impact on Industries

For manufacturing in Canada, the gains from the Agreement will be widespread. However, the net gains, industry-by-industry, will depend on a number of factors, including the current rate of trade protection provided in both countries, current competitiveness and the ability to improve price competitiveness, as well as the potential to exploit new opportunities in an expanded and more secure market. Reductions in U.S. levels of protection will benefit many Canadian industries as Canadian goods will tend to be cheaper in the U.S. marketplace. In addition, removing high levels of domestic protection will be a strong stimulus for change in many areas of Canada's industrial economy. Industries with a high potential to improve efficiency by achieving scale economies will clearly gain substantially over time. Industries using products from the United States will benefit from lower input costs.

In assessing the prospects for individual industries, a variety of other factors also need to be taken into account. In many industries, fundamental global changes in technology, cost and market factors have already stimulated the process of rationalization and specialization. The Agreement will provide an important further stimulus to accelerate this trend.

Indeed, the opportunities from expanded and more secure access to a market exceeding 270 million consumers will enhance the ability of Canadian firms to undertake the adjustments and repositioning required. According to the findings of researchers such as Baldwin and Gorecki, such adjustments are likely to include increased specialization, longer production runs, the introduction of new technologies, investment in new and expanded facilities and the retraining of workers. In addition, firms will be able to take advantage of lower priced materials and machinery purchased from both domestic and U.S. sources to improve their competitive position.

Benefits will also come in the form of increased investment in Canada, particularly by foreign companies interested in capitalizing on Canada's relative competitive strengths as a supplier of both the North American market and markets in third countries. Canada's extensive resource base, its energy supplies, its skilled labour and its efficient transportation system, combined with secure access to the world's largest market, will result in a climate attractive to investors from all countries.

For Canadian exporters, preferential tariff treatment in the U.S. market will help them to compete more successfully in the United States with offshore competitors. In addition, the stimulus provided by the Agreement towards rationalization and improved competitiveness will allow Canadian industry to benefit from further worldwide trade liberalization as a result of the current round of Multilateral Trade Negotiations.

Currently, tariff and non-tariff barriers are higher in manufacturing than in other sectors in both Canada and the United States. Manufacturing should, therefore, have the most potential to realize benefits from trade liberalization through cost reductions and improved efficiency. It is evident from Table 3.10, which shows the average rates of tariff protection for manufacturing industries in Canada and the United States, that levels of protection vary substantially among industries. In Canada, tariff protection ranges up to 22.7 per cent in knitting mills. In the United States, the range of protection is approximately the same with a high of 20.7 per cent in Tobacco. It is interesting to note, however, that industries which are highly protected in Canada also tend to be highly protected in the United States. This suggests that the increased competition from the elimination of protection in these industries in Canada may be largely offset by the opening up of new opportunities for exports to the United States, particularly with respect to third country imports.

The Overall Effect

According to a number of studies, by the Department of Finance, the Economic Council and various private sector organizations, such as Informetrica and the Conference Board, the net result of the Agreement will be positive since the benefits to firms adapting to and capitalizing on the opportunities flowing from the Agreement are expected to be greater than the potential costs which may be experienced by those firms which face more difficult adjustments. The Department of Finance estimates that the Agreement will result in an increase in real manufacturing output of over 10 per cent in the long run.

Implications for Adjustment

Free trade with the United States will be but one of the influences to which Canadian industries will need to respond over the next decade. Other important factors include the continuing globalization and growing interdependence of world markets as well as continuing and accelerating advances in technology. Canadian industries have responded positively to change in the past, including the significant liberalization of trade which has occurred over the past several decades.

The Agreement is designed in such a way as to ensure a continuation of the positive adjustment process through:

- the 10 year phase-in period;
- new safeguard provisions and dispute settlement mechanisms;
- grandfathering of existing policies in certain areas (services, investment, beer); and
- exemptions for certain industries (culture, agriculture marketing boards).

These elements of the Agreement are discussed in detail in the next chapter.

Various studies suggest that the necessary adjustment can be readily accomplished. Rugman (1987), in a study of how multinationals will adjust to trade liberalization[7], argues that (1) multinationals can bear the costs of adjustment themselves; (2) there will be few plant closures; (3) bilateral trade and investment will both increase; and (4) the large firms studied will continue to prosper.

In fact, the economy is constantly adapting to change. Data developed by Baldwin and Gorecki[8] (1983) indicate that, over the decade of the 1970s, which was characterized by multilateral trade liberalization, the main method of adjustment was the birth of new firms, usually by the creation of a new establishment. At the end of the decade, 30 per cent of existing establishments were new entrants, the large majority by the creation of new facilities rather than by acquisition. Conversely, 40 per cent of establishments which existed in 1970 were no longer in existence by the end of the decade.

These same researchers[9] (1984) also demonstrated that increased trade liberalization has resulted in increased specialization in Canadian plants and longer production runs, thereby allowing Canadian industries to reap the benefits of economies of scale and to improve relative efficiency and competitiveness. Plants faced with increased import competition tended to carve out specialist market niches.

As the Economic Council noted in a recent study of adjustment (1988) "firms are constantly engaged in a process of adaptation — contracting or expanding production and employment, entering or exiting industries, merging and divesting, building new plants and closing existing plants."[10] In the same study, the Council found that "the Canadian labour market is undergoing constant change... in a typical year 8 per cent of the jobs in the manufacturing sector disappear because of plant closings and contractions, while there is an increase of 9 per cent in the number of jobs created because of plant openings and expansion. Worker behaviour adds another important dimension to labour market turnover. The number of worker-initiated moves is equal, in a typical year, to at least 10 per cent of the labour force in the manufacturing sector. This excludes temporary movement."[11]

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[7] Rugman, A.M., 1987, "Living with Free Trade: How Multinationals Adjust to Trade Liberalization", *Business Quarterly*, U. of Western Ontario, Fall 1987.

[8] Baldwin, J.R. and P.K. Gorecki, 1983, "The Determinants of Entry and Exit to Canadian Manufacturing Industries", Discussion Paper No. 225. (Ottawa: Economic Council of Canada).

[9] Baldwin, J.R. and P.K. Gorecki, 1984, *The Relationship Between Trade and Tariff Patterns and the Efficiency of the Canadian Manufacturing Sector in the 1970s: A Summary*. (mimeo).

[10] Economic Council of Canada, 1988, *Managing Adjustment: Policies for Trade-Sensitive Industries*, Ottawa, p. 39.

[11] Ibid, p. 18.

Table 3.10
Canadian and U.S. Tariff Protection in Manufacturing*

Industry	Canada	United States
	(Per cent)	(Per cent)
Manufacturing (Total)	5.2	3.2
Food & Beverage	5.2	3.6
Tobacco	16.5	20.7
Rubber & Plastics	9.4	4.5
Leather	15.7	7.5
Textiles	11.4	8.5
Knitting Mills	22.7	12.3
Clothing	19.7	10.9
Wood	2.5	1.5
Furniture & Fixtures	12.5	2.0
Paper & Allied Products	3.5	2.4
Printing & Publishing	2.7	0.6
Primary Metals	4.2	3.1
Metal Fabricating	7.3	2.6
Machinery	4.9	2.8
Transportation Equipment	2.3	0.6
Motor Vehicles	1.8	0.2
Motor Vehicle Parts	1.1	0.6
Aircraft & Parts	0.5	0.9
Shipbuilding	10.1	0.3
Other Transportation Equipment	8.5	4.3
Electrical Products	7.8	4.3
Non-Metallic Mineral Products	6.3	2.6
Petroleum & Coal Products	0.5	0.5
Chemicals & Chemical Products	6.0	3.5
Miscellaneous Manufacturing	6.0	3.9

* 1987 Post-Tokyo Round most-favoured-nation tariffs aggregated using production weights.

Sources: Department of Finance and the Institute for Research on Public Policy.

Many government programs and services which support the adaptation process are already in place. As well, the Federal Government announced on January 11, 1988 the formation of the Advisory Council on Adjustment to assist the Government by:

- examining the possibilities for Canadian businesses and workers to position themselves for optimum benefit from the Agreement;
- identifying specific adjustment issues or circumstances; examining various Government programs that support adjustment by firms, workers and communities; and
- recommending any changes to those programs which would improve their effectiveness, efficiency or equity as instruments to facilitate adjustment to the opportunities or issues arising from the Agreement.

Conclusion

Canadian manufacturing approaches free trade from a base of strong growth, with a powerful history of benefiting from trade, and a proven capacity to deal with and profit from change.

The Agreement will provide a means of remedying existing weaknesses in the overall industrial base, especially with respect to Canada's competitive position. It will generate increased investment, provide larger markets, afford access to new products and processes, and reinforce the level of competition. These effects will all serve to help Canada meet the increasingly competitive international markets of the future.

Elements of the Canada-U.S. Free Trade Agreement — Synopsis

On October 4, 1987, Canada and the United States agreed in principle on the elements to be included in the Canada-U.S. Free Trade Agreement. The legal text of the Agreement was tabled in the House of Commons on December 11, 1987. The main elements of the Agreement are the following:

Tariffs and Rules of Origin

All bilateral tariffs will be removed, starting January 1, 1989 when the Agreement enters into force, on the basis of three formulas: a) some will be eliminated immediately; b) some will be eliminated in five equal annual steps; c) some will be eliminated in 10 equal annual steps.

Goods which originate entirely in Canada or the United States will qualify for the new tariff treatment. Goods incorporating offshore materials or components that have been sufficiently changed to warrant a change in tariff classification will also qualify. In certain cases, goods will need to incur 50 per cent of manufacturing cost in either country before they qualify.

Quantitative Restrictions

GATT provisions governing quantitative restrictions on imports or exports will continue to apply. Existing quantitative restrictions will be eliminated, either immediately or according to an agreed timetable, or will be grandfathered. With respect to export measures for short supply or conservation reasons, the Agreement goes beyond the GATT to allow for proportional access to supplies on a historical basis without any price discrimination being imposed by governments. The Agreement provides for co-operation on implementing any such export measures to prevent diversion to third parties.

Technical Standards

The two governments agree to build on the GATT Standards Code. They will endeavour to make federal standards more compatible in order to reduce technical barriers which interfere with trade, while still protecting health and safety, environmental, national security and consumer interests. Increased compatibility of standards at the state, provincial and private levels will be encouraged.

Agriculture

Both governments agree to eliminate tariffs on agricultural trade within 10 years and not to use direct export subsidies on their bilateral agricultural trade. There is a special tariff provision for fresh fruit and vegetables which enables the temporary reimposition of current tariffs under certain circumstances. Both governments will exclude each other from their respective meat import laws, and Canadian import licences for wheat, barley and oats will be eliminated once grain support levels are equivalent in both countries. Canada will be exempt from any future U.S. quantitative restrictions on products containing 10 per cent or less sugar. The Agreement retains the Canadian supply management and marketing board system and provides for a slight increase in Canadian import quotas for poultry and eggs. Both countries agree to reduce technical regulations which interfere with trade, while still protecting human, animal and plant health.

Wine and Distilled Spirits

The two governments agree to provide national treatment in listing and distribution practices, with certain exceptions for B.C. wineries and private wine outlets in British Columbia and Ontario. Canada will eliminate the price mark-up differential between Canadian and U.S. wines over a seven-year period, and immediately for distilled spirits. The Agreement does not apply to current restrictions on beer. All other price discrimination in Canada and the United States will be eliminated immediately.

Energy

Both governments agree to prohibit most restrictions on energy exports and imports, subject to existing GATT reasons for which such restrictions may be applied, including those related to supply or conservation. In the event of short supply export controls, however, the exporting country will allow for access up to the historical proportion for energy commodities and will not impose higher prices for export. As with the general quantitative restrictions, there is no obligation to supply.

Automotive Trade

The Agreement retains the Auto Pact and its safeguards for current participants. Canadian value-added commitments by the Auto Pact manufacturers are not changed in any way by the Agreement. Rules of origin in the Agreement encourage the sourcing of more parts in North America. Automotive duty waivers and remissions will be phased out, as will the Canadian embargo on used vehicle imports.

Emergency Measures

Both governments agree to more stringent standards in the application of safeguard measures (quotas or restrictions) to bilateral trade. Global import quotas or surtaxes imposed by either government under Article XIX of the GATT will exempt the other party if its shipments are not substantial (less than five to 10 per cent of total imports). During the period of transition of this Agreement, if imports from the other country alone are a substantial cause of serious injury, duty reductions provided by the Agreement may be suspended for a maximum of three years,but only one such action per product can be taken.

Government Procurement

Canada and the United States agree to expand access of each other's suppliers to purchases by governments at the federal level, building on the GATT Government Procurement Code. The coverage of the Code will be broadened to purchases between US $25,000 (about Can $33,000) and US $171,000 (Can $238,000). Further bilateral negotiations will be resumed once the GATT Code is renegotiated.

Trade in Services

The Agreement provides, for the first time, a set of disciplines covering many service sectors. In the future, both governments will extend the principles of national treatment, right of commercial presence and right of establishment, consistent with the investment chapter, to each other's providers of services. Sectoral annexes spell out these obligations for Tourism, Architects, and Computer and Enhanced Telecommunications Services.

Financial Services

The Agreement preserves the access that Canadian and U.S. financial institutions have to each other's markets and opens new areas of competition in securities underwriting and banking.

Cultural Industries

Cultural industries are explicitly exempted from the Agreement.

Temporary Entry for Business Purposes

Business persons trading in goods and services will benefit from improved and easier border crossing.

Investment

The two governments agree to provide national treatment in future to each other's investors and will not impose export, local content, local sourcing or import substitution requirements on each other's investors. Existing laws, regulations and published policies are grandfathered. The Canadian threshold for the review of U.S. direct acquisitions will be raised to Can $150 million by 1992. Review of U.S. indirect acquisitions will be phased out over the same period.

Dispute Settlement in Antidumping and Countervail Cases

A dispute settlement mechanism will guarantee the fair application of respective antidumping and countervailing duty laws. Either government may request a binational panel to review final antidumping or countervail determinations. Panel decisions will be binding. New legislation will not apply to the other country unless it is so specified. A binational panel may review such proposed legislative changes and issue opinions. Both governments will attempt to develop and implement a substitute system of countervail and antidumping laws within seven years.

Institutional Provisions

A Canada-United States Trade Commission will be established to supervise the implementation of the Agreement and resolve disputes. The two governments further agree to binational panel procedures at the insistence of either country to make recommendations for the settlement of disputes regarding the interpretation and application of the Agreement in other than antidumping and countervail cases. They will refer such disputes to binding arbitration in the case of safeguards and, with the agreement of both governments, may also do so in other cases.

"Introduction"
The Free Trade Deal

This reading is the "Introduction," *The Free Trade Deal,* by Duncan Cameron, ed., James Lorimer Press, Toronto.
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Discussion Note

This reading summarizes the case put by the FTA opponents during the 1988 Canadian election. As an interesting contrast, it should be read alongside the reading by Mr. Morici earlier in this collection.

Contributors

The introduction summarizes the main points of articles by a wide spectrum of opponents of the Free Trade Agreement. Some of the contributors to the volume cited in this introduction are: Giles Gherson, Washington correspondent of the *Financial Post*, a Toronto-based business newspaper; Riel Miller, a Canadian economist who holds a Ph.D. from the New School for Social Research in New York; Daniel Drache, a professor of economics at York University, Toronto, and author of a widely-read study, *The Other Macdonald Report,* attacking the conclusions of the royal commission on Canada's economic future recommending a comprehensive free trade agreement with the U.S.; Mel Watkins, a professor of economics at the University of Toronto, a long-time proponent of a Canadian industrial policy and the author of a pioneering study criticizing the branch plant structure of Canadian industry in the 1960s.

Other contributors named in the introduction are: John Calvert, a senior researcher with the Canadian Union of Public Employees; Marjorie Cohen, a professor at the Ontario Institute for Studies in Education and author of works on women in the economy; John Warnock, a professor of economics at the Universities of Victoria (B.C.) and Saskatchewan and author of works on the New

Continued next page

Discussion Note cont'd...

Right; Mary Beth Montcalm, a professor of politics at the University of Manitoba; Frank Tester, a professor of environment studies; Patricia Lane, a Vancouver lawyer; Susan Crean, a journalist and author of works on Canadian media and culture; Deborah Coyne, a professor of constitutional law at the University of Toronto; and Donna Desko, Ph.D., a nationally-known opinion pollster.

The Argument

Apart from traditional concern about U.S. intrusion, the main thrust of these arguments is that the Canadian government has ceded authority to make a centrally-directed national industrial policy. Instead, under the FTA, it has in effect delegated this right to multinational companies. In the process, these arguments go, the government has tied its hands on new social policies, including standards on maternity leave, etc., weakened its financial system, and undermined its cultural sovereignty. Combined with other measures contemplated by the government, such as adding to the already considerable powers of the provinces vis-a-vis the central government, the FTA will shift decisions over Canada's destiny to the U.S.

The Election

These arguments were not sufficient to overcome the lack of public confidence in the opposition parties. The government of Brian Mulroney was returned to power and the FTA ratified on schedule. But the opposition parties were returned with significantly more seats than in the previous parliament. Moreover, since most of the contests outside Quebec were three-way races, it was argued by the opposition parties that the majority of voters had voted against free trade. Result?

The opposition parties felt mandated to voice these arguments inside parliament and use them as a litmus test to judge the implementation of the agreement.

Here are the party standings following the 1988 Free Trade Election, compared with the 1984 election that brought Mulroney to power:

	1988	1984
Progressive Conservatives	170	203
Liberals	82	38
New Democratic Party (NDP)	43	32

The Progressive Conservative party corresponds to the U.S. Republican Party, although it favors considerably more government intervention and social spending than does the average Republican.

The Liberals are equivalent to Democrats in the U.S. political spectrum, although, once again, they are generally more "liberal" than is currently fashionable among Democrats. The NDP is a non-Marxist social democratic party, generally to the right of the Labor Party in Britain.

Question: How stable is the FTA given this political line-up?

On January 2, 1988, Prime Minister Mulroney and President Reagan signed an agreement to join Canada and the United States in a new free-trade area. The separate ceremonies took place 462 days after the prime minister announced to the House of Commons his intention to seek a comprehensive trade arrangement with the U.S. Scheduled to come into force on January 1, 1989, the accord is officially described as *The Canada-U.S. Free Trade Agreement*. It is both less, and more, than that. Less, because not all trade restrictions between the two countries have been eliminated; notably for Canada, American protectionist trade laws remain in effect. More, because in important respects, namely energy and other natural resources, services and investment, it goes well beyond what is generally understood by free trade. In fact, what has been agreed upon between the two countries is a continental economic treaty with important political implications, especially for Canada.

For the Conservative government, the free-trade agreement represents the centrepiece of its economic strategy for Canada. The accord is intended to enhance Canada's competitive position, using the American market as a springboard for reaching other international markets. The Tories argue that Canadian industry needs tariff-free access to the North American market with its 250 million consumers. In other words, Canada's economic future lies in rationalizing industry on a North American basis so as to better serve the world market. The government denies that Canada's political future will in any way be compromised as a result of forging closer economic links with the U.S.

For the U.S., the economic impact of the pact is small, but not insignificant. A report prepared for the U.S. Trade Representative by the American International Trade Commission showed that U.S. industry had little to gain, or lose, from tariff reductions. But the accord is important for the Americans. It offers the U.S. non-discriminatory access to Canadian natural resources, a significant long-term advantage. At a

time when the U.S. is running short of key raw materials, including petroleum, Canada has agreed not to favour Canadian resource users over American users.

For Canada, the agreement is by any measure an historic document. The preliminary agreement, reached shortly before midnight on October 3, 1987, was heralded by the American president as a "new economic constitution for North America." In Canada the entente has provoked strong reaction, both for and against. "Economic rape," "a magnificent achievement," "an unprecedented abandonment of national powers and massive transfers of authority and decision-making from Canada to the U.S.," "will secure jobs and better standards of living for Canadians to the end of the century and into the next" — these comments indicate the extent of controversy over free trade.

Within Canada there is good reason for the wide interest in the issues raised by the deal. Canadians have begun the most important political debate of this generation, perhaps of this century. Yet many people remain uncertain about what it all means. This book has been prepared to allow them to judge the agreement: to identify and understand the issues it raises. Expert commentary on the various articles of the accord should help the reader see what lies behind the complexities of the legal text. *The Free-Trade Deal* looks at the issues arising from the agreement as well as the text of the agreement itself. The perspective is critical but not unbalanced. While rhetoric and emotion are very much part of the debate over free trade, and legitimately so because of what is at stake, this book aims at improving the quality of that debate by providing information and informed comment that goes beyond the official interpretation of the text.

Buying the Deal

For many Canadians opposed to the free-trade deal, the accord represents a threat to our national existence. This is a serious charge. It is made by serious people. And it deserves to be considered carefully, not just dismissed as overstatement. Fierce opposition to free trade reflects the concern, not so much that Canada will disappear, but that if the deal goes ahead, Canadians will lose control over their destiny and that of their country. As this book will show, in addition to the far-reaching

concessions made as part of this deal, the ability of elected representatives to introduce new policies has been reduced as part of an undertaking to a foreign government. In a very real sense, a significant measure of national control over the economy has been handed over to the North American private sector. For many Canadians, including both opposition parties in the House of Commons and the provincial governments of Ontario and Prince Edward Island, this makes the agreement unacceptable.

It should be clearly understood that free trade is not a *fait accompli.* Since both the Liberals and New Democrats have pledged, if elected, to renounce the deal, only the re-election of a majority Conservative government will ensure that the agreement does not die before being implemented, or is not abrogated once it becomes law. For the deal to take effect on January 1, 1989, passage of legislative amendments to implement the agreement must first take place. The required amendments to existing legislation need the approval of the House of Commons and Canadian Senate before the end of 1988 in order to meet the implementation date. Therefore, an election will be called (or forced) if the legislative amendments get bogged down in parliament. Moreover, constitutionally, the Conservatives must call an election before the fall of 1989 at the latest. Given that the agreement contains a six-month abrogation clause, a new Canadian government could still withdraw from the deal, even if the Conservatives manage to implement it. And, of course, the American Congress must pass ratifying legislation as well, which raises additional uncertainties about the future of the accord.

Thus, barring failure to ratify in the U.S., the future of free trade will be resolved politically within Canada. Simply put, if in a 1988 election the Canadian people reject the Conservative government, they reject the agreement. Neither the Liberals nor the New Democrats are prepared to proceed on implementation. A letter from the new prime minister to the American ambassador would suffice to kill the accord before it comes into effect. A Conservative defeat in a 1989 election would likely have the same effect, though this is somewhat more problematic. Once an international agreement like this deal takes force there would be pressure on a new government not to pull out. Unless public opinion in Canada has clearly rejected free trade, this pressure might have some effect, particularly on a Liberal majority government.

It is clear, however, that an NDP government or one that needed NDP support would abrogate the agreement. Thus either a Liberal or NDP minority administration would withdraw from the deal. And a Conservative minority would be unlikely to survive in the House of Commons.

The Mulroney government is well aware of the hazards that lie ahead. As the prime minister said of the free-trade initiative on June 6, 1986, "of course my neck is on the line." Speaking at the University of Brandon in September 1986, Mulroney promised that the Canadian people would be consulted about free trade. Given the importance attached to the deal by all three parties, the public debate over the meaning of free trade for Canada will frame the impending election contest. The government and its supporters have already indicated on what grounds they expect to fight. Indeed, the government has been making its position clear since the bilateral initiative was launched and it is unlikely to change its basic message.

Selling the Deal

What does the government say to sell this deal? What is the official interpretation of the text? First, the government trumpets the creation of a binding dispute-settlement mechanism as a breakthrough for Canada. The U.S., it says, has agreed to relinquish some of its sovereignty, since the entente replaces U.S. judicial review of trade disputes with binational panels where Canada will be represented. This establishes an important historical precedent for joint management of the North American economy. From now on, trade harassment of successful Canadian exporters will be reduced. American companies will be deterred from acting against Canadian companies by the prospect of having favourable decisions under U.S. law overturned by a binational panel. In addition, it is held that the U.S. trade-remedy process will be less political under the accord. Decisions by U.S. authorities — the International Trade Commission and the Department of Commerce — will be more impartial with the new disputes agency in place than they were when faced only with judicial review by U.S. courts. The disputes agency can be thought of as a deterrent to politically inspired decisions in the U.S against Canadian industry.

Second, the government insists that the deal has limited scope: it is about tariff reductions and trade disputes, matters of commercial policy. Under the accord, Canada only continues the policy of increased trade liberalization that was begun through the seven successive GATT (General Agreement on Tariffs and Trade) negotiations since the second World War. The bilateral nature of the agreement is downplayed as well. Canada and the United States are simply setting out together on a path that will be followed by other nations within the current eighth GATT round. By acting now, Canada gets a headstart in making the economic adjustments necessary to compete in a tougher, more competitive international environment.

Third, the government believes that there is no better economic strategy alternative for Canada than a bilateral trade deal with the U.S. Since the U.S. is Canada's best customer, taking nearly 80 per cent of all exports, it makes sense from the point of view of trade policy to enhance Canadian access to the American market. At the same time, the deal opens the Canadian economy to American competition, and in so doing it should reduce the productivity gap between the two nations in the all-important manufacturing sector. The creation of a North American capital market, by removing restrictions on flows of investment and assuring national treatment to foreign investment in each other's economies, helps to increase the efficiency of spending on new plants and equipment. Further, a wider market, combined with more freedom for capital investors, points towards a more prosperous North America. Increased competition will lower prices, raise the Gross National Product (GNP) per capita and create jobs. For the government, this is a win-win agreement. Both Canada and the U.S. gain overall. A stronger Canadian economy makes for a more independent foreign policy. A richer Canada can be more generous with social programmes.

Finally, the Conservatives point to their record on economic issues and claim that they have justified the confidence placed in them by the Canadian people. Lower rates of unemployment and of inflation show that the objectives laid out in the 1984 election campaign are being met. When they elected more members to the House of Commons than any other party has ever elected, Canadians expected good government and they have got it from the Conservatives. The free-trade deal will

produce more jobs and prosperity. Canadians can trust the government on this score.

These arguments are made by Conservative ministers and members of parliament in defence of the accord. Since they will be heard over and over again, they require close examination. Do the arguments stand up to close scrutiny? At the very least it can be said that an alternative interpretation of the Conservative claims about the deal can be made. And it is clear that those concerned about the consequences of the agreement for Canada want to consider alternative views. As is to be expected, the official interpretation of the deal puts the agreement in the best possible light. In its public campaign in favour of the agreement, the government rarely considers arguments critical of the deal. Nevertheless, such arguments also merit attention. As the chapters in this book show, the government's case can be refuted.

Trade Politics

Though presented by the government as a Canadian undertaking, it is important that the negotiations be assessed from the American perspective. In chapter one, Giles Gherson sets out the American objectives in the bilateral talks. He demonstrates that the U.S. was able to achieve its main goals and that U.S. negotiators found the negotiations particularly useful for resolving specific trade grievances against Canada. Politically, the deal is part of the American strategy for dealing with a back-breaking trade deficit. It shows other U.S. trading partners that the Americans are serious about prying open markets abroad. If international negotiations under GATT fail to meet American demands, the U.S. is prepared to negotiate separate agreements with major trading partners. The pact with Canada is proof of its intention in this regard. Other U.S. trading partners, including Japan, Korea, Hong Kong, Taiwan and Singapore, are now reportedly prepared to risk bilateral talks in order to forestall unilateral American legislative or administrative action aimed at reducing the U.S. trade deficit. The conclusion is clear: by taking the world's largest trading relationship and putting it under a bilateral treaty, the U.S. and Canada are in effect weakening the multilateral trading system established under GATT.

While Canada has negotiated an agreement that liberalizes North American commerce, chapter two shows that the deal also has important implications for Canadian political practices. Bilateralism in trade represents a significant shift in Canadian foreign policy, since Canada has always championed international economic institutions. Also, provincial powers under the Constitution are restricted by the accord. Thus, Canada's ability to establish public goals is set into a new North American framework. The deal, then, constitutes a major undertaking, going beyond a normal political initiative. Whatever the benefits that may accrue to Canada from the free-trade deal, it must be evaluated in the larger context of changes to Canadian political life.

According to the government, it was all-important to eliminate the threat of American protectionism. A bilateral treaty that brought the rule of law to bear on trade relations was needed to restrain political actions on either side of the border. Indeed, if Canada could forego normal political channels, and deal with its superpower neighbour through a neutral mechanism, this would be attractive. Unfortunately, as Stephen Clarkson points out in chapter three, this seems highly unlikely to occur as a result of the agreement.

Under the terms of the deal, Canada's bilateral political dealings with the U.S. will increase substantially. The countries have institutionalized their economic relationship in the Canada-U.S. Trade Commission (CUSTER), but this body can be expected to reproduce the power dynamics of the bilateral relationship, where all the influence of the American government can be brought to bear directly on Canada's representatives. Canada is head to head with the U.S. within the commission, and, in contrast to our position in multilateral institutions, no allies are available to help out. At its heart, this is a deal based on goodwill, not on law as law is generally understood. If either party decides to ignore the wishes of the other it can do so. Nothing in the treaty prevents it. The only options available to an unhappy party are to retaliate against its partner or to scrap the deal altogether.

Free-trade supporters see the trade-disputes procedures as the key provision of the treaty. For Canada, they represent the major concession by the United States. Indeed, under the agreement, the creation of new dispute-settlement procedures for trade in goods is the best possible argument for justifying claims that Canada comes out ahead in the deal. But when the elaborate provisions set out in the treaty are

stripped down to essentials, they amount to very little gain for Canada. Most claims made by supporters are exaggerated. When measured against what Canada sought in negotiations — guarantees concerning market access — the trade dispute provisions are a disappointment. In brief, if the case for the agreement rests on the disputes provisions, it has to be judged severely, and indeed it has been judged on this basis and found wanting by free-trade supporters as well as critics.

Though the government is unwilling to admit it, Canada failed to achieve its principal objective in talks with the U.S.: secure access to the U.S. market. There is no reason for confusion on this point, as chapter four outlines. What Canada wanted from the U.S. was clearly stated by the government. As Brian Mulroney himself said: "U.S. trade laws can't apply to Canada, period." Yet U.S. trade laws still apply to Canada under the accord. Worse, the key U.S. protectionist measures — its countervailing duty and anti-dumping laws — are actually incorporated into Chapter 19 of the agreement! The intended outcome of the talks from the Canadian perspective was a *new* set of trade laws to govern commercial relations between the two countries, and a court of *first* resort to resolve disputes. Canada achieved neither.

The government argues that lower tariffs will expand trade. This creates wealth, and the increased competition in the larger market ensures that benefits will be distributed to the population in the form of lower prices. This argument is the basis on which many Canadians find free trade economically attractive. Riel Miller scrutinizes this argument in chapter five and finds it wanting. Though many have been led to believe that, as a result of free trade, all goods available in the U.S. will be made available in Canada, duty-free, this is hardly the whole story. It is correct that by 1998 all American-made goods could be imported into Canada duty-free, and that tariff reductions could eventually lower prices on those goods, but individual Canadians will pay Canadian sales taxes on American goods even if they bring them back themselves from the U.S. And, of course, duty will be paid on all goods purchased in the U.S. but made elsewhere. Under free trade, a Japanese video recorder purchased in New York would be subject to both a duty and a Canadian sales tax. Rules of origin will be in effect, and someone will still have to check where a good was made in order to determine if duty must be paid.

But there is a larger economic argument concerning consumer prices that is also addressed in chapter five. It is that lower prices will put more money in the hands of Canadians, which will then be spent to create new wealth. This new wealth could then be used as Canadians see fit — for example, new social programmes could be created as a result of the larger tax revenues accruing from the increased wealth. Such arguments rest on the premise that a wider North American market would promote greater efficiency in production, increase competition and thus lower prices. Yet, as Riel Miller shows, it is hard to believe that the removal of the few remaining tariffs in North America could have such an impact. The more likely effect would be to enhance the trend towards fewer, larger producers. Large firms could take advantage of national treatment provisions to buy out competitors, or drive them out of business by lowering prices initially, then raising prices once competition has been eliminated. Efficient small firms are always takeover targets; it is cheaper and easier to buy success than create it. Price competition is more properly understood as a tool of corporate expansion than as the natural result of a larger market. Though there is no doubt that large firms do compete, there is no convincing evidence to suggest that they do so primarily through price reductions that benefit the consumer. This may occur, but it is more often the case that companies try to secure advantages over competitors by various strategic methods, including advertising, marketing, new product research and development, and other measures that increase costs and thus, eventually, prices.

A New Economic Constitution for North America

Despite government assertions, the entente is much broader than a trade deal. Daniel Drache makes it clear in chapter six that the text deals with matters that go beyond anything ever signed by Canada in the trade field. Fully ten of the twenty-one chapters in the agreement cover matters other than trade in goods. These include technical standards, energy, services, movement of people for business purposes, investment and financial services, as well as the creation of joint institutions and the application of trade law. And provisions with respect to trade in goods go further than any trade agreement ever

signed by Canada. The deal opens negotiations to set common standards for tradeable goods, for instance. Under this agreement Canada agrees not just to treat American goods like Canadian goods for purposes of trade; Canada also agrees not to discriminate against American purchasers of Canadian goods by imposing higher prices, restricting supplies, or otherwise disrupting American access to Canadian goods and resources.

The deal introduces new North American economic rules that are based on the concept of national treatment. They bind governments, particularly the Canadian government, in many specific respects, and indeed justify the comment made by President Reagan that the deal offers "a new economic constitution for North America." The implications of these rules are stunning, so much so that critics believe that once they are well known the deal will likely be rejected by Canadians. But until the new rules are fully understood, the major difficulty is getting people to believe what Canada has in fact given away in this agreement.

The agreement extends the right of national treatment across the border to U.S.-based suppliers of the Canadian market. As Mel Watkins demonstrates in chapter seven, the deal allows American investors to purchase virtually anything in Canada that has a value of less than $150 million, no questions asked. And if a Canadian company is already owned by Americans, the limit is waived. Large acquisitions face nominal review and so-called cultural industries are excluded from this "up for sale" policy. Of course, some Canadian businesses welcome the deal because it allows them investment rights in the U.S. These new rights of national treatment do compensate for the lack of secure access to the American market for Canadian exports. Under the deal, a Canadian firm could forestall the threat of American protectionism and gain access to U.S. government contracts by moving to the United States. Therefore, the deal actually encourages what it was supposed to prevent: new investment by Canadian-based firms will now be more likely to take place in the U.S. rather than in Canada. For major Canadian firms, free trade means they get American citizenship.

Chapter eight focuses on resources. In this sector, Americans are guaranteed a share of whatever is commercially available in Canada without any discrimination allowed on the basis of nationality; the only qualifier is the provision that, for resources in short supply, Americans

cannot claim more than their proportionate share, based on historical precedent. Looked at from any perspective, this part of the agreement means that the larger American economy gains, permanently, rights of control over the resources of the smaller Canadian economy, unless they are in short supply, in which case Canada has still given up its right to control export levels. Furthermore, Canada can no longer require that American owners undertake to upgrade resources before they are exported. As chapter nine explains, a new common market for energy means that a made-in-Canada price for energy is gone forever. Thus Canadian decisions concerning resource extraction and energy pricing are divorced from our own industrial policy decisions.

Resource sharing in the energy field has dramatic consequences for Canada. For each three barrels of oil produced in Canada, one barrel is now exported to the United States. Canada can no longer choose to conserve diminishing supplies of petroleum by cutting off exports to the U.S., though conventional supplies of crude oil are only sufficient to meet Canadian needs for eleven years at current rates of consumption. Incredibly, under the deal, Canada in effect gives the U.S. ownership rights over one-third of these reserves. And yet Canadian reserves cannot even begin to meet American needs, since they only amount to a fraction of U.S. consumption. The only way Canada could forego shipping oil to the U.S. in times of short supply would be either to stop producing oil, or to set the domestic price so high that the Americans would no longer buy it. As if this were not enough, the inability to supply domestic customers at prices other than those prevailing in North America means that Canada gives up its comparative advantage in energy and simultaneously puts itself at a cost *disadvantage* with respect to American competitors. This is the case because Canada's climate leads it to use more energy than Americans. At equal prices, everything Canadians produce will be more expensive than what Americans produce, simply because Canadians use more energy. That Canada could agree to make Canadian products less competitive just as Canada moves towards free trade makes no sense whatever. But that is exactly what Canada agrees to in the energy chapter of the deal.

Chapter ten outlines the implications of the deal for the manufacturing sector. The government has argued that, just as the Auto Pact brought increased prosperity to southern Ontario, free trade will have a similar impact on the manufacturing industry as a whole. But

measures like those that made the Auto Pact a success are ruled out in the future for other manufacturing sectors by the deal itself! Canada cannot, for instance, introduce performance requirements for new American investments. With the new rules in place, Canada can no longer require of American companies that they undertake research and development activities in Canada. If, instead, Canada decides to subsidize such undertakings, the incentives must be offered to U.S. firms as if they were Canadian firms.

Without the undertaking by the big three auto makers to assemble one car in Canada for every car sold in Canada, there would be no Auto Pact. Yet under free trade Canada can no longer oblige an American manufacturer to do anything of this nature. Similarly, there would not be an Auto Pact without a commitment from American auto makers that 60 per cent of the value added in manufacturing automobiles in Canada be from Canadian-made materials. Under the terms of the free-trade deal, Canada can no longer require domestic sourcing by American companies.

Indeed the Auto Pact itself — and this point is made clearly in chapter eleven — may be significantly weaker as a result of the accord. Since the performance requirements in the pact (assembly and content rules) are enforced by withdrawing duty-free privileges from auto makers who fail to meet these safeguards, the elimination of duties under free trade simultaneously eliminates the enforcement mechanism of the Auto Pact. Under free-trade rules, about all Canada can do is offer an American company cheap labour, a cheap dollar and a pledge to maintain low costs across the board — minimal environmental restrictions and social benefits for workers, reduced taxes and so on — and hope for the best. Canada has always been able to negotiate favourably with American investors because it has the seventh-largest market in the world for automobiles. This rich domestic market, though small in comparison to the American market, gives Canada a good bargaining position with respect to any investor. In the free-trade agreement, Canada has given up this leverage with respect to American companies, not just in autos but in all sectors.

The new trade rules make it difficult, if not impossible, for Canada to introduce public policies to promote national industrial development. They have important implications for any industrial strategy that would tie public purchasing policy to job creation, for example, as John Calvert shows in chapter twelve. Interestingly, what has been given away to the U.S. with respect to performance requirements under the treaty has, by extension, been given away for Canadian business as well. National treatment is a two-edged sword. Eliminating performance requirements for American investors eliminates them for Canadian investors also. What, under the terms of the deal, Canada cannot require of American companies, it can hardly turn around and require of Canadian companies.

Marjorie Cohen explains in chapter thirteen that the agreement allows national treatment for American sellers of certain commercial services and offers the right of establishment and commercial presence to all others. In international trade negotiations this represents an unprecedented concession to the strong American services sector. Unlike other nations that have resisted American attempts to include services in trade agreements, Canada has agreed to open its domestic market to American service firms. There is no evidence that sufficient thought has been given to the consequences of this action for Canada's economic future. Services account for nearly 70 per cent of GNP and are growing faster than any other sector in the economy. Yet no studies of the potential impact of the deal on this sector have been made by the government. In addition to specific concerns raised for the future of data processing, telecommunications and other service industries, Marjorie Cohen shows that the agreement creates a major obstacle for the future development of public services in Canada.

Under the deal, the creation of any new social programme would have to meet the requirements of Article 2010, the "public monopolies" clause and Article 2011, the "nullification and impairment" clause. Taken together, these clauses imply that, if Canada were to create a public sector programme for, say, day-care, American day-care firms would have to be compensated for the loss of any potential commercial benefits they could expect in the absence of the public sector programme. These provisions of the accord make the costs of such a social programme significantly higher than they would otherwise be. In fact, the cost of compensating American firms for their potential losses could be so high as to rule out the creation of new programmes in all areas where American firms already provide services. These would include auto and other insurance schemes. As well, compensation

would have to be paid in the event that a Canadian government decided to create a Crown corporation in any sector.

By requiring compensation, these provisions of the deal effectively redefine the role of the public sector in Canada. Indeed, they make it conform to the American idea of government services — something better left to private producers. And yet Canadians should know that in the area of health care, for example, Canada's public medicare scheme costs about one-third less than American private health care (as a percentage of GNP). The publicly financed Canadian programme brings health care to every citizen at less cost than the private American system; moreover, the American health system simply does not cover those 35 million people who cannot afford a private health plan. Given these facts, the American model hardly seems an appropriate one to imitate, but under the trade deal Canada has little choice. The nullification and impairment clause could force Canada to compensate expensive private producers in the U.S. before introducing a less expensive public sector programme with better coverage. For public services, and in other sectors as well, the free-trade deal would thus thwart any government intent on creating what Canadians now take for granted: not only medicare, but a public broadcasting system, a national railway or a provincial hydro company.

Chapter fourteen looks at financial services. Here, too, Canada gave up much more than it got. When combined with domestic deregulation, the financial services provisions of the deal may well erode national control over the one sector that has been Canadian-owned: banking and finance. Canadian industry needs a safe, solid, domestic financial structure in order to take advantage of lower American tariffs. Yet it appears that the deal actually weakens the national commitment to a strong financial sector that serves Canadian needs. For instance, American firms may now come in and buy up Canadian trust companies and investment dealers. The deal removes the distinction between Americans and Canadians with respect to ownership of Canadian banks. In return Canada gets nothing more concrete than a promise to be accorded national treatment if and when the U.S. lifts national restrictions on banking practices.

In agriculture, as John Warnock outlines in chapter fifteen, Canada makes concessions that threaten farm production in some sectors — such as seasonal fruit and vegetables — and will weaken its competitive position in others — such as egg, poultry and turkey production. Moreover, Canada has agreed to negotiate agricultural issues internationally in concert with the U.S. Since the U.S. wants to eliminate GATT provisions that provide the basis in international law for domestic marketing boards, it would appear that the government reassurances made to farmers that marketing boards will not be affected by the trade deal are suspect to say the least. The elimination of tariffs puts Canada's food processing industry, employing some 250,000 people, at serious risk and could well kill many farms as well. Without the tariff, food producers and processors will struggle against each other and feel increased pressure from American competitors. The likely result is that food processing will be "rationalized" (that is, move to the U.S.), leaving Canadian farmers no choice but to ship production south and compete against American producers who have a competitive advantage because of a more favourable climate.

Under the deal, Canada closes off all its economic strategy options with the exception of the North American market option. This is a high risk strategy to say the least, particularly when the deal does not assure secure access to the American market for Canadian exports. It seems that the fixation on the size of the American market has persuaded the government that the removal of remaining American tariffs amounts to the best economic strategy available to Canada, bar none. Worse, by accepting this deal, the government does bar, by treaty, any future adoption of a domestic industrial strategy. Canada not only gives up this option willingly, it does so in the form of a treaty that takes away the option for as long as the treaty remains in force. No other interpretation of the agreement can be admitted. Rather than constituting an alternative policy for Canada, free trade eliminates all other alternatives.

Beyond Trade

Because free trade is an economic strategy it has implications for Canada that go well beyond the specific provisions of the deal. As Mary Beth Montcalm shows in chapter sixteen, the drift towards continentalism in Canadian economic life explains much of the support and opposition to the deal. In addition, chapter seventeen leaves no doubt that

free trade will accelerate a trend that has led to regional divisions within Canada. Indeed, Canada as a whole could well suffer a fate similar to that of the Maritime provinces at the beginning of this century when increased industrial concentration led industry and finance to migrate to more populous centres.

That the physical appearance of Canada could well change as a result of the workings of the free-trade deal is the conclusion of chapter eighteen on the environment. Frank Tester shows that the provisions of the agreement dealing with energy, forestry, and agriculture will act to encourage environmentally destructive mega-project developments.

The way Canadians deal with issues in the workplace is likely to be affected by the deal as well. In chapter nineteen, Patricia Lane argues convincingly that the ability to set national and provincial standards on issues like maternity leave, part-time work and job training will all be influenced by the need to compete on the "level playing field" with American companies. The role of unions in Canadian society and also the outcome of specific contract negotiations can hardly be separated from the new competitive conditions introduced by the trade deal.

In chapter twenty, Susan Crean discusses Canadian culture, noting that it is neither excluded nor exempted from the deal. In fact, any new initiatives in the cultural field will be subject to a blanket retaliation clause that allows the Americans to take measures of "equivalent commercial effect" if Canada introduces a programme that American firms feel impinges on their ability to make money in the cultural marketplace. By the terms of the deal, Canada has accepted the American definition of culture: a commodity to be bought and sold for profit.

Deborah Coyne argues in chapter twenty-one that the most unwelcome result of the free-trade deal may be that the capacity of the federal government to exercise national leadership in the public interest is imperilled. Taken together with the Meech Lake agreement, the trade deal opens a new constitutional era. While major international economic transformations call out for national initiatives, neither the federal, nor the provincial level of government will be able to respond. The balance of power between the two jurisdictions is altered in favour of the provinces by the Meech Lake Accord, while the ability of both the provinces and the federal government to respond to new challenges in

social policy, energy or finance is tied down by the continental economic framework of the bilateral deal with the United States.

Canadian public opinion has evolved with the free-trade debate. In chapter twenty-two, Donna Dasko explains how the issue has been perceived over time. Since it was first raised in a general way by business groups, public opinion has shifted. According to Dasko, Canadians still tend to support free trade in the abstract. However, opposition to this deal is growing as Canadians learn more about the specific concessions made to the U.S. by the Mulroney government.

A Matter of Trust

Initial foreign reaction to the pact is revealing. Clayton Yeutter, the top U.S. trade negotiator, is reported to have said, while selling the deal to Congress, that Canada does not know what it signed, and that, within twenty years, it will be sucked into the American economy. Israel's senior trade official, the man who negotiated a bilateral deal for his country with the U.S. earlier in the decade, suggested that Canadian negotiators gave up one hundred times more than was necessary to get the deal. Mexican authorities have said that, unlike Canada, they have no intention of signing an agreement with the U.S. that hands control over natural resources to the Americans. Such reactions abroad only stiffen the resolve of critics at home.

And there are many critics of the trade deal. Not only do many people not trust the government's interpretation of the agreement, they do not trust the government. For them, the process of negotiating free trade is revealing of the government's unwillingness to be frank and honest with the Canadian public. From the outset, the Conservative government was intent on maintaining secrecy with respect to what was being negotiated. Canadians were kept unaware of the progress of the talks. According to the government, this was largely because of the need to conceal Canada's hand from the Americans. And for the same reason the government was not prepared to discuss or debate openly with opponents of the bilateral strategy, except in the most general way. Organizations like the Canadian Labour Congress, the most important labour body in Canada, representing more than 2 million workers, were not a part of the process. Consultations were undertaken, however, with

representatives of Canadian industry through the Sectoral Advisory Groups on International Trade (SAGITs).

Labour leaders are strongly opposed to the deal and they are joined in their opposition by such grass-roots organizations as the national Pro-Canada network. This group has brought together churches, women's organizations, social agencies, farmers, seniors, teachers, nurses, environmentalists, academics and the Business Council for Fair Trade, as well as labour, in opposition to free trade. Coalitions to fight the deal have been formed in every province. Their message is simple. In a parliamentary democracy an important departure from usual practice requires either that the government seek an electoral mandate, or that the policy have all-party support in the House of Commons. Since the Liberals and New Democrats oppose free trade, constitutional tradition suggests that the government should seek the approval of the Canadian public before implementing the deal.

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