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ECONOMIC REALITIES AND POLITICAL CHOICES**

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I. Introduction

This paper's title gives equal billing to the economics and the politics of the bilateral trade issue, but its content is mainly political. Politics involves debate by the members of a community about the options open to them, and also decisions, taken through a variety of structures and processes. Collective choice is intrinsic to politics. Canadians are now debating this country's trade options, and while it is useful to delineate some economic dimensions which should inform this debate, I think it more important to examine options. Implicitly this reaffirms the simple fact that room for choice exists, a message summed up in a quotation from Tony Benn which slips, year after year, onto the final examination my students endure: "There are powerful international economic forces to which we must react. But these forces do not determine the nature of our responses to them." As the question concludes, "Discuss."

Political choice is worth emphasizing now for three reasons, which also constitute the central themes of this paper. Advocates of all sorts of initiatives resort to the banal argument that their favoured option is inevitable or unavoidable; hence, the first part of the discussion shows that a Canada-U.S. free-trade agreement is not in this strict sense necessary. Second, the Canadian debate threatens to become terribly bitter. The degree

* This paper was presented as part of the 1987 Wilkenson lectures at McGill University on the topic "Canadian-American Free Trade, Historical, Political and Economic Dimensions".

of division will depend on the scope of the agreement, so Part III of this paper analyses the forces which will determine the choice between a limited, incremental deal and one which is comprehensive and daring and which takes continental economic integration to new levels. Finally, if some bilateral agreement is likely to emerge, a precise touchstone for assessing it is essential. In my view, this touchstone should derive from the goal of maximizing the range for political choice, while securing the economic base without which sovereignty is meaningless. Assessing a deal means asking whether its terms will neutralize the policy instruments necessary for development over the next several decades. Within the constraints of an agreement, in short, can Canadians secure their culture, operate desirable social programs, and implement essential industrial policies? This question is approached in Part IV through an analysis of Rick Harris's work for the Macdonald Commission, and this leads at last to predictions about the outcome of the issue.

II. No Deal

There are three options open in the area of Canada-U.S. trade enhancement: to conclude no agreement, a limited agreement, or one covering enough tariff and non-tariff barriers [NTBs] that it deserves to be called comprehensive. In the view of some, to sign no agreement would be disastrous. John Crispo, for instance, has stated that "For Canada to continue to exist as a wealthy industrial society, it must gain secure access to America's large and wealthy market."¹ Simon Reisman, this country's chief negotiator, has put it more flatly still: "Whether Canadians like it or

not, the harsh truth is that the only real option available to Canada today is to try to reach a bilateral free-trade arrangement with the United States that would cover all or virtually all the goods and services we produce."²

These authoritative statements are supported by several well known arguments which need only a brief summary. Economists focus on the welfare gains to be won through bilateral trade liberalization, often citing an estimate of 5% to 9% of GNP which is derived from the models developed by Rick Harris and David Cox.³ These gains depend on Canadian industry adjusting to wider markets. And this depends crucially on achieving 'secure access' to the American market; that is, an exemption for Canadian producers from U.S. protectionism in the form of countervailing duties against subsidized exports, 'safeguard' protection for industries injured by fairly traded goods, and other measures authorized by Congress or contemplated by its members, who seem increasingly determined to defend American industry. The fear of lost exports, profits and jobs now motivates the free-trade initiative more than the expected welfare gains. Canada's primary goal in the trade talks is to gain protection from protectionism, or, as the Business Council on National Issues put it, to "somehow 'get behind' United States non-tariff barriers".⁴

Free-trade advocates also contend that a bilateral agreement in North America could set a salutary example for the multilateral trade talks under the General Agreement on Tariffs and Trade [GATT]. On the one hand, accords in new areas like services and intellectual property could show how progress is possible; on the other, Canada and the U.S. could join to crack open Japanese and European resistance on matters like agricultural subsidies.⁵ Finally, some advocates regard a trade agreement as a welcome means of disciplining Canadian governments. Many non-tariff barriers are instruments of intervention and industrial policy, and some critics of the state hope the

constraints imposed by a treaty on subsidies, protective regulations and discriminatory government purchasing would roll back the activities of both the central and provincial governments. In this view, the pathologies of politics lead to interventions which defend established interests rather than promoting adjustment, so forced harmonization of the Canadian policy environment with that prevailing in free-enterprise America would produce a more efficient, market-driven economy.⁶

My own arguments against concluding a bilateral free-trade agreement have been laid out elsewhere.⁷ This case as presented originally rested on the economic costs of adjustment, the medium-term consequences of adapting not according to some idealized comparative advantage but to the niches left by American industrial and governmental power, and the long-term contraction of Canada's trade diversity and of this country's latitude for autonomous decision-making, both of which would inevitably accompany greater continental economic integration. To these basic arguments in favour of the 'no agreement' option, it suffices to add here only a few supplementary points.

First, the evidence is mounting that the predicted GNP gains from Canada-U.S. free trade were highly optimistic. One model has found regional gains to be far lower than expected; careful empirical work has shown that the all-important economies of scale are not realizable to the extent envisioned; and the Harris-Cox specifications of pricing behaviour and the magnitudes of existing NTBs are questionable.⁸ Summing up the emerging contradictory findings, Wilkinson has concluded that they "are largely the result of variations in assumptions processed through sophisticated programs. At most they tell us that we do not really know in any detail what the industrial consequences of BFT [bilateral free trade] might be."⁹

As for the secure-access argument, two points stand out. First, the protectionist bark has been worse than the bite. According to one compilation, between 1980 and 1985 the U.S. International Trade Commission [ITC] found against Canadian producers in one of nine countervail cases, four of twenty anti-dumping cases, and eight of fourteen unfair practices cases; as well, the International Trade Administration has set modest levels of punitive duties.¹⁰ Over the same period, only 0.9% of Canadian exports were subject to countervail.¹¹ It is true that softwood lumber has since been added to the list, that steel has been sideswiped by measures aimed at other producers, that potash is threatened by an anti-dumping action, and that safeguard measures have affected industries like sugar and shakes and shingles. Nevertheless, compared to the profits accruing from rising exports, the costs of fighting the cases and the penalties imposed have been very low.

Despite this reality, the proponents of free trade are fully engaged in the politics of fear. While they accuse the anti-free traders of fearmongering and of grossly exaggerating an agreement's impact on employment, culture and sovereignty, their own rhetoric is becoming more extreme. The obvious intent is to mobilize interests in support of a deal by magnifying the perils which American protectionism may bring. This prospect cannot be ignored. But neither should we fail to recognize it for what it is - a threat.

Whether the alternatives to a free-trade deal are viable depends in part on the force of protectionist pressure in the United States. This will decline as the sliding American dollar helps redress that country's trade imbalance by increasing exports and cutting demand for imports. Despite the clear intent of both the ITC and Congress to broaden the definition of what constitutes an unfair subsidy, it seems now that the 1987 trade bill will be

less threatening than those proposed in 1986. The Democrats want not to be perceived as purely retrograde protectionists, and much of the emphasis in Congress is shifting towards positive measures to strengthen competitiveness and win access to foreign markets.¹² This, then, is precisely the wrong time to negotiate an agreement which will endure for decades.

Hence, one alternative is the 'hunker down' strategy. This involves riding out the storm, absorbing some blows against particular industries and dodging others. During the Nixonomics episode in 1971, Canada absorbed such blows through passing the Employment Support Act to assist affected firms. That Act is still on the books. Obviously this country cannot finance a protracted trade war with the U.S. Yet retaliation worked in the shakes and shingles case, and in other sectors like potash and newsprint, American customers are both dependent on Canadian supplies and fairly concentrated: unless one presumes that Congress and the ITC are irrational enough to ignore importers and consumers entirely, then the current degree of Canadian-American economic integration should moderate protectionism in many sectors. The other part of this strategy is to 'track' the evolving U.S. trade law. Canadian governments would simply abstain from any policies and programs declared unfair by Congress and the ITC. Most 'unfair' programs would have to be abandoned anyway under a trade agreement as part of the price of gaining secure access. Voluntary restraint could accomplish the same object, without forever alienating sovereign rights. Whether American safeguard measures could be avoided through similar restraint on the part of Canadian business is unclear. Steel is not an encouraging example. But the principle remains: self-discipline in the short run could substitute for a permanent agreement.

The second part of an alternative strategy is to rely on the multilateral

system, which has been Canada's principal guarantee of access to world markets, including that of the United States. Free-trade advocates maintain that the GATT system is weakening, that the process is slow, and that a Canada-U.S agreement could serve as a model and a stimulus for new negotiations. The multilateral system is indeed fragile, due to protectionism, massive capital flows, and structural problems in the U.S., Japan and the EEC. As Lester Thurow warned, "the current degree of economic integration has outrun the world's collective political willingness to manage it."¹³ This, however, should make Canada more interested, not less, in working within the GATT. A separate bilateral deal can be seen by our GATT partners as a vote of non-confidence by Canada in the multilateral system, especially when part of its domestic appeal lies in the chance it offers to displace third-party competitors from the American market.¹⁴ Indeed, the bilateral alternative can be seen as an effort by the United States at once to threaten Japan and the EEC and to provide insurance should the attempt fail: if the U.S. cannot achieve freer multilateral trade on its terms, it may substitute for a system where it is no longer the hegemonic power a set of bilateral arrangements, each one of which it can dominate.¹⁵ Canada is merely next in line, moving to the fore because of its extraordinary trade dependence and vulnerability.

The GATT is making progress. The September 1986 meeting at Punta del Este agreed to insert agriculture and services in the next round of negotiations, and set a four-year target for concluding the round. Yet Canada's efforts remain concentrated almost entirely on the bilateral talks. Rather than negotiate alone to keep markets open, is it not sensible to operate multilaterally, joining the U.S. to prod Europe and Japan to open their markets, and joining the others to fight American protectionism and

retain access to the U.S. market under clear rules? In the bilateral arena, Canada's bargaining position is weaker and less flexible. Moreover, a bilateral deal would remove multilateral support permanently. If North American rules and a joint dispute-resolution mechanism were established, U.S. actions against Canada would shift out of the purview of GATT rules and agencies. "Canada would be isolated in a one-on-one situation with the United States. ... Without the constraint of a possible appeal to a GATT panel, U.S. officials would have considerable latitude in interpreting obligations and rights."¹⁶

Finally, there remains the ideological argument for a treaty which would constrain Canadian governments from indulging in inefficient industrial policies. This motive has emerged more clearly over the last few years. As André Raynauld put it, "So much the better if free trade makes Canadians more aware of the consequences of their policies; so much the better if our external obligations force us to see that we have an interest in being productive and competent, rather than life pensioners."¹⁷ At the abstract level, extreme forms of this view can be condemned as contemptuous of democracy. Its adherents advocate introducing by subterfuge constraints which they see as necessary but which the Canadian public has been unwilling to impose on its elected representatives. There is good evidence not only that direct government interventions have been less widespread and inefficient than is often claimed, but also that they reflect genuine mass preferences.¹⁸

More practically, recent analysis suggests that the neo-conservative agenda cannot be realized through a bilateral trade deal. On the Canadian side, Bruce Doern has shown how continental free trade may well require an expanded state, rather than one which is rolled back and scaled down.¹⁹ In America, even under Mr. Reagan, there is an industrial policy, one which works

through the Pentagon, and this is far less likely to be bargained away than are Canada's more visible industrial and regional subsidies. Whether the Republicans or the Democrats capture the White House in 1988, this industrial policy will probably be broadened, as it has been at the state level, for pragmatic reasons.²⁰ Hence, many sectors of Canadian business would face a tough competitive struggle against policy-driven American firms. If equity prevails, Canada's governments could retain considerable leeway for wasteful interventions; if, as seems more probable, equity does not prevail then Canada will have an industrial policy made in Washington.

We will return in Part IV to the scope which a free-trade agreement may allow for Canadian economic and industrial policies. Here, it is enough to conclude that the arguments representing a bilateral deal as imperative, or even as desirable, are readily contestable. Canada does have options: one is not to proceed with a free-trade treaty with the United States.

III. A Limited Deal

The second possible option is to reach a limited agreement to liberalize bilateral trade. In 1986, I tried to lay out several reasons why the Mulroney administration might find this outcome attractive.²¹ The example used then was a deal covering government procurement only, though one can conceive of other pacts which cover tariffs or NTBs like subsidies and customs regulations, or which are limited to several sectors, or which merely establish bilateral agencies. Until early 1987, it seemed likely that the outcome of the negotiations would indeed be one or a series of such limited deals, and it is worth examining the argument briefly.

A government procurement treaty (GPT) would eliminate domestic

preferences in the purchase of goods and services by governments. It would open large new markets to Canadian firms, while the Americans would gain access to a relatively larger public sector market; hence there would be gains, and symmetrical ones. A GPT would not weaken the GATT but would build on the existing procurement code, and other nations could join as signatories. Compared to a comprehensive deal, a GPT would create less pressure to harmonize a wide range of domestic policies which affect trade. It would neutralize one instrument of industrial policy, but there would be few backwash effects on other instruments arising from the need to create a homogenous competitive environment - the famous 'level playing field'. This would reduce nationalist opposition, as would the exclusion by irrelevance of sensitive sectors like culture. Finally, a GPT would create few obvious and organized losers, and their opposition would have little legitimacy since no one has a permanent right to sell products to governments. In sum, this limited deal would be politically saleable by a government prepared to lead from the centre, as, on the one hand, a compromise with widespread apprehension about full free trade and, on the other, a step in the direction to which the government is committed.

The strategic attraction of such a limited agreement, or a set of them, rested upon a number of assumptions. It seemed that a comprehensive accord was unlikely for several reasons. The most important was that Congress would never accede to the key Canadian demand, an exemption from existing trade laws about contingency protection. "Congress", I argued, "will not surrender its authority over the U.S.A.'s largest bilateral trade flow, and allow disputes to be settled by new, neutral institutions buffered from aggrieved domestic interests." This obstacle would halt the considerable institutional momentum, originally provided by business seeking secure access, which carried the

initiative forward. Equally compelling was the rising domestic resistance to a comprehensive treaty. This was expressed by both opposition parties, the trade unions, some provincial governments, affected interests in sectors like agriculture, and nationalists both within and without the cultural industries. Opinion polls showed support for free trade to be waning. And the declining popularity of the government, centred around a lack of trust in the Prime Minister himself, suggested that the Mulroney administration risked losing power if it attempted to force through a comprehensive deal in a decisive, climactic struggle over the fundamental issue of continentalism versus national sovereignty. Once begun, however, the trade talks had to produce some tangible result. Otherwise face would be lost, Canadian business would gain nothing, and the U.S. side would be further irritated by Canadian ambivalence about a prospect which the U.S. Trade Representative had said should cause "dancing in the streets in Ottawa." As David Leyton-Brown put it, "Depending on the degree of failure, Canadian retrenchment could range from a return to the status quo ante to a period of severe tension. At best there would be a normal, arms-length relationship, but at worst there would be bitterness, resentment and hostility."²²

It seemed that the likely product of this complex of forces would be a limited agreement to liberalize trade in circumscribed areas. Such a pact, perhaps followed by others, might initially cover most tariffs, the more overt industrial subsidies, and procurement, and it would establish a new bilateral agency along the lines of the International Joint Commission, to investigate trade disputes and make non-binding recommendations about resolving them.²³ This result is still possible; indeed, it is the most likely outcome. But within the first half of 1987, the prospects of a far more comprehensive agreement seem to have improved considerably. The

negotiators are discussing a very wide range of topics, the premiers have been muted in their criticism, Mr. Reagan has put the issue high on the American agenda, and Mr. Mulroney seems to have crossed the Rubicon, stating that "the choice is ours for all Canadians, and personally, I have made mine."²⁴ The proponents of free trade have become much more optimistic. Why is this so? Have there been changes in the considerations which made a limited, incremental deal seem probable?

First, it may be that business interest in a free-trade agreement is such that nothing short of a comprehensive deal would satisfy it. Canadian sales to the United States have continued to rise, especially in finished products, where protection was most sought in the past. Excluding products under the AutoPact, exports of inedible end products to the U.S. rose 74% between 1982 and 1986, and they surpassed exports of crude materials for the first time ever in 1984.²⁵ Businessmen have gained confidence in their ability to compete, they fear the prospect of exclusion from the American market, and a long phase-in period for tariff reductions provides reassurance.

Arguably, the leading elements of Canadian business have never viewed the Americans as a threat, but these interests are now more coherently organized than ever, jointly with the executives of major American subsidiaries, in the Business Council on National Issues. The BCNI articulates the collective, long-term interests of large private-sector corporations, and it strongly supports trade enhancement. One can suggest other reasons, both structural and conjunctural, for the near unanimity among businessmen in support of free trade. These include the shock of the 1981-82 recession, the rising proportion of both sales and assets in the U.S., and the increasing concentration of firms into conglomerates capable of internalizing cost-benefit calculations of free trade's effects (and of silencing the

losers, which if independent would have mounted resistance). But the sheer commitment at the ideological level and its enforcement by peak business organizations cannot be neglected as a factor.²⁶ It is almost heresy to speak against the trade initiative. As in the cases of the NEP, the Benson White Paper on Tax Reform, and Quebec independence, even firms which may lose by adopting the consensus position do not oppose it overtly, but seem content to suggest minor embroidery on the pattern of implementation.

If business remains firmly behind the free-trade initiative, the opposition to it may be decreasing. This resistance arises from several sources, among which are those interests expecting to suffer from bilateral trade liberalization. Trade unions, led by the Canadian Union of Public Employees and the Canadian Auto Workers, have mounted well organized campaigns against free trade. On the other hand, new efforts by proponents of the initiative to amplify the threats of protectionism have mobilized potential losers among those who have reason to fear cuts in export markets. Hence, labour is by no means unanimous on the issue. Where workers have been stung recently by countervail and safeguards, as in steel and lumber, their unions have moved to support free trade.

Another significant locus of opposition is in the provincial capitals. If we can presume that B.C., Alberta, and Saskatchewan will support any deal from which agriculture is excluded and that the Atlantic Provinces will do the same if transfer payments, equalization, and regional development funds continue to be available, then Ontario and Quebec are the central players. Each of these governments naturally is subject to the same free-trade forces which animate Ottawa, but each also has particular concerns. The issues for Quebec are hydro exports, the soft sectors like textiles, and the state's continued ability - despite the neo-conservative pronouncements of Mr.

Bourassa and his advisors - to implement an active industrial policy in support of the new Quebec entrepreneurial class. Ontario must be concerned with the last issue too, for it has been considerably more activist than many analysts allow, but its main preoccupations are the AutoPact and what American subsidiaries will do should tariff protection cease. It is in Ontario as well that the cry for secure access to the U.S. market is strongest.

Currently, the stance of both provincial administrations is a cautious one. They appear to be allowing the Mulroney administration room to manoeuvre and to bargain. In contrast to the truculent statements of 1986 about their ability to veto bilateral arrangements, each premier seems prepared to let the initiative carry through to a concrete set of proposals. Of course each has other concerns. Mr. Peterson in particular must engineer an election to secure a majority and free himself from the NDP. After campaigning on the need for a strong mandate to protect the province's interests in the negotiations, and winning a majority, the Liberal premier of Ontario will then demonstrate what his government's position on free trade really is.

Another, deeper reason for the non-confrontational attitude of these premiers is that a more realistic appreciation of their bargaining power may have sunk in.²⁷ It is undeniable that provincial governments can frustrate central-government treaty arrangements by refusing to implement the necessary legislation to remove NTBs in their areas of jurisdiction. Unlike the case in the U.S.A., where treaties and some executive agreements have direct applicability, and the trade and commerce clause has been interpreted by the courts in favour of the central power, the Canadian provinces are paramount in their jurisdictional fields. But the central government has formidable weapons insofar as the current negotiations are concerned. In particular, it is entirely within Ottawa's power to eliminate all tariffs immediately. This

would weaken the AutoPact (to which Ottawa is the signatory in any event). It could also produce the withdrawal of multinational subsidiaries which Ontario fears might happen over time. Apart from tariffs, the central government retains jurisdiction over energy exports, banking, and foreign investment, powers which provide Mr. Mulroney with considerable leverage over Ontario and Quebec in the federal-provincial negotiations about trade. Moreover, there are clear signs that Ottawa will try to sell a free-trade deal as a redistributive, regional-development measure. As in other respects, this represents an excuse not to take positive action and instead to deploy free trade as a panacea. (It suffices to see the irony in a Prime Minister proclaiming that "we are in the process of building two Canadas, one which is rich and promising and one which is underdeveloped and unemployed."²⁸) Still, given the aggravating regional disparities in employment and incomes, central-Canada-bashing may give the initiative a boost. Messrs. Peterson and Bourassa may have good reason to be subdued.

Apart from the provinces and the obvious winners and losers from a free-trade deal, the other important source of opposition is general public opinion. As is well known, public support for the free-trade initiative has slipped substantially as the issue has risen on the policy agenda. Yet Canadian opinion about such matters revolves around two core attitudes - the general sentiment towards the United States and its influence on Canada, and the economic impact which a changed relationship might have. On the first dimension, the distribution of views seems fairly stable over time. Canadians regard the U.S. as our closest ally; they also tend to think that it has too much influence on this country.²⁹ This is consistent with the Decima Research interpretation which suggests Canadians prefer a close but proper, or businesslike relationship with the U.S.A., and perhaps an agreement which

establishes a bilateral agency could be presented as consistent with this image of formal partnership.³⁰

On the economic side, Richard Johnston has argued in a study for the Macdonald Commission that Canadians are "pre-eminently concerned with job creation and protection". The public does support abstract declarations about competitiveness; in "more concrete cases, however, most Canadians seem protectionist."³¹ On the other hand, Johnston also found the public willing to temper these sentiments when jobs were thought to be at stake. As well, when attitudes towards macro-economic issues were explored, he found that Canadians have "rather weak information about the future of the economy and hold, at best, rather soft opinions on specific instruments which might affect that future."³² The conclusion was that public opinion is based both on self-interest and on concern for the country as a whole, but that Canadians "are preoccupied with economic results, with ends more than with means."³³

What does this imply? It suggests that the downward trend in public support for free trade may not reflect a definitive swing but rather an underlying uncertainty about the effects of freer trade. The real story of the change in public opinion could be that it is changeable. After all, support for free trade has declined from its 78% peak to around 52%, but only after rising from a 1983 figure of about 40%.³⁴ Although the public has mixed feelings about the United States, there may be room to persuade Canadians to support free trade not only because it would improve their individual economic welfare but also because it would strengthen the country as a whole. This opens the opportunity for the government to represent anti-free traders as narrowly selfish groups concerned only with preserving their special advantages, a tack it is sure to take in defending either a limited or a comprehensive agreement.

On the American side, major changes have also taken place. The issue of Canada-U.S. free trade, like others, must be seen in the contexts of larger American concerns and the new power relations between the President and Congress. First, the Administration has moved the issue higher up the policy agenda. Mr. Reagan has been politically enfeebled by the Iran-Contra affair, and has few attainable policy objectives for which to strive in the remainder of his term. A trade deal so ardently sought by a trusty ally offers an attractive opportunity for historic accomplishments. As well, with Mr. Baker as chief of staff, White House liaison with Congress will be improved. Congress, like nobles who set the agenda and make most decisions for a tottering monarch, has gained much power. This may diminish the incentives for confrontation between the two branches and, paradoxically, increase the sense of responsibility and the vision of Congressmen and Senators who may be more inclined now to take the long view and weigh more carefully the national interest in trade matters.

The capacity of Congress to do other than react to narrow, defensive, constituency pressures may in any case have been overestimated. For many members, the deployment of protectionist measures and of threats to enforce the rules of 'fair trade' may be as much a tactic in a larger game as a knee-jerk response to constituency demands. In the past Congress has proven itself capable in the end of advancing the long-term national interest of the Union. It suffices to recall Lend-Lease, the Marshall Plan and, more relevant, the Alaska purchase of 1867. In the last case bribes were necessary to convince some Congressmen to approve spending all of \$7,200,000, but the final vote in each chamber was overwhelming, and some representatives were quite capable of taking the larger geopolitical view: "The entire Pacific Coast of the North American continent fronting Japan, China and India

should belong to the nation whose capital is here, and whose destiny is to grasp the commerce of all the seas and sway the sceptre of the world. Let us, then, while perfecting our institutions, not refuse to extend our boundaries."³⁵

All this could mean that the American side may be prepared to move after all on the key Canadian demand for relief from U.S. trade remedy legislation. At first, the American position on this issue was quite intransigent. The U.S. Trade Representative said the proposed exemption was a "non-starter" and the U.S. Ambassador said Canada's hopes in this area were "unrealistic".³⁶ Congress would be terribly reluctant to delegate its authority over America's largest trade flow. It did not do so in the case of Israel, despite the small volume of trade involved, Israel's strategic importance, and the presence of a strong pro-Israel lobby in the U.S. But much depends on the precise mechanism through which the exemption would work.

Some officials believe that if tariffs are eliminated, then anti-dumping measures can be abandoned, because dumped goods can be shipped back and sold in the country of origin and because antitrust policy could handle cross-border predatory pricing.³⁷ As for countervail, proposals have been made to establish a bilateral agency which might gradually assume de facto binding authority through the evolution of precedent.³⁸ Some such suggestions are wildly optimistic in that they fail to specify what would happen when the authority of a new joint agency conflicts with Americans' legal right to an ITC ruling.³⁹ It does seem conceivable that countervail could be largely eliminated as a threat to Canadian exporters, were a new subsidies code both comprehensive in scope and detailed in its provisions. But there are always shadowy areas needing interpretation as well as violations requiring enforcement, so Congress would still be asked to delegate

authority to the new, joint agency.

More important, the area of safeguard remains, under section 201 of the 1974 Trade Law which permits tariffs or quotas to be imposed when rising imports seriously injure American industries. Even if these imports are fairly traded, protection is quite legitimate under GATT's article XIX, which allows countries to 'escape' normal rules, and which enshrines the sovereign right of states to defend their producers. Congress would be most hesitant to override the right of domestic industries to petition to relief from Canadian imports. As an aide to Senator John Heinz (Pennsylvania, Republican) put it recently, "We would be strenuously and unalterably opposed. We can't take away the rights of American individuals to seek redress under the administrative proceedings we now have."⁴⁰ Beyond these problems lies the power of the President to retaliate against violators of trade commitments, as well as several other provisions in existing law about agricultural imports and threats to national security, and Congress's authority to pass laws at any time to deal pragmatically with trade problems. Asking Congress to exempt Canadian exporters from these various provisions is demanding little short of a revolution in U.S. trade law.

Yet two developments can be noted on this front. First, the Canadian government continues to press its key demand, with increasing clarity and obduracy. Mrs. Carney, the minister for International Trade, said in March 1987 that the government would sign no agreement which would continue to let Canadians be held "hostage to the unpredictable whims of American protectionism."⁴¹ The Prime Minister told American reporters bluntly that "the trade remedy laws cannot apply to Canada, period."⁴² Similarly, business opinion remains firm and united in Canada: as Ronald Anderson wrote, without relief from U.S. contingency protection, "the trade agreement could

deliver nothing that would give substance to the visions of the free traders."⁴³ Like the statements of certain Senators, this may be a bargaining tactic; for the government it may also leave open an exit route from the talks.

But on the other side, there has been some movement. Both Senator Bentsen (Texas, Democrat) and Ambassador Niles have indicated the U.S. is prepared to listen to Canadian representations and suggestions about secure access.⁴⁴ The door is not entirely closed either in Congress or the Administration. The Americans are open to offers, and given the importance to Canada of this critical demand, they can expect generous proposals. Shortly, I will argue that the trade-off for secure access may lie in the area of investment. The key point, however, is that Congress might move to grant Canada's exporters their prized relief from contingency protection. This raises the possibility of a comprehensive agreement, because the essential difference between a limited deal and a sweeping one lies in secure access and in what Canada is willing to concede to get it.

One last factor in the set which will determine the scope and provisions of a free-trade agreement has changed little recently. The Mulroney government's political fortunes continue to be depressed. The Tories' popularity is low, even for an administration three years into its term, and the Prime Minister's perceived credibility and trustworthiness have not improved. A free-trade deal requiring a leap of faith - rather than a hop - will need persuasive explanation by leaders who can draw on public confidence. It is true that powerful institutional and economic forces underpin the free-trade initiative and sweep it forward. But for economic options, however desirable, to become crystallized in political reality they must be sold. Mr. Mulroney now shows no greater personal capacity for

reassurance, or for leading Canadians to rise to new opportunities, and so for building a broad consensus in support of a comprehensive agreement, than he did when this factor first seemed conducive to a limited deal.⁴⁵ But other elements have changed and the comprehensive option needs to be analyzed.

IV. A Comprehensive Deal

In the House of Commons trade debate on March 16, 1987, Mrs. Carney listed the following topics as under negotiation in the Canada-U.S. talks: tariffs, quotas, protectionist standards, discriminatory procurement policies, customs procedures, agricultural matters including tariffs and health standards, subsidies, the protection of intellectual property, trade in services (notably engineering, financial consulting, computer services and banking), and, finally, investment. "So far", she said, "we are dealing only with trade-related investment matters. The Americans want more."⁴⁶

Indeed the U.S. side undoubtedly does want concessions on the investment front, and herein could lie the core of a basic trade-off underpinning a truly comprehensive trade agreement. The essence would be to concede secure access to Canadian exporters in return for national treatment of American capital. The free movement of goods would be exchanged for the free movement of capital.

There is a core logic here, which may be illustrated by the sort of extreme counterfactual which beguiles historians ("If the South had won the Civil War, what would the U.S. constitution be like today?"). If all Canadian exporters were American-owned, would contingency protection be deployed against them? In milder form: if Canadian firms are owned by U.S. companies, does the American government have any interest in stifling their exports and

cutting their profits?

Some evidence suggests this logic is not misdirected. In the softwood lumber case, American firms with Canadian subsidiaries tended not to join the petitioners and to be moderate in condemning the rising imports.⁴⁷ Similarly, in the current anti-dumping case against Canadian potash exporters, International Minerals Corporation did not associate itself with the petition: it has mines in Canada. Of course ownership does not preclude other interests like labour from using trade remedy processes, but the general principle is clear enough: American ownership in Canada buffers 'our' exports from contingency protection.⁴⁸

Apart from the logic which suggests that eliminating restrictions on American investment could win more secure access for Canadian goods, there are other indications of this emerging link. One is Mrs. Carney's statement, which was followed by the candid disclosure that Cabinet is "listening" to American representations, (as the U.S. side is receiving Canadian views on contingency protection), but that it "has not given the negotiators a general investment mandate." Other signs are the addresses of Tom d'Aquino from the BCNI and of Louis Lahn from the U.S. Commerce Department at this very conference. Each spoke repeatedly of an agreement enhancing "trade and investment opportunities." Mr. d'Aquino may have meant, in part, new foreign investment entering Canada from third countries in the knowledge that exports to the U.S.A. would not be blocked, but Mr. Lahn referred to bilateral relations. As he concluded, "The challenge as I see it is for both countries to have the vision to be willing to change current barriers to trade and investment in order to secure long-term benefits of historic proportions."⁴⁹ Murray Smith of the C.D. Howe Institute has suggested that minimal U.S. movement on contingency protection would produce only limited Canadian

movement on foreign ownership restrictions.⁵⁰ And the U.S. Commerce Department's undersecretary for international trade, Bruce Smart, listed trade remedy laws and liberalized investment rules as two of the big "rocks" standing in the way of a sweeping agreement (the others being protection for Canadian culture and intellectual property issues).⁵¹ As the negotiations come down to the crunch, it seems that the access-investment nexus, if solidified, will form the cornerstone of a comprehensive agreement.

What, then, would such an agreement contain? What might a comprehensive Canada-U.S. trade agreement really look like? It would begin with the main elements of the limited deal discussed above - tariffs to be phased out, simplified and harmonized customs procedures, a subsidies code specifying permissible direct aid to industry, a declaration that negotiations will continue towards fuller liberalization of trade in services, an end to discriminatory procurement policies, and the establishment of a new joint trade agency.

The comprehensive agreement, however, would deepen integration in these areas. Tariffs would include agricultural products, customs procedures would need strict enforcement of rules of origin, and there could be provision for jointly collecting trade data. Were countervail to be effectively renounced by both sides, the subsidies code would have to be very detailed, with permissible exceptions - agriculture, small business, national defence, remote and highly underdeveloped regions - clearly identified, and with the methodology for calculating the trade effects of subsidies entirely clarified. Some service-sector agreements would be included: initial candidates are those where regulation is neither intense nor shared between levels of government and where employee migration is minor, such as data processing. But many obstacles to service trade would fall as a consequence

of agreements about procurement and the entry of capital. On the procurement front, exceptions would be minimized and the states and provinces would be included, either through their agreement or through a commitment to make federal grants conditional on non-discriminatory purchasing practices. Last, the bilateral agency would have extensive investigative powers and more authority to settle disputes not only about the application and extension of the treaty provisions but also about the use of contingency protection. The straightforward delegation of full powers might be avoided in two ways. The agency could make final decisions in cases where small volumes or percentages of trade are involved; alternatively, decisions could be subject to Parliamentary and Congressional and/or Presidential over-ride.

A comprehensive deal would leave several areas untouched: most of the agricultural support system, grants for some regional infrastructure, and assistance to cultural industries (though these would be narrowly defined, to include newsmagazines, for example, and to exclude trade journals and commercial printing). It is probable that the AutoPact would be left intact, though falling tariffs would diminish its impact and the Canadian system of duty remissions to attract foreign manufacturers may end.

In other areas, a comprehensive agreement would go far to eliminate what the Americans call "irritants". On intellectual property, Canada would very likely remove copyright differences as well as pushing through changes in pharmaceutical patent protection. Tough negotiations on the cultural front would likely see the replacement of regulatory protection with direct subsidies: this would involve ending cable-signal piracy (or the 'simultaneous substitution' of Canadian commercials), along with the protection afforded border broadcasters and Canadian magazines under the tax laws.

Finally there is the investment issue. A range of possibilities exists here. Canada could guarantee national treatment to American-owned firms already operating in this country, ceasing all discrimination against them and relieving them of performance requirements of the kind required by the Foreign Investment Review Agency and Investment Canada or currently negotiated as Memoranda of Understanding by the Department of Regional Industrial Expansion.⁵² Beyond this, the right of establishment could be extended to American firms starting new operations in Canada. This would not be incongruent with the Mulroney government's general attitude towards new job-creating investment. Even further, free entry could be conceded to U.S. companies intent on buying out Canadian firms, directly or indirectly. With respect to American capital, in short, Investment Canada could be entirely neutralized. Or it could continue to review cases of great magnitude or those arising in particular sectors like publishing and telecommunications.

These are large concessions, especially since national treatment of incoming capital is not now extended by the United States, where foreigners entering some sectors face a minefield of regulations and restrictions. Hence, Canadian exceptions could mirror those prevailing south of the border.⁵³ Or, American restrictions under the control of Washington could be ended for Canadian firms. In either case, there is asymmetry since Canadian capital poses no threat whatsoever to Americans' control of their economy. Nevertheless, if the U.S. side is to move on contingency protection, which is the key Canadian goal, Canada needs to reciprocate elsewhere. Especially if the cultural industries are to continue receiving protection and support, then nothing short of very significant liberalization of existing restrictions on capital flows seems capable of generating the desired movement.

How, then, will Canadians assess the desirability of a comprehensive agreement which takes this form? Earlier, I suggested a fundamental touchstone for assessing any agreement, one based on the desirability of political choice. Will a comprehensive deal neutralize necessary policy instruments and foreclose fruitful options for development over the next several decades, or will it leave Canadians still able to secure their culture, to operate desirable social programs, and to implement essential industrial policies?

The social policy question can be dispensed with quickly. An agreement would impose constraints only indirectly, through the Canadian political process. First, there would be freer entry into some sectors like health services and hospitals, which would broaden the mix of significant interests represented in the relevant policy communities: pressure to amend programs could result. Similarly, there could be a de-unionization trend in both the public and private sectors, through greater competition in industries like construction and through new pressures to increase contracting-out. This, however, is no necessary consequence of an agreement: it is an internal matter subject to policy choice. Second, and more broadly, an agreement would increase the competitive pressures on all Canadian firms, and this could lead to stronger demands for relief from payroll and other taxes that increase business costs to support social programs. The main threat to social programs, in short, would be internal complaints, not externally imposed constraints. The effect would simply be to sharpen the attack on existing programs which is bound to occur in any event as a consequence of heightened exposure to the world economy.⁵⁴ Indeed, insofar as Canada would become more highly integrated with the relatively inefficient American economy, the effect on social programs would be less severe than would result from, say,

more Canada-Pacific Rim trade.

The cultural dossier is a more complex one. Many Canadians, especially on the periphery, have little sympathy for policies which protect rich, eccentric publishers operating from Toronto townhouses. There is also widespread hesitation to endorse measures which restrict freedom of choice in listening, viewing and reading material according to its national origin. On the other hand, Canadians have a right to know themselves, and whatever one presumes to be the ultimate engine of national unity - economic ties, institutional arrangements, or cultural identification - no one can doubt the immediate impact on behaviour of the last and the consequent stakes in preserving Canadian culture. Cultural industries are also characterized by significant scale economies such that in Canada, to the extent they contain indigenous content, they are likely to be infant industries forever.

Presumably, a comprehensive agreement will allow considerable scope to governments to support the cultural industries (narrowly defined). This would fulfil public promises by Mr. Mulroney and various ministers. It is also congruent with Ottawa's recognition that Canadians will need reassurance that 'sovereignty' as embodied in national identity has not been compromised by the deal.⁵⁵ On the other hand, the U.S. side will likely insist that measures restricting the entry of cultural materials and the operations of foreign subsidiaries in the industry be ended. In other words, positive subsidization of Canadian culture will continue, but restrictions on American culture will be dismantled. This is a considerable shift, but the continued right to subsidize culture will be regarded as a major concession by the U.S. side. As suggested above, if 'secure access' in some meaningful form is also to be won, Canada will have to move a long way towards the national treatment of American investment, both in place and incoming.

This brings us to the economic repercussions of a comprehensive agreement. With respect to real costs and benefits, most analysts seem fairly sanguine. The major anticipated impact is seen as flowing from tariff reductions, which would be gradual in highly protected sectors and which, in any case, would be less significant than a currency appreciation of around 15%. It is clear, though, that costs will be imposed on some sectors, and there remains the likelihood of U.S. subsidiaries winding down their operations in Canada. These losses would be balanced to some degree by growth through fresh investment and rising exports in other sectors. It is also possible that a new comprehensive system of social security and retraining could ease adjustment costs (and buy out political opposition using some of the gains expected to materialize). But the net economic effect of any Canada-U.S. agreement is imponderable. It depends too much on factors extraneous to the accord itself, including decisions of a multitude of private actors and changes in the overall world political economy.

What is far more significant is whether Canadian governments will retain the capacity in the future to influence private decisions and respond to external changes; that is, to implement industrial policies. In the grossest terms, this capacity will be reduced, unavoidably, because any agreement will heighten North American economic integration and increase American leverage over Canada. Already this leverage in the form of the threat to close markets has brought Canadians to the bargaining table, after having discarded important bargaining counters like the Foreign Investment Review Agency. To believe that an 'impartial', 'non-political' joint agency will, in the crunch, insulate Canada from this power is simple foolishness.⁵⁶ But within these ultimate parameters of American dominance, would the provisions of a comprehensive agreement limit recourse to necessary industrial policies?

Much depends on what is necessary. We may eliminate as unrealistic some proposals for full-blown industrial planning of the European socialist variety, though paradoxically some of its main elements like nationalization and more government spending would not be precluded by a comprehensive deal.⁵⁷ At the other extreme, those who view the economy as successfully adjusting now, and advocate therefore only simple, non-discriminatory measures like tax incentives to increase investment, would sense no constraint in a comprehensive agreement.⁵⁸ Yet even those at the very non-interventionist end of the spectrum could be forced to oppose a comprehensive deal were it to contain provisions limiting monetary and exchange-rate policy. The ultimate device for absorbing and moderating competitive disequilibria, in this view, is currency devaluation (which, though this is less often discussed, does impose heavy costs on some). Were a Canada-U.S. agreement to specify exchange-rate limits, so establishing a 'mini-snake' joining the currencies, this mechanism would be unavailable. Even the staunchest free-trade proponents admit this constraint would be unacceptable.⁵⁹

But most analysts fall between the extremes of laissez-faire and dirigisme. Joseph D'Cruz and James Fleck, for example, have argued that secure access is important, but that governments must also follow a coherent set of policies in managing Canada's 'industrial portfolio'. As they put it, Maintaining and enhancing Canada's access to the American market must remain high on the national agenda. In the short run, much of the policy debate about these issues will revolve around questions of tariffs and treaty arrangements to exempt Canadian exports from trade-limiting devices that may be developed in the United States to provide protection for that country's domestic industries. However, it is important that

such concerns do not draw the attention of Canadian policy-makers away from the more fundamental and longer-term issue. Ultimately, the extent to which Canadian industry can continue to maintain a significant market position in the United States has to depend on its competitiveness.

Canada must continue to be able to provide products that are in demand at competitive prices. And it must also prune those parts of its portfolio in which it has lost competitive advantage while nurturing new industries to take their place.⁶⁰

But can both be done? Will the constraints imposed in order to win secure access eliminate the possibility of pruning and nurturing?

Industrial policy generally refers to sector- or firm-specific interventions. Turning first to the resource sectors, it is clear that a comprehensive subsidies code which reflects current U.S. trade law could restrict policies aimed at enhancing Canadian competitiveness. At the National Economic Conference in 1985, Carl Beigie and James Stewart argued that comprehensive bilateral free trade should be pursued, but that it had to be accompanied by appropriate policies in several core sectors where "Canada must succeed to achieve its future potential".⁶¹ These included (1) effective use of agriculture, forestry, mineral and water resources, (2) assurance of energy availability, (3) provision of transportation at prices reflecting both efficiency costs and developmental benefits, (4) accessibility to world-leading telecommunications services, and (5) world-class training and education. Achievement of these objectives, they stressed, "must not be jeopardized in negotiations with the United States." And yet upstream subsidies in the primary sector which might be socially efficient have been under American attack and will be unlikely to be excluded from the subsidies code. Transportation subsidies certainly will be constrained if they are

trade-distorting; that is, if they lower export prices (and note that if firms in Montreal and Boston are competing for a contract in Los Angeles, subsidies to the transport costs of the Boston firm would not be trade-distorting while those to the Montreal firm would be). Finally, on the telecommunications front, Canada now enjoys world-class services, but many are provided by the Bell-Northern complex, which has been the target of American complaints about its market dominance and about Canadian NTBs like procurement which restrict the entry to the sector of foreign goods and firms.⁶² A free-trade deal which cracked open this relationship and the whole sector might still provide a world-class service, but one not under Canadian control.

The significance for any economy of such dynamic sectors and of powerful, innovative firms like Northern Telecom has been underlined in Rick Harris's remarkable study for the Macdonald Commission, a study worth careful consideration not only because it was so influential but also because of its precision and quality. Harris's central thesis was that Canada needs both free trade and industrial policy. The two should not be seen as antithetical, because of the fundamental fact that international markets are not purely competitive; instead, "dynamic and oligopolistic firms in international industries impinge on trade and industrial structure."⁶³ Harris focussed on competitive advantage in manufacturing, and especially on 'Schumpeterian' sectors and firms. In these technologically progressive sectors, which are often highly concentrated, rents from innovation are maintained by entry barriers, and market strategy is vital because initial success can breed high profits, more research and development [R&D], fresh innovation and further rents.⁶⁴ This view is rather close to positions associated with the Science Council of Canada, except that Harris maintains these firms and sectors require both a facilitative industrial policy and wide export markets.⁶⁵

Under a comprehensive free-trade agreement, unfortunately, these cannot be expected to occur together.

After establishing the importance of knowledge-driven, innovative firms in advanced manufacturing, Harris discusses the position of countries with small, open economies. These nations can often free-ride on others' technological innovations, if only to secure efficient inputs to their own specialized industries, and they also benefit, believes Harris, from technology transfers through subsidiaries. But such nations also have a very strong incentive to foster Schumpeterian firms in key sectors, because existing firms are likely to be sub-optimal in size and to underinvest in R&D.⁶⁶ It is fundamental to the success of such companies that qualified workers be available and export markets open, but equally important is government action to help these firms get a strategic start in the worldwide technological races.

Harris advocates several forms of industrial policy for Canada. On the resource side he devotes some attention to mega-projects, and argues that domestic control of energy prices could provide cheap inputs to key industries, and so use "Canadian comparative advantage" in a "strategically important way".⁶⁷ As we have seen, however, the U.S. is unlikely to accept upstream subsidies in the form of cheap energy if they confer trade advantages. Another use of industrial policy concerns 'losing industries' and 'basic industries'. As a component of sectoral rationalization, Harris proposes using subsidies and loan guarantees to encourage mergers, new product development, and accelerated automation, and he indicates export cartels might be sensible.⁶⁸ These may be economically preferable to defensive protectionism, but it is hard to imagine targeted subsidies being countenanced under a free-trade agreement, when products are to be exported.

Most centrally, Harris argues the case for supporting Schumpeterian firms in the small economy. Other countries do it. More important, governments should act to correct for market failures in industrial R&D and to offset entry barriers in export markets. "The whole emphasis should be on getting a base of potential domestic entrants to technologically progressive world industries."⁶⁹ The requisite strategy is to concentrate on small and medium-sized firms either about to enter or having just entered export markets, and to support them in the early phases of development: individual firms or projects would be targetted. The policy instruments Harris advocates to fund R&D include tax incentives, subsidies, loan guarantees and procurement; to support more investment and expansion he favours low-cost government loans.

But some instruments like procurement would be unusable under even a limited free-trade agreement. Others, like tax incentives, would have to apply to all firms in a sector, not targetted ones, and this is expensive for the small economy. Subsidies and loan guarantees would be much constrained under any conceivable free-trade deal, precisely when exports are involved. The U.S.-Israel agreement, for instance, which covered a very small proportion of American trade, not only specified that infant-industry tariff protection had to be phased out by 1995, and that discrimination in procurement could continue only on contracts worth less than \$50,000, but also provided that subsidy programs to aid exporters had to be eliminated (and 'subsidy' was strictly defined as the difference between the government lending rate and the international capital market rate available to the government).⁷⁰ With the volumes of trade involved between Canada and the U.S., it is absurd to expect the Americans to sign a deal allowing more freedom than this for Canadian governments to subsidize dynamic firms so that they could compete in U.S.

markets.

Harris himself explains why. If rents are involved, the large-country interests lie in keeping its technological advantages by slowing the transfer of technology out of the country and in restricting imports even of non-subsidized innovative goods, (especially those produced by small countries unable to retaliate), so as to weaken foreign Schumpeterian firms.⁷¹ Harris may be correct in arguing that "small countries have obvious incentives to seek insurance against these large country protection policies by seeking trade alliances which assure them access to large markets."⁷² But he provides no reason whatsoever why large countries should conclude such agreements. In terms of his own model, it is certainly odd to expect large countries both to sign such agreements and to leave small countries still free to bolster Schumpeterian firms at the expense of their own. He makes the error, more concretely, of thinking Canadians can get access to the U.S. market on Canadian terms.

In his language, Harris presumes that Canada can follow an industrial strategy which mixes "parallel" policies (ones similar to those in the U.S.) with "differentiated" policies (ones suited to the Canadian industrial structure and designed to bolster dynamic manufacturing exports).

The most striking advantage of [the latter] approach is the possibility that comparative advantage could be engineered in those industries where the United States does not have a comparative advantage. If one accepts the legitimacy of engineered comparative advantage, and if the United States continues to pursue a non-interventionist strategy, then Canada could pursue a strong interventionist approach to industrial policy following a differentiated strategy."⁷³

He does admit that the "differentiated aspect of industrial policy must be

tempered by recognizing where we risk competition with U.S. interests."⁷⁴

But of course Canada faces competition with American interests, not American comparative advantage, on each and every front. It is perverse to expect the United States to conclude any agreement allowing Canadian firms, targetted by government for assistance, freely to take on those interests. The Americans have most leverage in the negotiations, they extended no such leeway to Israel, and Congress has recently assailed both subsidies and the practice of industrial targetting.⁷⁵

Harris claims that "failure to develop domestic firms that could enter the world industry relatively soon would effectively ensure the decline of the Canadian manufacturing sector over the long run, or reduce this sector to one serving the domestic market only."⁷⁶ If this is the case, and a comprehensive bilateral agreement precludes the policies necessary to achieve success, perhaps Canadians are right in hesitating to proceed.

One can still imagine other policy instruments subtle enough to achieve some industrial-policy goals while escaping the provisions of a comprehensive agreement. The main covert instrument is the government holding company, of which the outstanding Canadian example is the Caisse de Depot et Placement. Such enterprises are close enough to the business world to possess the information and flexibility which government bureaucracies may lack, and they are capable of bolstering 'winners' and of winding down 'losers' through subtle devices which include taking up equity, making loans and assembling consortia of lenders, encouraging mergers, and installing innovative managers.⁷⁷ Such holding companies could partly fill the strategic role identified by some analysts for institutionalized financial-sector co-ordination with governments and firms.⁷⁸ In Quebec, the Caisse has played a very substantial role in this regard.⁷⁹ Perhaps its activities

would be beyond the purview of even a comprehensive free-trade agreement, and so Quebecers might be unconcerned about losing other industrial-policy instruments through free trade. Yet this provides no comfort for the federal government or other provinces which have not developed such capital pools. Moreover, even the Caisse is constrained by its need to balance economic growth in Quebec with the security of the pension funds it administers.⁸⁰ Another limitation on the extent to which government holding companies can interfere to counteract market forces arises from the conflict they engender with managers and with other shareholders of companies in which they have a stake. Finally, they offer very little purchase over foreign-controlled companies.

This returns us to foreign investment, the probable keystone of any comprehensive agreement. What are the implications for Canadian industrial policy of national treatment and of increased foreign ownership of Canadian manufacturing? Rick Harris, here representing the mainstream view of economists, regards foreign direct investment as benign and beneficial for its technology-transfer effects, and advocates no discrimination against subsidiaries when supportive programs are implemented. Others disagree, basing their arguments on the relatively low R&D effort of subsidiaries compared to parent firms, their weak export performance, their tendency to purchase services from parents, and the ultimate outflow of dividends.⁸⁰

It is clear that a comprehensive agreement, minimally, would prohibit Canadian governments from negotiating with American firms performance guarantees in the form of agreements to purchase Canadian products, transfer technology, maintain employment, re-invest, do R&D, export goods, or acquire world product mandates. Even if agreements covering some such activities were negotiated with all firms in a sector as a matter of course, rather than only

with foreign subsidiaries, it would be hard to argue that all companies received equal or 'national' treatment since the agreements would be firm-specific. Moreover, with a treaty guarantee of autonomy in hand, U.S. subsidiaries would be less likely than they are at present to adhere to 'voluntary' or informal arrangements such as Harris's export cartels or D'Cruz and Fleck's government-led oligopolies in the commodities sectors.

Insofar as firms are responsive to governments in general, it is hard not to conclude equally generally that parent companies and their subsidiaries must ultimately respond most to the government of their home country (or that in which firms have sunk most capital, economic and political). So one must agree broadly with Molot that "high levels of American ownership of Canadian industry have impeded the ability of the federal government to make and implement national policy decisions."⁸² More American investment, therefore, would render national economic policy more difficult to formulate and to enforce, whenever that policy diverges from U.S. policy.

Of course this proposition is debateable. So are many others which have been advanced about the effects of foreign investment.⁸³ But no amount of empirical testing of past economic reality will determine the choices Canadians will make about bilateral free trade. Foreign investment could, it seems, play a significant role in the free-trade debate - as will other economic aspects of any new agreement - but the ultimate decisions will be made in the political arena, and it is there to which we now return.

V. Conclusion

Canadians have three different options about bilateral free trade. I would rate the chances of there being no deal as very low; similarly, a

comprehensive deal seems improbable. The outcome of the talks is likely to be a limited package of agreements, as depicted in Part III above.

The reason for this lies in the Mulroney government's political fortunes, though the basic causes are much deeper, having to do with what is politically possible in Canada, given the economic, social and cultural fabric of the country. It is certain that the New Democratic Party will oppose any Canada-U.S. deal, because it will in their view entail adjustment costs and lost sovereignty. Yet the Prime Minister's image and popularity are such that his party alone cannot build an adequate consensus to support a comprehensive free-trade agreement. The Tories could attempt a kamikaze manoeuvre, signing such a deal in the knowledge that electoral defeat would follow. But the Red Tories in the Cabinet who have doubts about the initiative as it is, and others with a strong instinct for political propriety (or for electoral survival) would resist. As well, against two determined opposition parties capable of obstructing all Parliamentary business and of whipping up public resistance, the government could not implement such an agreement. It is conceivable that a plebiscite on trade could save the government and perhaps the initiative by removing the issue from its association with the Tories, while also avoiding Parliamentary deadlock. But again, facing a resistance led by two united parties the comprehensive option would very probably fail to command a majority.

No, if the Mulroney administration is to push through a deal, there is only one avenue open. That is to produce an agreement which splits the Liberal party. Currently the Liberals can dodge and shift on the issue. They avoid their obvious internal divisions by attacking the government's strategy and tactics, while advancing only the vaguest of alternative goals. A Liberal position paper of mid-1986 nicely illustrates this: "In the process of

reacting to someone else's initiatives, honest answers cannot be reduced to simplistic slogans. If asked 'Are you for free trade?', the answer is 'no, if you mean the Mulroney government approach to trade policy'...If the question is 'Are you for a good trade relationship with the U.S.?', the answer is 'Yes...'."84 As the issue comes down to the crunch, the internal differences have become harder for the Liberals to paper over. These are not matters of mere personality, but of a perennial division within the party between national determination and continentalism, one perhaps more difficult to surmount when in opposition than when in power.

When an agreement emerges, the luxury of attacking the process rather than the product will end abruptly. An agreement will be no more open to amendment in Canada than under the American fast-track procedure, and the Mulroney government will present the deal in the starkest possible terms: take it or leave it. If enough Liberals are prepared to take it, then the government, in coalition as it were, might manage to sustain public opinion in favour of the agreement.

But if Canada concedes the right to restrict U.S. investment in vital sectors like energy, manufacturing, banking, informatics, publishing and health services, then public apprehension about a literal sellout would rise enormously. And the Liberal party would not be divided, for they could not resist getting out in front of public fears and spearheading them. Not only would failure to do so concede too much policy space to the NDP, but foreign investment is also too symbolic in the party's past and economic development planning too essential in its future. In reality, capital may have neither home nor loyalty, but the Liberals, like most Canadians, would agree that any development policy beyond a simple faith in international market forces requires the ability to foster, to favour, to guide, and certainly to preserve

a national business community.

This analysis suggests that the government is indeed near the brink in the free-trade talks. If a comprehensive agreement hinges on the trade-off between secure access for goods and unimpeded investment flows, then it cannot be sold in Canada. If the talks are broken off, then Canada would be exposed to the full ire of the Americans, who were asked to negotiate, after all, and who might place no more credit in their special relationship with Canada. The most likely alternative is for the government to draw back and to settle - assuming the Americans would agree - for a limited deal. This will meet neither the core demands of Canadian business nor the expectations of the U.S. side, but it may be just tolerable politically. In any case, Canadians will pay for their government having invested so much time and effort pursuing the chimera of winning access to the American market on Canadian terms.

FOOTNOTES

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8. Elizabeth Beale, 'Trade Flows Between Atlantic Canada and the United States', presented to the Atlantic Canada Economics Association, Sackville, New Brunswick, October 24, 1986; P. Rao and M. Daly, 'Free Trade, Scale Economies and Productivity Growth in Canadian Manufacturing', presented to the Canadian Economics Association, Montreal, May 31, 1985; Randall M. Wigle, 'General Equilibrium Analysis of the Effects of Multilateral and Canadian Trade Liberalization', Ph.D. thesis, University of Western Ontario, December 1985, esp. 44-109, 117-137.
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10. Alan M. Rugman, 'U.S. Protectionism and Canadian Trade Policy', presented to a conference on Canada-U.S. Free Trade: Bilateral and Multinational Perspectives, Provo, Utah, April 4, 1986, 11-21.
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12. Giles Gherson, 'U.S. Import Bills Posing New Threat to Trade Pact', Financial Post, April 6, 1986: 4.

13. Lester Thurow, 'America, Europe and Japan: A Time to Dismantle the World Economy', The Economist, November 9, 1985, 21-26: 21.
14. R.J. Wonnacott, Canada/United States Free Trade: Problems and Opportunities, Ontario Economic Council Special Research Report (Toronto: OEC, 1985), 9-10.
15. Albert Breton, 'The Political Economy of Free Trade', presented to the Atlantic Canada Economics Association, Sackville, New Brunswick, October 24, 1986.
16. M.G. Clark, 'Nontariff Measures: Perceptions and Reality', in Conklin and Courchene, eds., Canadian Trade at a Crossroads, 265-287: 274.
17. André Raynauld, 'Trade Deal, or As We Are', Policy Options, 8:3 (April 1987), 16-18: 18. The Macdonald Commission made the point most clearly: "The explicit premise behind our free-trade proposals is that the Canadian economy must be made more competitive, and that domestic adjustment-retarding policies must be replaced with adjustment-facilitating strategies. Our basic international stance complements our domestic stance. We must seek an end to those patterns of government involvement in the economy which may generate disincentives, retard flexibility, and work against the desired allocation of resources." (Report, Vol. 1, 50.)
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