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Institutional Arrangements for U.S.-Canadian Negotiations

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INSTITUTIONAL ARRANGEMENTS FOR U.S.-CANADIAN NEGOTIATIONS
PART I: CANADA-U.S. TRADE AND ECONOMIC ISSUES: DO WE
NEED A NEW INSTITUTION?
PART II: INSTITUTIONAL ARRANGEMENTS FOR MANAGING THE
CANADA-U.S. ECONOMIC RELATIONSHIP.

Rodney de C. Grey

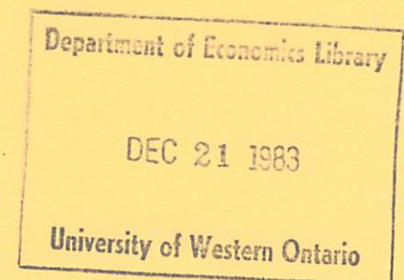
and

John Curtis

This paper contains preliminary findings from research still in progress and should not be quoted without prior approval of the author.

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Implications for Ontario and the Global Economy

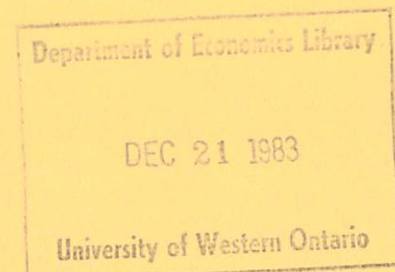
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Spencer Hall
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London, Ontario

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Institutional Arrangements for U.S.-Canadian Negotiations
Part I: Canada-U.S. Trade and Economic Issues:
Do We Need a New Institution?

Part II: Institutional Arrangements for Managing The
Canada-U.S. Economic Relationship



First Draft
October 26, 1983

CANADA/U.S. TRADE AND ECONOMIC ISSUES:
DO WE NEED A NEW INSTITUTION?

PART I: Rodney de C. Grey

1. The purpose of this brief note is to examine the proposition that some of the disputes, problems, issues and differences of policy as between Canada and the United States in trade and economic relations could more easily be resolved if there was some new consultative, or adjudicative, or arbitral institution with authority to address such matters. The question of whether there ought to be some sort of joint body, possibly revival of the Joint Cabinet Committee on Trade and Economic Affairs or some new, mixed body of governmental representatives and members of the business community is examined at intervals, in Ottawa, and, I would assume, in Washington. There are a number of private sector cross-border bodies and participants in the more cordial of the encounters of these groups must ask themselves whether the habit of friendly dispute and exchanges of views with which they are familiar could not be extended in some organized, structured manner so that random disputes between the two national governments are more intelligently managed.

2. Donald Macdonald, who, as a Minister had some experience discussing issues with U.S. cabinet officers, has argued that there is a range of trade policy disputes that could perhaps be dealt with, as between Canada and the U.S., by some new body with arbitral, if not adjudicative powers.¹ In this note I question whether it is likely that we can solve our Canada/U.S. trade policy and economic policy issues by putting any new institution in place.

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3. Asking this broad question leads to inquiry in two directions: first, we should ask why do disputes arise as between Canada and the U.S. in relation to our two national trade policies and our two economic policies; and, second, what institutions are now in place in this area, or in other related areas and does their functioning suggest we could gain by adding another institution with some dispute-resolving scope.

4. It is usual to argue that the reason there are at any given moment a number of disputes between Canada and the U.S. in regard to trade and general economic policies is because there is such a volume of trade and such a complex web of economic relationships between the two countries that differences of view, frictions, are bound to arise. And, this explanation concludes, given that Canada and the U.S. are two different countries, there are bound to be differences, in these and other areas, of national interests. Hence the occasional difference of opinion, hence the odd nagging dispute. This perspective, which reeks of common sense, was frequently expanded by Mr. Pearson. In my view, relying on this view encourages an unhelpful complacency. The first component of the view is a truism; clearly, if we had no trade and economic relations with the U.S. there would be no scope for dispute, but this glimpse of the obvious does not get us very far. The second component, that there are differences of national interests, is too easy a view, and is therefore, likely to be misleading.

5. My view, based on some twenty-five years of participation in the process of Canada/U.S. economic relations, and on some, perhaps unorganized, reflection and study, is that the supposed differences in national interests are, in regard to many issues, just that — supposed, perceived, but not real. Canada and

the U.S. are each other's best customers; their economies are meshed in a more detailed manner than the economies of any two other nations. Canada, as John Dafoe had to remind an earlier generation, is an "American nation" and it is unlikely, that, in the nature of that fact, that in the longer term, U.S. national interests and Canadian national interests will be so different as to be irreconcilable. Many perceived differences are no more than failures to think through carefully what is the U.S. interest and what is the Canadian interest. And in both countries the political process yields a short-term premium for politicians who wish to capitalize on supposed differences. In the U.S. a politician can usually secure some attention by complaining about the laxness of the Administration in dealing with some other country, and there is often something to be gained from taking up the special pleading of some special interest group that has a complaint against Canada. Canadians hold that the U.S. congressional system and the separation of powers tends to institutionalize, even to magnify, the pressure of special interests. This may be so, but in Canada special interests are also adept at special pleading, and there has never been a time when in Ottawa one could not find some politician eager to take the field against supposed U.S. pressures on Canada. I would not go so far as to say that there could never be a real, bedrock quite unreconcilable difference of national interests in the economic policy area as between the two countries, but I find it difficult to think of one. The Canada/U.S. issues which spring to mind prove to be issues in which there is a perceived difference of interests but not any real difference when the issue is closely examined. Let us consider some recent trade and economic issues in a moment.

6. There is one assumption underlying the general view set out above: that is, it is in the interest of the U.S., given that the Canadian

confederation exists, it should continue to exist, and that it should be politically and economically viable. It is not in the U.S. interest that Canada should get relatively poorer or less viable. This is a simple proposition of which many American politicians, journalists and administrators seem often to be unaware.

7. Related to or perhaps an aspect of, the frequent failure to think out what is the real national interest, and to question whether an alleged difference of interests is real, is the habit of considering the conduct of Canada/U.S. relations as necessarily yielding a series of gains or losses, of being, to use the jargon, a zero-sum game. If one fails to examine an issue carefully, and so imagines a difference of interest where there is none, it is easy to adopt the view that its solution must involve one interest and not the other being served. It seems to me to be ridiculously obvious that many, if not most, transactions and relationships between countries or between individuals are mutually advantageous, that both sides gain. Why then should anyone think of Canada/U.S. relations as involving one side or the other winning, the other or the one losing, as though the analog was of the relationship between a used-car salesman and a customer he is unlikely to deal with again.

8. Some years ago a Mr. Joseph Nye, who was, I was given to understand, an expert from Harvard, called on me to interview me for a study of Canada/U.S. relations. He had with him a long list of issues in the trade and economic areas which had been raised in such bodies as the old Joint Cabinet Committee, and he wanted my opinion as to whether, on each of these issues, Canada had won or lost. I do not recall that, for any of these issues there was any real difference between the interest of the USA and the interest of Canada, and I thought that for many of the issues, it was evident that either both

countries had been disadvantaged by the failure to solve an issue, or by its solution on terms which one or other party felt was unreasonable, or that, for other issues, both countries had obviously gained by the process of identifying interests more fundamental than those of the interest groups involved, and then devising mutually advantageous solutions. Mr. Nye seemed to get rather exasperated with me because I kept insisting that he was asking either the wrong question, or, at best, an uninteresting question, and because I kept insisting on speaking to a different question.

9. The reason why Canada/U.S. relations should not be approximated to that between a used-car salesman and his one-time customer is because the relationship between the two countries is a continuing one. If one country acts to its short term gain to the disadvantage of the other, if the U.S. uses its overwhelming power and its multiplicity of bargaining counters to impose an unwelcome solution on Canada, the U.S. will pay a price in terms of suspicion and resentment that will affect other future matters. If Canada tries to outsmart, outmanoeuvre the U.S., perhaps by getting together a temporary anti-American alliance in some international meeting, there will be a price to be paid in terms of the impact on U.S. conduct in the future. Of course there are many occasions, far too many, when U.S. and Canadian representatives have had to defend opposed positions; it is my experience that this arises because one side or the other, often both, have not thought through the issue and/or have failed to communicate their view to the other. I have been involved in a number of Canadian disputes with the U.S., and I cannot recall that any of these involved anything more than attempts by one country to force mistaken policies and mistaken perceptions on the other. Fairly frequently, the representatives of both countries knew this to be the case. The fact is that relations between

Canada and the U.S., as between other countries, is a process, ideally, a process of constant adjustment and accommodation, but, too frequently, a comedy of political error and misconception.

10. Lets look at some recent issues in this light. The episode involving the application by the U.S. of the so-called Interest Equalization Tax, and the proposition that borrowing by Canada should be exempt, was a case where U.S. policy makers initially failed to perceive that they could not advance U.S. interests by imposing a burden on Canada, which would raise costs in Canada and would disrupt Canadian financial markets.² This was merely a case of U.S. policy makers failing to assess the U.S. interest correctly. Again, at the time of the "Nixon shock" in 1971, there were many Americans, apparently even the secretary of the Treasury, who seemed to be under the illusion that if the U.S. imposed a barrier to the exports to them of its best customer, the U.S. would somehow have improved its position. This perception that the U.S. can better itself by impoverishing Canada is frequently revealed; it is a common Washington error. Aside from the fact that it is dubious economic reasoning, it is at variance with my assumption that it is not in the U.S. interest to weaken Canada, and is consistent, unfortunately, to thinking of issues in the we-win you-lose, zero-sum fashion.

11. If we take a different issue, say the so-called "border-broadcasting" issue, we can ask the same sort of question about real U.S. interests. Is there really some fundamental national interest in licensing radio broadcasting firms in the U.S. to solicit advertising from Canadian firms? Given that broadcasting is a heavily regulated industry, in both countries, is it unreasonable to ask: Why was this issue allowed to arise in the first place? Why were these stations licensed

by the U.S. authorities? Is there anything more here than the fortunes of a few private investors? It is hard to believe otherwise. Similarly, we might ask why the U.S. acted as though some vital national interest was affected when Canada moved against the "Canadian" editions of certain U.S. magazines. Was there any danger that U.S. culture, U.S. perceptions, would be less well known in Canada because of the Canadian action? Given the massive circulation in Canada of the U.S. editions of U.S. periodicals, and given the effectiveness of the U.S. book publishing industry, there was no threat to continued Canadian awareness of the U.S. fact. Was there really anything more here than special interest? We could, of course, ask the related questions about Canadian action in this area. Are Canadians somehow more worthy, more informed, more virtuous, more Canadian because some revenue, we assume, was diverted to Macleans from Time Magazine? I doubt the answer would be unanimous.

12. There are a whole set of issues between Canada and the U.S. involving the proper role and status of the private corporation. In regard to a number of issues the U.S. appears to act on the view that the subsidiaries abroad of U.S. parent firms can properly and legally be brought within the jurisdiction of U.S. law, and can quite correctly be used as a conduct by which U.S. policy may be imposed on other countries. This is the current issue of "extraterritoriality", as manifested in regard to securities regulation, banking, controls on the re-export of U.S. goods and goods based on U.S. origin technology (the Export Administration Act of 1979) and anti-trust legislation. No other country seems to have gone as far as the United States in asserting a jurisdiction in these matters outside the national territory, and no country uses the subsidiaries of domestic corporations as vehicles for its foreign policy. Here U.S. policy is quite at variance with what is said to be the U.S. view as to the role in economic

development, in the creation and distribution of wealth, of the private corporation. In accordance with that view the U.S. urges that Canada should accord the Canadian subsidiaries of U.S. corporations treatment no less favourable than the treatment given in Canada to Canadian owned corporations; so-called "national treatment".³ It is a characteristic of the failure to work out just what is the national interest that contradictory perceptions come to be followed in different areas. Clearly the U.S. cannot ask for "national treatment" of subsidiaries if it is plain that, in the U.S. view, the foreign subsidiaries of U.S. parent firms are different from other firms, that is, that they are subject, not only to the law of the host-country, but also to U.S. law.

13. There are, of course, real problems, which many Canadians have perceived, as to how corporations, particularly subsidiaries of foreign parent firms, should conduct themselves in this economy. There is a pull of influence and method, exercised by the larger market and the stronger economy, manifested in procurement habits, in export allocation practices, in the allocation of research and development. The negative effects are not transmitted solely by U.S. controlled corporations but are also manifested through the conduct of Canadian based multinationals. If that is so, then the solutions to the working out of standards or rules that apply to all corporations operating in Canada (say, in regard to procurement) and not merely proposed new entrants from abroad. A policy of non-discrimination in this area will be less objectionable to the U.S., more consistent with our views as to how Canadian controlled corporations should be treated in other countries, and perhaps more effective. It seems to me that we can serve Canadian interests without having a negative effect on U.S. national interests, although, of course, we might be disliked by some heads of some corporations, both U.S. and Canadian.

14. It may be questioned from these examples that it is my view that, on balance, Canada is more sinned against than sinning, in the area of trade and economic relations with the U.S. I think that is the case, and for a simple reason. Canadian actions which annoy and irritate the U.S. are often, perhaps nearly always, directed at the U.S. or designed to counter some U.S. action or pressure or policy. Often it is motivated by little more, by way of policy, than anti-Americanism which is so fashionable on the left everywhere and on the right not infrequently. Some of the U.S. exasperation with us, from time to time, is because some Americans understand that these may be our motives. By contrast, U.S. actions which annoy, irritate, many Canadians are often directed at third countries, at issues in which Canada is not part of the problem. Not infrequently, ill-thought-out U.S. action fails to achieve its purpose, but damages Canada, and it is the case that the U.S. representatives are sometimes not quick to see that they have designed a given measure foolishly. A case in point is the DISC issue; a measure designed to offset the subsidy practices of other countries has had, I suggest, its main impact in affecting decisions on plant locations within North America.

15. I have argued above that Canada/U.S. issues in the trade and economic area are frequently the result of failure in one country or another to think out what is the national interest, and that this is compounded by the tendency to think of the conduct of relations between nation states as a zero-sum game. The question to be addressed is: Do we need, could we make good use of some new consultative, adjudicatory or arbitral institution to resolve such issues? It seems fair to insist that the onus is on those who argue for a new institution to make a convincing case; we skeptics should not be required to prove a negative. I would go further and argue, by analogy, a sort of Ocean's ?

Razor approach: we should avoid creating new institutions unless there is a convincing case for them.

16. It would be helpful, at this point, to look at the various institutions, or models, and to note some history, relevant to institutions and proposed institutions, in this policy area.

17. Economic policy in general is political policy, and trade policy, which deals, often enough, with micro issues, is so politicized and particularized, that it is a matter of fine judgement, case by case, as to whether it is preferable to seek cover by referring the issue to some extra-political body (e.g. a GATT panel) or to keep it in the political realm, to be negotiated away. However, it is of some interest that in drafting the Havana Charter, the U.S., with support from Canada, pressed for a role in resolving trade policy disputes (i.e., disputes as to the meaning of the Charter provisions) for the International Court of Justice. This was strongly opposed by France. This Charter provision (Article 96) provided that the organization or its signatories could refer issues of interpretation to the Court; however, the Havana Charter was not given effect and this particular provision was not carried into the GATT. To this date it has remained the view of the trade policy community that trade policy issues are really too political to be passed to the ICJ. That may not remain the view indefinitely; in part developments in this direction will be affected by changes in the role and manner of working of the court itself.

18. Turning now to consider the various institutions or established arrangements for addressing Canada/U.S. trade policy and economic policy issues

and recent proposals for new institutions, we see that there is a broad range of models and proposals.

a) Multilateral fora: Many experienced Federal officials have a clear preference for addressing issues with the U.S. within the terms of the relevant multilateral agreements. This has two separate but related aspects. First, it is possible to discuss bilaterally, informally or formally, at various levels, some particular issue in the terms of the existing rules of the agreement. Thus the issue of the alleged procurement requirements negotiated by FIRA with U.S. firms proposing new direct investment in Canada could be addressed bilaterally in terms of the rights and obligations of GATT Article III (National Treatment). Conceivably, such an issue could be examined bilaterally for a considerable period; during the course of the discussion one or other or both parties might decide that it would be useful to involve the institutional arrangements of the multilateral agreement. This is a second related technique. In the FIRA dispute, the U.S. decided, after what was virtually a Canadian invitation, to invoke the GATT dispute settlement mechanisms. This brings into play a judgement by representatives of the international community. If we made a list of Canada/U.S. issues in the trade policy area that have arisen in say the last twenty years, it would be clear that a broad range of issues have been resolved by the examination of the GATT rules, and that only a small proportion have had to be taken to the multilateral forum. However, the fact that the multilateral institution is available has an impact on how and how quickly issues are resolved. It seems to me that the record would show that there is no demonstrated need, that is, the case has not been made, for an institutional arrangement which would displace or complicate the existing arrangements for the resolution of the broad range of issues covered by the General Agreement. I would guess the same

logic applies to the subject area of other institutions such as the IMF, the IBRD, etc. The fact is that the multilateral institutions do work well enough over a range of issues as between Canada and the U.S. that there is no reason to not continue to rely on them.

b) Specialized Bilateral Institutions: Another important model, which anyone who thinks that Canada/U.S. issues in the trade field could, ideally, be better managed, is bound to consider, is the International Joint Commission. The experience of this joint institution, as I understand, tends to show that a narrow range of detailed, specific issues can be assigned to such a body. If there is prior argument that these issues are unlikely to be highly politicized. At the same time, there is a measure of insurance against issues becoming political if they can be assigned to such a specialized body, given that it has expertise and prestige. However, if the process fails, and an issue nominally within the purview of such a body becomes unmanageably political, then the standing of the institution can be damaged. It seems to me that if there was no GATT, and no multilateral dispute settlement mechanism, then they would be a case of a joint commission to deal with such trade policy issues as would arise from the working of the bilateral trade agreement. However, given the GATT apparatus, this basis for a trade-policy IJC sort of body, does not exist. A contrary view has been advanced by Donald Macdonald. In the article cited above he argues that we should draw on our experience with the IJC in creating a Canada/U.S. Trade Commission. We shall address this issue below.

c) High-level Consultative Mechanisms: At the opposite pole from a IJC type of constitution is an arrangement for consultation at the Ministerial level on some regular basis. Donald Macdonald sums up our experience

succinctly: "...when an institution has been established between the two governments to deal with matters of high policy, such as ministerial committees to resolve economic problems, it has not worked. Ministers...need more manoeuvrability than a bilateral committee can provide." This is a comment on the Joint Cabinet Committee on Trade and Economic Affairs. Macdonald's judgement is concurred in by the Canadian American Committee.⁴ The problem with such an organized, institutionalized device is that while it is sometimes useful for Cabinet officers to meet their opposite numbers from the other country, such occasions cannot be planned for and held at regular intervals. If a meeting of such a Joint Cabinet Committee is scheduled many issues which could easily be settled bilaterally and advantageously at a lower level are kicked upstairs and politicized. Moreover, issues not ripe for resolution get put on the agenda. The result is often to sharpen differences, to encourage an adversarial approach, and to politicize many issues which involve essential/technical rather than policy considerations. Clearly we do not need to repeat this experiment.

d) Recent Proposals: Against this background we can consider two recent proposals. The first is Donald Macdonald's proposal for a Joint Trade Commission, to help resolve a range of trade policy issues essentially by fact-finding. I do not think that in Mr. Macdonald's article he fully developed his idea; in particular he did not make clear why in his view such a body would be preferable, in the working of the various GATT codes, to the GATT machinery. Nor did he make clear just what would be the relationship, in legal terms, between a view expressed by his proposed joint body, and a finding of some such national body as the U.S. Court of International Trade. This is important because private parties can pursue their cases through the national system; Mr. Macdonald has suggested that they should also be able to go to his new Trade

Commission. There is, it seems to me, a case for taking the state out of the business of participating as a principal in the resolution of essentially private disputes: for example, there may be a case for treating dumping not as an issue in which investigation and action by the state is required, but as a matter to be dealt with as between the parties, like a question of patent infringement. It may be too, that we should try to widen the area of arbitral procedure, using the established institutions of arbitration, to deal with some of such trade issues. In such a more radical re-assessment of the administration of trade policy issues, there would then be a better case for looking at Macdonald's proposed Trade Commission. The second proposal is that advanced by the Canadian-American Committee (in the paper cited). "We suggest that each government designate at some appropriate location within its structure a focal point to facilitate its management of bilateral economic issues, permanently staffed with a small nucleus of experienced persons." The difficulty of this proposal is that in their brief pamphlet the Committee did not make a clear case why a "focal point" is what is required; it seems to me that the Committee should set out the case in more detail. If they do they will see that there is one major problem: If in Canada and the U.S. we have the intelligence and the will to manage our affairs, then a "focal point" is not essential. The issues will be focussed on where and when necessary. On the other hand, if we fail to apply will and intelligence, a "focal point" may be at best irrelevant, and at worse harmful, in that it may give great power to ill-informed officials with little understanding. We do not want them to have a "focal point". Reading and rereading the Committee's proposal, I came inevitably back to the notion that it is perception, will, understanding that is required, and all that is required; indeed, the most compelling part of the Committee's publication is Donald Macdonald's footnote on the sorry record of the U.S. judicial system in addressing issues with a U.S./Canada content.

FOOTNOTES

1 See Donald S. Macdonald: "Enforcing the MTN Codes: A Proposal for a Canada-United States Trade Commission" in J. Queen and P. Slayton (cas.) Non-Tariff Barriers After the Tokyo Round, I.R.P.P., Montreal, 1982.

2 A.F.W. Plumptre: Three Decades of Decision Canada and the World Monetary System 1944-1975, p. 204-211.

3 See Rodney de C. Grey: "Extraterritoriality and Export Controls: A Canadian View", Tri-lateral Conference, Los Angeles, September 20, 1983, photo-copied.

4 See Bilateral Consultation on Economic Issues, A Policy Statement by the Canadian-American Committee, October 1981, p. 11.



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INSTITUTIONAL ARRANGEMENTS FOR MANAGING THE CANADA-U.S. ECONOMIC RELATIONSHIP*

PART II

John M. Curtis

Introduction

The Canada-U.S. economic relationship is once again becoming an important subject of Canadian public policy. While met so far with polite expressions of understanding and interest from the U.S. side, Canadian proposals for a strengthened, perhaps more institutionalized, bilateral arrangement are coming from an increasing number of sectors of Canadian society. There is a danger, indeed, that too much momentum will be built up too quickly without due attention being paid to each suggestion or idea put forward.

* Thanks are due to Frank Stone and Carol Osmond, Research Visitor and Research Assistant, respectively, for their advice and assistance with respect to this paper.

Nowhere is this truer than in the area of institutions. Each sign of a new source of tension between the two countries, or a resurrection of an old one, or evidence that the interests of one country or of the other have been overlooked because of a certain unilateral action, gives rise to a call for some new institution or an improvement in an existing one. Private sector groups enter into this discussion at times as well, often in response to some change in national policies as much as in anticipation of them. And provinces and states have become important factors over the past decade or so as the volume of regional cross-border trade has increased much faster than that of trade within the two nations.

Rarely, however, has a persuasive case been made either in the academic literature or in proposals elsewhere that new or improved institutions are needed to deal with particular issues or to manage the broad bilateral relationship more effectively. The possible functions of any new or revamped institutional arrangements - trade liberalization, research, advice, consultation, dispute settlement - have been left vague; and there has been little analysis of the multilateral implications of proposed new bilateral arrangements.

This paper makes the case that the management systems in place covering the Canada-U.S. economic relationship are basically sound, but that they might be strengthened in certain respects. Their evolution over time, and the important province/state and private sector involvement in particular, are reviewed. As well, existing arrangements are evaluated in terms of problems

and issues both inherent in the relationship and arising from particular policies and practices on both sides. In this latter context, a case is developed for some changes in the way the bilateral economic relationship is managed.

The Assymmetric Relationship

It is a truism to state that frictions between Canada and the U.S. on economic issues are both frequent and numerous because of the large volume of bilateral trade, the complexity of economic linkages, and the close interdependence of the two countries. It is not so obvious, however, how these frictions can be managed given the widely disparate sizes of the two economies.

Canada is generally a regional economic concern to U.S. policy-makers; the U.S. is the foremost foreign economic policy concern to Canadians. Thus most Canadian economic policies, domestic or international, anticipate or are in response to U.S. actions, and these responses can have adverse effects on particular U.S. firms or industries. On the other hand, U.S. economic policies, which are often directed at third countries, can have profound effects on the overall well-being of the Canadian economy. Thus actions by either country can adversely affect the other, but given the assymetrical nature of the relationship, the impact on Canada is generally far more serious.

How to manage well the economic relationship in this highly imbalanced context has always been a challenge, particularly to the junior partner. As the

world economy evolves rapidly and as the relationship between Canada and the United States becomes ever-closer, more complex, and more important, the challenge of bilateral management is becoming even greater.

Elements of An Effective Management System

An effective management system includes the necessary institutions, rules, and procedures which govern the economic and trade policies of the two countries. To a large extent, these instruments of policy have been provided by the post-war multilateral arrangements such as the GATT, which both countries have played a leading role in creating and maintaining. But there exists also a wide variety of special bilateral arrangements that have been put into place to deal with uniquely bilateral issues and problems, as well as to carry out the routine business of the two countries with each other.

A strong case can be made that existing institutions rules and procedures for managing economic and trade relations should not be tampered with if they are working well and serving useful functions. These arrangements should, however, be sufficiently flexible to respond to changing needs and issues. Some might be allowed to lapse when no longer needed. Others might be renewed when needed again. New institutional arrangements should not be invented for their own sake, but rather only to fill recognized gaps and meet recognized needs.

Arrangements for managing economic and trade relations cannot be viewed in isolation from arrangements to manage other sectors of Canada-U.S. relations, such as in the defence or environmental areas. And the principles on which arrangements in the economic area are based must be consistent with those governing the management of relations in other areas.

An effective system for managing bilateral economic relations should have as its broad goals firstly the opening up of opportunities for co-operative action that will bring benefits to both countries through trade and other economic activities, and secondly, the resolving of bilateral issues and problems in ways that are fair to both sides and that add to the mutual interests of both countries.

Management in the Pre-war Period

In looking at today's and tomorrow's needs for an effective system of managing economic and trade relations, it is instructive to look back. On the trade side, in the pre-war period, the main policy instruments of both countries were their customs tariff systems, bolstered by such supplementary devices as anti-dumping duties and complex arrangements for administering the customs system. In contrast, the present trade policy systems of both countries contain a far greater array of non-tariff, often contingent, measures of one kind and another that can be used to obstruct or distort all international, including bilateral, trade.

Until the mid-1930s, both countries maintained extremely high protective tariffs on bilateral trade, especially in the area of manufactures and most agricultural products.¹ The reversal of U.S. trade policies in the early 1930s under the administration of Franklin Roosevelt provided a new basis for Canada-U.S. trade relations. Following the adoption in 1934 of the U.S. Reciprocal Trade Agreements Act, Canada was quick to respond to the U.S. invitation to reduce barriers to cross-border trade. The bilateral trade agreements of 1935 and 1938 began a process of liberalization of cross-border trade, and the adaptation of rules governing this trade, which has continued until the present time.

1. For a brief decade in the middle of the 19th century, the Reciprocity Treaty removed customs duties on most so-called "natural" products but only on a few manufactures. After its abrogation by the United States in 1864, and for seventy years thereafter, the United States levied high tariffs on most imports from Canada, except on needed raw materials. Partly in response, Canada increased its tariffs on most imports from the United States, under the "National Policy" put in place by Sir John A. MacDonald's government in 1878. On both sides, the highest rates allowed by tariff legislation were applied to bilateral trade as well. On the Canadian side, meanwhile, preferential tariff arrangements were put in place for trade with British Empire areas. During this long period, no bilateral trade agreements existed between Canada and the United States. For the most part, relations between the two countries were conducted through London, although the Canadian government effectively controlled the operation of its own commercial policies.

Post-War Multilateral Economic Management

In contrast to the pre-war period, a complex array of institutional arrangements for managing Canada-U.S. economic and trade relations has come into place, not only on a bilateral basis but also within the multilateral economic system to which the two countries belong. Since the second world war, an important part of the management of Canada-U.S. economic relations has taken place within the framework of multilateral systems, notably the GATT, the IMF and the OECD. In the more recent period, the facilities offered by these multilateral institutions have been supplemented, in certain respects, by the periodic "quadrilateral" meetings of the trade ministers of the United States, the European Community, Japan, and Canada, and the annual summit meetings of the seven leading industrial powers.

With respect to trade, the Canada-U.S. agreements concluded in the later 1930s were in effect replaced by the GATT when it was adopted by the two countries in 1947. Since then the GATT has served effectively as the main trade agreement between the two countries, incorporating rather more provisions governing the bilateral relationship than the earlier agreements did, or those usually found in bilateral trade agreements. More specifically, the GATT has served the following functions in terms of the bilateral relationship.

- First, the GATT has provided a framework for the reduction of tariffs and other barriers to cross-border trade. A question that now needs to be addressed is whether some supplementary bilateral

framework is needed, beyond the GATT, within which the two countries could proceed to liberalize further their bilateral trade, possibly on a sector by sector basis. This question has been raised in the document recently published by the Department of External Affairs, entitled Trade Policy for the 1980s.

- Secondly, the GATT has provided a body of rules governing bilateral trade. It may be noted here that the 1965 Automotive Agreement provides a precedent for liberalizing bilateral trade in a specific sector and adopting special rules for this trade beyond those in the GATT. This bilateral agreement was accepted by other GATT countries in the light of the uniquely bilateral problems which it dealt with, despite the fact the Agreement contained preferential features. It is not suggested that further bilateral trade liberalization or the adoption of special bilateral trade rules should be aimed at preferential arrangements.² This is a separate issue. But it may be expected that any new preferential arrangements could be accommodated within GATT, as they have been in the past, provided the legitimate interests of third countries were not unduly affected.

2. Again, the publication Trade Policy for the 1980s has raised the question of whether the two countries should conclude some special rules, supplementary to the GATT rules, to deal with particular bilateral issues.

- Thirdly, the GATT has provided facilities for ongoing consultations on trade matters between Canada and the United States, as have the other multilateral arrangements referred to earlier. This consultative function, however, has operated more consistently and effectively through the bilateral channels which will be examined later. It may be noted here, however, that no formal or permanent framework for such consultations at senior levels has existed since the early 1970s, when the periodic meetings of the Canada-U.S. Ministerial Committee on Trade and Economic Affairs were discontinued.
- Fourthly, the GATT and the other multilateral arrangements referred to earlier, especially the OECD, provide certain facilities for independent research and analysis of developments in world trade and the policies of the main trading countries. Some of this research and analysis is directly relevant to Canada-U.S. bilateral trade and other economic issues. But for the most part, as discussed later, the process of independent research and analysis of bilateral trade and economic issues is carried on by research institutes and universities in the two countries.
- Fifthly, the GATT provides useful facilities and procedures for the resolution of disputes over trade issues, which have been used on a number of occasions by both Canada and the United States to help resolve bilateral trade disputes. It has been suggested several times

in recent years that supplementary facilities are needed that could be used to help resolve disputes over issues of particular bilateral interest.

- Finally, the GATT represents a set of rights and obligations enjoyed by Canada and the U.S. in their bilateral trade relationship, and a set of underlying principles governing this relationship. Again, it might be considered whether some supplementary statement of principles and objectives with respect to bilateral trade and possibly other economic relationships could be put in place, which would serve, among other things, to avoid the emergence of frictions and conflicts between the two countries.

In other economic areas, apart from trade, multilateral arrangements also serve as the framework for dealing with bilateral issues. In the OECD, for example, a continuing process of analysis and consultation goes on with respect to an entire range of economic policies of the member countries. Obviously, such a process contributes to a better understanding between Canada and the United States of each other's policies, and provides additional opportunities for each country to lean on the other to avoid measures which can damage its interests. This process of consultation has been reinforced by the annual summit meetings, which provide additional opportunities at the level of heads of government for Canada and the United States to consult each other on important economic developments and issues, and to attempt to influence the formulation and operation of each other's policies.

In the area of monetary policy, the International Monetary Fund and the Bank of International Settlements provide a multilateral framework for continuing consultation between Canada and the United States on developments and issues that can have a direct bearing on bilateral relationships. Both countries manage their domestic economic policies, and periodically their exchange rates, within the broader multilateral system. And the facilities for co-ordinating Canadian and U.S. policies in this area that are provided by the IMF and the BIS are as useful as ever, and perhaps even more so, in the absence of the IMF rules for fixed exchange rates that were abandoned in the early 1970s.

Similarly, the World Bank serves as a framework for co-ordinating the development assistance policies of the two countries within a broader global system. The facilities provided by the World Bank for research and analysis of development needs and programs in the developing world serve to increase the effectiveness of both countries' bilateral programs, and have provided a basis for a number of co-operative projects that have been co-ordinated by the Bank and assisted by its own resources. The several regional development banks to which the two countries belong serve similar functions in Asia, Latin America, the Caribbean, and Africa.

The evolution of the particular bilateral economic relationship between Canada and the United States should not, indeed cannot, disregard the role and functions of these multilateral arrangements which have served the two countries well in their bilateral relationships as well as in the broader global

context. The maintenance and strengthening of these multilateral arrangements may in one sense be more important to Canada, as the junior partner, than to the United States. Within the multilateral system, Canada's influence can be joined with others to bear more effectively on the formulation and operation of U.S. policies than would be possible on a one-to-one bilateral basis. In part for this reason, successive Canadian governments have stressed Canada's support for the GATT and other multilateral arrangements. At the same time, the United States, as the world's leading economic power, has a special stake in the maintenance of effective multilateral arrangements in trade and economic areas. The United States has played a determining role in their creation and operation. And recent statements by government leaders in Washington have reasserted their interest in the preservation and strengthening of these systems.

It would thus be in the interest of neither country, and contrary to their stated policies, to pursue bilateral arrangements for managing economic and trade relations that would weaken these multilateral systems. But it should be possible to design bilateral arrangements which would build on the multilateral systems to deal with issues of uniquely bilateral interest.

Bilateral Management

The federal governments of Canada and the U.S. are primarily responsible for managing their bilateral trade and economic relations. Their responsibilities and authority for the conduct of foreign relations are set out in international law

and the constitutions of the two countries. A variety of channels and contacts have been created at the federal level for conducting relations between the two countries.

The Embassies and consulates of both countries are the principal channels of communication and the main instruments for the conduct of regular business, as each country pursues the interests of its own country in the other's capital. Canada's Embassy in Washington is the largest and most important of Canada's diplomatic missions anywhere. In comparison, the U.S. Embassy in Ottawa is rather modest, reflecting to some degree the imbalance in the relative importance of the bilateral relationship to the two countries.

The different federal structures in Canada and the U.S. have posed considerable difficulties in managing relations between the two countries. On the Canadian side, decisions taken by the responsible ministers are almost automatically translated into government policy. U.S. Secretaries can offer no such guarantee, and a number of agreements, for example the 1979 treaties on east coast fisheries and maritime boundaries, failed to be ratified by Congress. A somewhat parallel problem in Canada is the need to obtain the approval of the provinces for certain agreements entered into by the federal government - an example being the agreement signed between the Governments of Canada and British Columbia prior to the signing of the Columbia River Treaty in the early 1960s. Although the federal government has the sole authority to enter into treaties with foreign governments, the Canadian Parliament cannot legislate to implement a treaty if the subject matter falls within the exclusive legislative jurisdiction of the provinces.

Within the executive branch of both federal governments, there are a number of departments with interests in Canada-U.S. economic and trade relations. But the principal responsibilities for bilateral relations is carried by the Department of External Affairs in Canada and the State Department in the U.S. As part of the Canadian government's plans to give increased priority to trade objectives, the federal bureaucracy has recently undergone a major reorganization with the trade responsibilities of the former Department of Industry, Trade and Commerce being incorporated into the Department of External Affairs. Within the new department, there is an assistant deputy minister of a United States Bureau, which has beneath it six separate divisions including the United States Trade and Economic Relations Division.³ The reorganization of the Department of External Affairs thus demonstrates an increase in the priority given to relations with the U.S. by the Canadian government.

Understandably, the same level of high priority has not been accorded Canada within the State Department. However, on September 1 of this year, a new position came into effect, that of Deputy Assistant Secretary for Canada, within a renamed Bureau of European and Canadian Affairs. This new position represents a renewed interest in and higher priority being for relations with Canada.

3. The others are: the United States General Relations Division, United States Transboundary Division, United States Marketing and Customs Information Division, United States Trade and Investment Development Division and the United States Programs Division.

The U.S. Government is also considering a proposal for reorganization which would incorporate the economic and business element of the present Department of Commerce with the Office of the United States Trade Representative to create a new Department of International Trade and Industry. In terms of Canadian interests, this would likely be a retrograde step. It would reduce the stature within the administration of the trade representative and remove his direct access to the President. Secondly, by combining the Office of the Trade Representative with the Department of Commerce, a new department could be more open to protectionist pressures from U.S. manufacturing and industrial sectors.

In addition to the above mentioned departments, there are a number of others with an interest, to a greater or lesser degree, in trade relations between Canada and the United States. On the Canadian side, these include for example the Departments of Finance, Agriculture, Defence, Consumer and Corporate Affairs, and National Revenue; on the U.S. side, the departments of Treasury, Agriculture, Defense, and Interior. There are frequent direct contacts between ministers and officials of these functional departments outside the regular channels established by the Embassies or the Department of External Affairs and the State Department. These contacts serve to exchange information and resolve issues between the two countries as they arise. They can also give rise to serious problems of coordination.

Formal visits between the President of the United States and the Prime Minister of Canada also serve as an important forum for the exchange of views

on broad areas of mutual concern to the two countries, both in a bilateral and a global context. These meetings establish personal relationships and have an important symbolic value. They are not meant, however, to settle specific disputes, although they may set the tone for a particular round of negotiations or help to break an impasse. In setting the tone of the bilateral relationship, the personal attributes and approaches of the heads of government are particularly important. It is generally acknowledged, for example, that one of the most favourable periods in Canada-U.S. relations was between 1935 and 1945, largely reflecting the close relationship between President Roosevelt and Prime Minister MacKenzie King. Conversely, bilateral relations can be seriously hampered when there are strained personal relations between the leaders of the governments.

Meetings and other contacts between Canadian ministers and U.S. secretaries also establish personal relationships which serve to keep ministers informed and can provide a basis for dealing with some issues more effectively. Such contacts are generally one-on-one, and serve to deal with issues on an ad hoc, rather than on a regular, basis. A noteworthy exception to this pattern has been the regular series of highly successful meetings since mid-1982 between the Secretary of State for External Affairs, Mr. MacEachen, and Secretary of State Shultz. These meetings have given personal direction to the management of the bilateral relationship. However, because of the frequent turnover of ministers and secretaries, these special relationships cannot be relied upon in the ongoing management of bilateral economic relations.

In addition to the ad hoc meetings and contacts between officials and government leaders, there have been a number of efforts to establish joint committees of ministers and/or officials to manage general or specific aspects of the bilateral economic and trade relationship on an ongoing basis.

The Canada-U.S. Ministerial Committee on Trade and Economic Affairs was established in 1953 on Canada's initiative. It was hoped that this committee not only would improve the exchange of information and consultation between the two countries, but also would help reduce the imbalance in the Canada-U.S. relationship by providing Canadians with a direct means of influencing American trade and economic policy. The Committee was composed of a number of Canadian Ministers and U.S. Secretaries concerned with bilateral trade and economic affairs.⁴ Each delegation also included some 15-25 civil servants, and occasionally special advisors such as the heads of the central banks. The meetings, which were held fairly regularly up until 1970, were initially designed to be informal discussions on issues which might adversely affect economic relations but which might then lead to proposals for measures to improve

4. The Committee membership initially consisted of the secretary of state for external affairs and the ministers of finance, trade and commerce, and either the minister of agriculture or the minister of fisheries from Canada; and from the United States, the secretaries of state, treasury, agriculture and commerce. In 1961, the U.S. secretary of the interior was added, and in 1963, the Canadian minister of industry.

relations for the consideration of the two governments. However, no permanent secretariat was created, nor was there any attempt by the ministers to carry on work collectively on a year round basis. Any unresolved problems were referred for further study to Canadian and U.S. officials, or joint working groups.

The Ministerial Committee established several joint working groups to consider specific, usually technical matters, which have had varying degrees of success. For example, the Canada-U.S. Balance of Payments committee, comprised of officials from both countries, met between 1963 and 1968 to help clarify, and where possible modify, the trade and financial policies of the two countries for their mutual benefit. However, their efforts met with little success primarily because members of the committee were not of a sufficiently high level in their respective bureaucracies to have much influence on policy formulation, and secondly because Canada preferred to deal with issues on an ad hoc basis.

The U.S.-Canada Trade Statistics Committee, established in 1971 to reconcile, harmonize, and monitor counterpart Canada-U.S. trade statistics, has been considerably more successful. Creation of the committee was prompted by the persistently wide discrepancies between the trade statistics of the two countries which tended to exacerbate trade related disputes. These statistics are now reconciled on a quarterly basis, utilizing increasingly computerized techniques.

The two governments continue to establish, from time to time, joint committees to discuss specific matters of mutual concern; a recent example is the Energy Consulting Mechanism (ECM), a bilateral group of officials set up to consult on a broad range of issues related to energy.

Finally, there is at the federal level another bilateral committee of a somewhat different type, the Canada-United States Interparliamentary Group. Since 1959, this group has held meetings at least annually to provide liaison between the legislatures of the two countries, and to promote mutual understanding in a general way. It serves as another form of response to the difficulties posed by the U.S. Congressional system of government by affording Canadian Members of Parliament and Senators the opportunity to put forward directly Canada's position and interests to Members of Congress.

Thus, there already exists at the federal level a variety of mechanisms for the exchange of information, the settlement of disputes, and the management of the bilateral trade and economic relationship in general. However, except for a very few ongoing joint committees, these mechanisms are ad hoc in nature which over recent years appears to have been the preferred method of dealing with issues between the two countries. Joint committees have posed a number of difficulties. For example, the Ministerial Committee on Trade and Economic Affairs at the outset had been fairly successful as an informal mechanism for consultation, but it became increasingly formal and structured resulting in a decline in its effectiveness. Some issues became unnecessarily politicized, and it became difficult to assemble so many busy ministers and secretaries at

one time. Finally, increasing press attention tended to focus on the failure of the Committee to arrive at concrete decisions and agreements, thereby exacerbating any disputes. This adverse publicity further prompted ministers and secretaries to abandon the Committee. While there appears to be little interest in its revitalization at present, the Committee could presumably be reactivated if circumstances warranted.

Within the bilateral relationship, there is a historical precedent for joint committees or commissions of a rather different order. These joint bodies include several which are not directly related to trade and economics, notably the International Joint Commission, and those related to fisheries and to defence cooperation and procurement. They have served both countries well. They have tended to equalize an otherwise greatly imbalanced relationship; in some of them, particularly those which are technically oriented, Canada appears to have fared better than the U.S. by developing greater expertise and being better prepared.

Provincial/State Involvement

All of the provinces and most of the U.S. states have a substantial interest in the management and promotion of the Canada-U.S. economic relationship. Although the two federal governments have overriding responsibility for international trade, provincial and state governments also carry important responsibilities for economic development and regulatory measures - for

example, government procurement policies and various tax and subsidy measures - and these can have an obvious impact on bilateral trade and other economic relations.

The provinces have long sought a larger role in the formulation of Canada's trade policy, but not until the 1970's, when the Tokyo Round of multilateral trade negotiations was in progress in Geneva, was there a concerted effort to involve the provinces in the development of Canada's trade policy position. In 1975, a Canadian Tariffs and Trade Committee (CTTC) was established followed in 1977 by the appointment of a Canadian Coordinator for Trade Negotiations (CCTN) to liaise with provincial governments and private sector organizations. The CCTN in particular vigorously sought to initiate consultations. It is generally agreed that, as a result, the communications process and the role of the provinces were greatly improved. These were temporary arrangements, however, created to aid in the development of Canada's position during the Tokyo Round. Once the negotiations ended, so did the CCTC and the CCTN.

In September 1982, the federal minister responsible for international trade initiated the first of a series of federal-provincial conferences on Canada's international trade policy. The ministers agreed to meet "as appropriate" to review current trade issues and to seek ways of coordinating efforts in export promotion. Some three or four highly successful meetings have been held to date.

In addition to their input into bilateral trade and economic policy through the federal government, the provinces have had further impact by way of their direct links with U.S. state governments which take a number of forms. First, there are the meetings between provincial and state government leaders and legislators for the discussion of issues of mutual concern, including trade and economic matters. The premier of Ontario, for example, meets regularly with the Great Lakes governors. Since 1973, annual conferences have been held between the New England governors and eastern Canadian premiers. At their most recent conference, in June 1983, a special committee was established to continue ongoing work towards broadening trade and economic relations between the Atlantic provinces, Quebec, and the northeastern United States.

Secondly, several provinces have set up offices in a number of states to promote trade and tourism and to encourage economic development. These offices include those set up by Ontario, Quebec, and British Columbia in a number of larger U.S. cities, the Alberta Government Office in Los Angeles, and the Nova Scotia Information Office in New York City. Similar offices have been established by several U.S. states in certain Canadian cities.

Finally, there are a great many formal and informal arrangements between the states and provinces covering a wide range of areas. A number of these are related to trade and economic matters, such as transportation, natural resources, energy, commerce, and industry.

Because of provincial jurisdiction in a variety of economic areas, and particular provincial linkages with certain U.S. states, the Canadian provinces have not only an interest in Canada-U.S. trade, but also can have considerable impact upon the bilateral relationship. The importance of the provincial role is increasingly being recognized, most recently in the establishment of the above-noted federal-provincial trade conferences.

Private Sector Involvement

Private sector interests in the Canada-U.S. economic relationship are large and complex. Like the provincial governments, representatives of the private sector are pressing for greater inputs into federal trade policy. Groups from various sectors of the economy - industry, small business, agriculture - have their own channels into policy making processes in the federal government. Concurrent with the Tokyo Round, the Canadian Trade and Tariffs Committee, and the Canadian Coordinator for Trade Negotiations, referred to above, provided the point of initial contact for making representations to the federal government, without precluding efforts to directly lobby ministers and government departments. More recently, the federal government's trade policy review involved consultations with groups and individuals representing private sector interests.

Canadian private sector groups also have an important role in the promotion and management of the Canada-U.S. trade and economic relationship

through their direct contacts with groups and individuals in the United States. These contacts serve a number of specific functions including the gathering and exchange of information, the encouragement of research and discussion on economic and trade policy, and the promotion of trade and Canadian business interests in the United States. These groups may be broadly classified as research organizations, including universities, and business, industry, and labour union associations. Some of these functions are also carried out by both Canadian and American public relations and consulting firms located in Washington which monitor developments in trade policy and other areas in the U.S. that are of special interest to Canadian firms and industries.

In the area of research, a number of Canadian institutes have formal and informal contacts with research groups in the United States. For example, the Canadian Institute of International Affairs has conducted joint research with a number of American universities and, since 1971, has sponsored, with the Council on Foreign Relations, a series of conferences on the Canada-U.S. relationship, at times covering economic issues. The Institute for Research on Public Policy in Canada maintains informal links with the Brookings Institution, the newly established Institute for International Economics in Washington, the Johns Hopkins School of Advanced International Studies, and the Centre for Strategic and International Studies at Georgetown University. The most structured of the bilateral research efforts has been that conducted by the Canadian-American Committee which since 1957 has been jointly sponsored by the C.D. Howe Research Institute in Canada and the National Planning Association in the United States. Most of the contact between research groups

of the two countries is informal, and there is an evident lack of overall awareness and coordination of the research being conducted by these various groups.

In addition, various business and industry groups in Canada have established their own arrangements for the exchange of information with their American counterparts. For example, the Canadian and American Chambers of Commerce co-sponsors a joint Committee on Canada-United States Relations which meets semi-annually to discuss a broad range of issues of mutual interest, and subsequently reports back to the two governments. The Canadian Manufacturers' Association and the National Association of Manufacturers of the United States have a less structured arrangement, meeting annually for an informal discussion and exchange of views. The Canadian Business and Industry International Advisory Council (CBIIAC) has recently made a submission to the Canadian Government on the subject of Canada-U.S. consultative arrangements and the Business Council on National Issues (BCNI) has become involved in trade matters to the extent that it is preparing a study of the bilateral economic relationship. Presidents of some of the larger trade and industry associations, such as the Canadian Export Association, make regular trips to Washington to meet with both American and Canadian officials with responsibility for trade between the two countries.

Finally, a very few of the larger Canadian firms, such as Northern Telecom, Alcan, and Seagrams, have set up public relations offices in Washington to establish contacts with American officials and to monitor events on Capitol

Hill which are of particular significance to their specific business interests. Many more Canadian firms hire American consultants on a continuing or ad hoc basis to perform a similar function. While the ability of Canadian business to make representation and gather information in Washington appears to have improved in recent years, there appears to be a continuing inadequacy of information with regard to events in Washington and an inability to identify and make contact with American constituencies that share Canadian interests.

Elements of an Effective Bilateral Management System for the Future

As noted above, many elements of an effective system of managing Canada-United States economic and trade relationships are already in place. Some are operating very well and should be left alone; others could be elaborated or strengthened; and some new elements might be designed and put in place both bilaterally and on a multilateral basis.

It is useful to examine those existing and possible additional elements in the management system in the light of the various functions that they should be designed to serve. These various functions could be distinguished in different ways. But I suggest that there are five or six essential functions in an effective management system which could be identified as follows:

1. Facilities to assist information flows between the two federal governments, amongst provincial and state authorities concerned, and

among the private sector interests that are involved. At the federal level, the embassies and consulates of both countries have been strengthened over recent years to serve this function in various ways. As noted above, provincial and state governments have progressively opened new offices across the border to meet their particular needs; and, in Canada at least, there has been a degree of improvement in mechanisms for facilitating the flow of information between Ottawa and provincial capitals. In the private sector, several constructive proposals have been made recently to improve facilities for gathering and disseminating information to business corporations and others. For example, the President of Northern Telecom recently suggested the need for a centre in Washington which could monitor and provide information on developments in the United States of special interest to Canadian business firms.

2. Facilities for some kind of co-operative research and analysis of issues of bilateral concern to identify and assess the interests involved on both sides and to suggest to the authorities in each country constructive solutions to bilateral problems. As noted above, there are a variety of public policy research organizations functioning in this area, and in several universities in both countries there are a number of special schools and programs devoted to the study of bilateral problems. What seems lacking is a more structured and continuing program for co-operative research and analysis of bilateral trade and economic issues. The concept of such a program of co-operative research and analysis is not new. In 1978, joint conferences on Canadian-U.S. economic relations were held in Washington and Ottawa

between the Brookings Institution and the Institute for Research on Public Policy. At these conferences, it was proposed that a permanent program should be established to sponsor joint research on issues of bilateral interest. For such a program to get off the ground and to be successful, it seems clear that a degree of encouragement and support by the two federal governments, and also by others, is essential.

3. Mechanisms for continuing consultations between the two federal governments on developments in their policies that affect the interests of the other country. As noted above, the regular annual meetings of the joint Ministerial Committee on Trade and Economic Affairs, for various and presumably good reasons, have been discontinued. It is difficult, from outside, to assess the effectiveness of the existing facilities for joint consultation between the two governments. But it does appear remarkable that some more formal and permanent structure for consultations is not in place between the two governments, and that the process of consultations does not embody some formal commitment by the two governments to consult each other in advance on the development of policies that have a significant impact on the interests of the other.
4. Facilities for the resolution of bilateral disputes. There exists a variety of such facilities in the multilateral institutions which both countries actively participate and support, such as the GATT and the OECD, but it might be desirable and practicable to build upon these multilateral facilities some kind of additional procedures for dealing with uniquely bilateral disputes in

trade and economic areas. It would seem timely for a new and more thorough examination of such possibilities.

5. Facilities for negotiating the further removal of tariffs and other barriers to cross-border trade in goods and services. Both countries have committed themselves to the goals of freer trade and indeed have made spectacular progress towards these goals as a result of negotiations within the multilateral GATT framework. The Canadian Government, as noted earlier, has recently suggested the desirability of proceeding further toward these goals on a sectoral or issue-by-issue basis. The same Canadian government discussion paper also stresses the simultaneous need for strengthening and enlarging the multilateral trade and economic institutions which have provided the principal framework of rights and obligations of both countries in these areas. The two approaches are not incompatible. Indeed, progress towards the removal of barriers to cross-border trade can be multilateralized in the future as they have been in the past, and can result in strengthening the world trade system. What seems needed at this point is the creation of some joint mechanism for exploring possibilities for liberalizing bilateral trade, perhaps in the form of a framework committee of officials from both countries which could identify areas for trade liberalization and organize processes for these negotiations.
6. The conclusion of some form of framework-type agreement between the two countries which would be designed to formulate a set of general principles guiding the policies of the two countries in their relationships in

these areas. The need for some such arrangement between Canada and the United States was suggested by Prime Minister Pearson and President Johnson following their meeting in Washington in 1964. They suggested the development of some acceptable principles that would make it easier to avoid divergences in economic and trade policies of interest to each other, and which would take full account of existing, broader international arrangements.

Conclusions

Given the underlying mutual confidence and the similarity of basic objectives and approaches in Canada and the United States, solutions to bilateral issues can usually be found through a process of classification of the interests involved, constructive analysis of each others objectives and interests, and continuous cross border dialogue involving the various levels of government in both countries and also private sector interests. Where entirely satisfactory solutions cannot be achieved on particular issues - and this is not always possible - the two countries should look for some tolerable modus vivendi, assisted where appropriate by whatever facilities are available for research, consultation, arbitration or conciliation.

However, the satisfactory resolution of bilateral issues on a continuing basis requires an underpinning of adequate structures for the management of bilateral trade and economic relations as no country, especially smaller ones, can

or should rely on a management system that rests mainly on the interactions between individuals on the two sides, no matter how highly placed and well-qualified they may be.

As reviewed above, management structures already exist both on a multilateral and bilateral basis, but they might well be reappraised in light of today's problems and issues, and those likely to emerge over the next few years. There appears to be a need for improved mechanisms on both sides of the border for gathering and disseminating information about developments of special interest to the private sector. Further and better coordinated programs for research and analysis of problems of common concern may also need to be developed. Existing mechanisms for consultation between the two governments also might need to be strengthened, especially with respect to advance notice of policy initiatives by one country that can have a significant impact on the interests of the other. While the GATT dispute resolution processes operate reasonably well, there may well be a need for supplementary facilities to deal with issues of unique bilateral concern. If further liberalization of bilateral trade is to proceed, it will probably be necessary to create some institutional framework for the negotiations. Finally, some new formal commitments by the two countries might be entered into embodying the broad principles governing the conduct of their cross-border trade and economic affairs, and perhaps including as well new obligations to work towards the further liberalization of cross-border trade.

The elaboration of institutions to manage the bilateral relationship should never, of course, be pursued for their own sake, but rather in light of the need to respond to the needs of the two countries, and changes in the problems and issues facing them. Adequate structures for management are particularly important from a Canadian perspective because of the imbalances inherent in the relationship.

Given the magnitude of U.S. economic involvement in Canada, these structures are important for the larger partner as well. A stable, prosperous and predictable neighbour must necessarily be an integral part of global U.S. economic and political strategy.

DISCUSSANT'S REMARKS

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COMMENT on Grey-Curtis Paper: Institutional Arrangements

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Not being a political scientist, I am perhaps not the ideal person to comment on the paper by Rodney Grey and John Curtis. The adherents to the school of bureaucratic politics -- whereby "where you stand depends on where you sit" -- will be reassured, however, to note that former negotiator Grey believes the fundamental requirement is for statesmanlike negotiators, while policy-researcher Curtis finds as one major conclusion that more funding is needed for policy research institutes.

The authors have provided a useful enumeration of approaches to, and possibilities for improvement in, institutional arrangements for negotiations. My only observation on these arrangements is that they should depend on the objective of negotiations. If that objective is modest, concentrating mainly on resolution of ad hoc problems that may surface, then a low level commission of some sort would seem appropriate. It is difficult to see under existing law how a negotiating entity could be given arbitration power, although this might be a possibility. An entity involving ministerial level policy-makers would appear inappropriate in the scenario of modest goals;

cabinet officials are already overcommitted for international meetings.

If the goal of negotiations is to be a serious move toward a free trade area, however, or even toward a set of major sectoral agreements on free trade, the negotiating modality should be forceful. There should be a time-limited program of negotiations at high levels. Such negotiations might involve a two- to three-year program beginning with trade authorities and subsequently involving finance and foreign ministers. This strategy would amount to a U.S.-Canada Round of negotiations, rather than a more leisurely and ongoing bilateral trade commission.

With the liberty granted by the organizers of the conference, I would like to turn the remainder of my comments to the substance rather than the institutional modality of U.S.-Canadian trade negotiations. A fundamental issue concerning the trade relationship is the more general choice between bilateralism and multilateralism.

The process of multilateral trade negotiation is currently at a hiatus. The November, 1982 GATT Ministerial meeting failed to get the machinery moving for a new general round of negotiations. A logical way to move ahead at this juncture would be through interim bilateral negotiations. For example, at the Ministerial meeting the United States sought to move ahead in new areas, including services, export performance requirements on direct investment (not covered by GATT), and high-technology sectors. U.S. and Canadian negotiators could possibly make progress in these areas that would serve as a model that could

later be generalized within the GATT.

Over the longer run, however, a difficult choice must be made between bilateralism and multilateralism. Consider either a free trade area between Canada and the United States, with zero tariffs, or a sectoral free trade arrangement involving several sectors and modeled on the automobile pact. Either approach contradicts the U.S. (and perhaps Canadian) tradition of most-favored-nation (MFN) treatment and multilateralism, even though technically a zero-tariff area would be compatible with GATT while sectoral agreements would require a GATT waiver. The United States has already violated the MFN tradition in its recent Caribbean Basin Initiative, and similar departures may be in store for U.S. trade relations with Israel. If the United States entered a free trade area with Canada, many abroad would ask whether the United States was turning to a basic approach of regional-bloc trading. There could be repercussions if this action seemed to justify the increase of bloc-regionalization of other areas. It could be misleading to calculate that no further room remains for additional integration and trade diversion in Europe (including the Mediterranean, African, and Commonwealth states). New initiatives between Japan and other Asian countries might emerge if regionalization became the new direction in global trade policy.

Some politically important trading partners could be adversely affected. Latin American countries would feel left out in the cold. Trade diversion could jeopardize Mexican producers of petrochemicals and steel, Brazilian producers of steel, and

perhaps other country-sectors that are less obvious.

The same principle of MFN treatment and multilateralism casts doubt on the appropriateness of the view, mentioned several times in this conference, that Canada has been unfairly affected as an innocent bystander when U.S. safeguards are applied in response to new import flows from third countries. This viewpoint fails to recognize that one of the central objectives of MFN treatment is to help keep the trading system open by mobilizing pressure from all foreign suppliers against protection rather than allowing protection to be focussed on the newcomers (the "selectivity" issue in safeguards negotiations).

In short, policy-makers in both countries must carefully consider the potential contradictions of Canadian-U.S. free trade against the MFN tradition of both countries. They must also consider what kind of signal bilateral integration would send to the international trading system, and what repercussions might follow for some important developing countries in particular and the outside world more generally.

Ironically, U.S.-Canadian trade is already largely free. After the Tokyo-Round tariff cuts are fully implemented, 80% of Canadian exports to the United States will be duty free and 95% will face either free entry or tariffs lower than 5%; the corresponding figures for U.S. exports to Canada will be 65% and 91%.

Despite much criticism of the system of contingent protection, it is not evident that non-tariff barriers are of great significance either. Stern's paper for this conference

enumerates areas of major friction, yet for the NTBs he cites, the case of Maine potatoes is in doubt, that of lumber is now resolved, and that of subway cars has been withdrawn. Wonnacott's paper from the Canadian viewpoint focuses on future possibilities but does not present a damning bill of particulars on current non-tariff barriers. With considerable justification, U.S. and Canadian authorities could adopt the General Gavin solution for the Vietnam War: declare that the battle for free trade has already been won.

Nonetheless, scope remains for further liberalization. The Canadian government has proposed sectoral free trade in four areas: textiles, petrochemicals, specialty steel, and urban transit equipment. Tariffs remain high in some of these sectors -- on the order of 20% in textiles and 12% in processed petrochemical goods.

However, even for a sectoral approach issues remain. Trade diversion is a real possibility. U.S. producers of textiles and specialty steel seem unlikely to accept free entry from Canada unless they are assured that there will be corresponding reduction in imports from other areas (through adjustment of quotas in the Multi-fiber Arrangement, for example). Although U.S. producers could seek additional sales in Canada, the firms affected by imports could be different from those achieving new exports, with resulting pressure for protectionist trade diversion. As a consequence, imports from Brazil, Korea, Mexico, and other newly industrializing countries in particular could decline.

The MFA is already a regressive arrangement that permits unlimited entry of textiles and apparel from rich countries while limiting imports from developing countries. A bilateral free trade arrangement in textiles would seem to move further in this distorted direction by eliminating tariffs to North-North trade, adding another disadvantage to North-South trade.

As for petrochemicals, U.S. producers seem unlikely to accept a free trade arrangement unless Canada changes its National Energy Policy to end favorable pricing for feedstocks.

A more ambitious general free trade area, in turn, would not be very meaningful unless it set up machinery for elimination of non-tariff barriers and for the resolution of investment misunderstandings, considering that tariffs are already so low. Moreover, there are certain dynamics to a true free trade arrangement that require consideration.

A free trade area would imply greater opportunities and risks for Canada than for the United States. The benefits would be greater for Canada because the scale of the U.S. market is already adequate for efficient production, whereas a central benefit to Canadian firms would be the assured access to a continental market with scale far greater than the Canadian market, permitting production at efficient scale. Integration would increase the U.S. market by only 10%; it would multiply the Canadian market ten-fold. Studies of minimum optimum scale have shown that many industrial sectors require scale on the order of 5 to 10% of the U.S. market for efficient production (Scherer, p. 96), suggesting that efficient scale within Canada

in isolation is difficult, especially if monopoly is to be avoided.

The assymetry of market dimensions means greater opportunities from free trade for Canada than for the United States, even under constant returns to scale. With comparable tariff levels, the increased market opportunity for the typical Canadian firm as the result of free trade would be 100 times as great as for the typical U.S. firm. That is, the market opening per firm equals: $\Delta t(C_u)/N_c$ for a Canadian firm and $\Delta t(C_u)/N_u$ for a U.S. firm, where t is the tariff rate, C is market size (consumption), N the number of firms, and subscripts c and u refer to Canada and the United States respectively. Because $C_u = 10(C_c)$ and $N_c = 0.10 N_u$, per-firm market opening is 100 times as large for Canadian firms as for U.S. firms.

This phenomenon, combined with Canada's greater gains from new economies of scale, suggests U.S. bargaining leverage in any negotiations, because it is Canada that has the more to gain. Viewed alternatively, free trade would have minimal impact on the terms of trade for the United States but could improve them proportionately more for Canada.

However, if the potential gains are greater for Canada, so are the risks. Because U.S. firms already have large scale advantages, Canadian firms in many sectors may be hard pressed by new competition. Indeed, integration experiences have often shown fears of smaller partners against inundation of manufactured goods from the larger partners (for example, in

Latin American integration experience). European integration was successful in part because it involved partners of comparable economic size.

A true U.S.-Canadian integration would seem likely to lead to situations in which Canadian firms produced only a small percentage of their output for the home market and a large percentage for export to the United States. This structure would be inherently risky for Canada. As long as the two countries have separate legislatures, there will be political risk to the development of Canadian industry on the basis of an export-platform structure. Investment decisions appropriately would apply some risk discount to production premised heavily on exports to the U.S. This caveat applies especially to those sectors in which either employment size is large, giving strong political influence, or import penetration is high (Cline, 1984).

A safer strategy would be Canadian production premised on perhaps 30% to a maximum of 50% reliance on the U.S. market, oriented toward the regional market in the U.S. snow belt rather than the entire U.S. market. Even in this approach risk would remain, especially if the snow belt remains a high unemployment area.

The broad implication of these observations is that Canadian-U.S. negotiations can be a helpful step to advance the currently moribund GATT negotiations, but that careful consideration must be given by each country to the long run consequences before moving ahead into sectoral or generalized free trade on a bilateral basis.

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