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U.S.-CANADIAN TRADE AND INVESTMENT FRICTIONS:

THE U.S. VIEW

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and
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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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THE U.S.-CANADIAN TRADE AND INVESTMENT RELATIONS
which was a slightly lower figure than in 1970. If we consider the figures in 1970, according to two-thirds of Canada’s total trade in 1970, Canada’s exports and imports were in significant increase in 1970. Trade especially with the US, which accounted for about 15 percent of total US’s merchandise exports and imports in 1970. This was almost the same proportion as in 1970, proportionate to 1970’s foreign trade with the US figures. In order to provide some perspective on the various issues, some and policies of the US and Canada are outlined in this section.

"Contingent protection in the U.S., specifically in the U.S. and Canada, are outlined and policies toward government intervention and the increased use of national policies. For the purpose of discussing the economic implications of each country's government intervention and direct foreign investment and foreign exchange policies, we consider the implications of the foreign and economic relations between the two countries, such as services, international reserves, and direct foreign investment.

Reviewing the economic relations between the two countries, we consider the implications of the foreign and economic relations between the two countries, such as services, international reserves, and direct foreign investment.

In section II, we consider the various alternative policies and alternatives, providing some alternative policies and alternatives to direct foreign investment. In section III, the policy options are then considered in section IV, these include the role of the IMF, and a variety of sources of trade and investment, and investment sectors that exist currently.

II. Introduction

The Department of Economics and Institute of Public Policy Studies

Research Staff

The U.S. and Canada: Trade and Investment Alternatives

Since 1970 especially, there has been a marked increase in frictional
composition of bilateral trade, manufactures were 84 percent of U.S. exports to Canada and 60 percent of imports from Canada in 1981. Comparing bilateral with total trade, U.S. trade with Canada was concentrated relatively more on manufactures, especially on the export side. This was the case as well for Canada, although it is noteworthy that primary products accounted for 40 percent of Canada's bilateral exports to the U.S. and nearly half of its total exports in 1981.

The more detailed data on the composition of trade in Tables 1 and 2 provide further insight into each nation's "revealed" comparative advantage. Thus, according to Table 1, in 1981 the U.S. had net imports from Canada in all of the categories of primary products and semimanufactures indicated and net exports of engineering products, except for road-motor vehicles, and consumer goods. Using Canadian data in Table 2, the results are broadly the same, although there are some differences which may be attributed to the C.I.F. valuation of imports by the U.S. as well as differences in classifications used in the two countries. Looking at total trade, the U.S. had substantial net exports of food, raw materials, and chemicals and net imports of iron and steel, road-motor vehicles, household appliances, clothing, and other consumer goods. The U.S. pattern of trade is thus much more varied globally than it is bilaterally with respect to Canada.

Receipts and payments on merchandise trade and services by category and area are shown for the U.S. and Canada for 1973 and 1981 in Tables 3 and 4. U.S. net receipts of investment income from Canada were substantial in 1981 and more than offset the U.S. deficit on bilateral trade with Canada. This was the case also for the U.S. with respect to the other industrial countries and the rest of world comprising OPEC, other developing countries, and the socialist countries. In 1981, Canada's net payments for interest and dividends and other services more than offset its merchandise trade surplus. The bulk of these net service payments went to the U.S.

The Composition and Geographic Distribution of Direct Foreign Investment

It can be seen in Table 5 that, in 1981, mining and petroleum accounted for 30 percent of U.S. direct foreign investment in Canada, manufacturing for 42 percent, and trade, banking, finance, insurance and real estate, and other industries the remaining 28 percent. Petroleum accounted for 13 percent of Canadian direct foreign investment in the U.S. in 1981, manufacturing for 47 percent, and trade, etc., for 40 percent. Overall, 21 percent of U.S. direct foreign investment was in Canada in 1981 and 14 percent of foreign investment in the U.S. was accounted for by Canada. Direct foreign investment in the U.S. increased substantially between 1973 and 1981, especially from the other industrial countries.

The data for Canada's direct foreign investment are presented for 1973 and 1978 in Table 6. Since the system of classification and terminal years differ, comparisons cannot be made directly with the U.S. data in Table 5. In any event, the data indicate that more than half of Canadian direct foreign investment abroad was in the U.S., and the U.S. accounted for about 80 percent of the total in Canada. Canada's net position in 1978 was a negative C$32 billion. Further industry detail is provided in Table 7, which distinguishes between foreign ownership and control by the U.S. and other countries for 1977. It can be seen that U.S. ownership and control of capital were 30 percent in mining and smelting, 42 and 51 percent in petroleum and natural gas, and 39 and 42
Canadian federalism is closely linked to the structure of the government. The federal and provincial governments share powers, but the provinces have more autonomy and control over certain areas such as education, health, and transportation. The federal government has the power to make laws that apply to the entire country, while the provinces can make laws that apply only within their borders. This system is designed to ensure that both levels of government can address the needs of their residents effectively.

The economic policies of Canada are closely tied to the country's geography and resource wealth. Canada is a large country with significant natural resources, including forests, minerals, and farmland. The government has implemented policies to promote the development of these resources, such as subsidies for the forestry and mining industries. These policies have helped to create jobs and stimulate economic growth, but they have also raised concerns about the environmental impact of resource extraction.

Canada is also a major player in the global economy, with a strong export-oriented economy. The government has implemented policies to promote exports, such as tax incentives for businesses that export goods and services. These policies have helped to make Canada a leader in areas such as manufacturing, mining, and natural resources, but they have also raised concerns about the impact of globalization on the domestic economy.

The Canadian government has also implemented policies to promote social cohesion and equality. These policies include programs to provide social assistance to low-income families, as well as initiatives to improve access to education and healthcare. The government has also implemented policies to promote multiculturalism, recognizing the diversity of its population and encouraging the integration of new immigrants.

Overall, Canada's economic policies are designed to balance the needs of the government with the interests of its citizens. The government has tried to create a stable and prosperous economy while also addressing the social and environmental challenges facing the country. However, there are still challenges to be faced, such as the need to address climate change and the ongoing debate about the role of government in the economy.
the federation overall, and from such major actions as FIRA which is viewed especially in the U.S. as discriminatory and some features of the NEP which are considered to be confiscatory.

Numerous examples of U.S. intervention can of course be cited, including instances in which foreign rights of establishment and ownership have been constrained or prohibited. Typically these interventions are justified by arguments involving public goods, although there may well be cases (e.g., merchant shipping) in which protection is the major motivation. By the same token, there are also prominent examples of U.S. deregulation in such important sectors as airlines, trucking, financial institutions, and energy. These actions are designed to moderate or eliminate intervention domestically. Problems may arise, however, if foreign regulations remain intact at the same time that deregulation alters the environment and incentives governing international trade and investment.

Governments are naturally sensitive to changes in political and economic currents at home and abroad, and it is common for policies and administrative procedures to be altered in response to changing conditions. For example, personnel changes were made in the Canadian cabinet and in the direction of FIRA in 1982 which have resulted in a much less strident approach to direct foreign investment and a noticeable increase in the rate of approval of applications. These changes were made apparently in recognition of the criticisms of FIRA which had been expressed by business executives in both Canada and the U.S., by the heads of some provincial governments who viewed foreign direct investment as beneficial to regional growth and employment, and by U.S. Government officials. The severe recession affecting Canada and the prospect of a federal election in 1984 were no doubt major contributing factors in making these changes. While the NEP is still very much in place, with its "back-in" and discriminatory incentive payments provisions intact, the decline in energy prices and the financial difficulties being experienced by Canadian energy firms have certainly altered the premises on which the policy was based and dimmed the enthusiasm for foreign takeovers. It would not be surprising therefore to see some fundamental changes in the NEP especially after the forthcoming election.

One final and important point relates specifically to international trade policy. This involves what Grey (1982, p. 452) has called the rise of "contingent" protection, which refers to the increased use of nontariff measures and a corresponding shift away from tariffs as the focal point of trade policy. The resulting system is much more legalistic and yet more discretionary, with protection being imposed under certain conditions as defined by law and subject to the interpretation of the domestic investigatory bodies. Many of the changes in trade policy in the U.S. reflect the increasing influence of the Congress. This was especially evident during the Tokyo Round negotiations and in the drafting and approval of the various codes and legislation governing dumping, countervailing duties, and unfair trade practices. Further, as Baldwin (1983) has noted, even though the Reagan Administration has paid lip service to a policy of freer trade, it has encouraged fairly strict enforcement of U.S. trade laws. The motivation has at times been to force changes in foreign government trade policies, but there have been significant protectionist pressures as well which the Reagan Administration felt compelled to oblige. It is of course
The right of a person to receive any financial or direct investment in the formation or provision of nonfinancial or financial services (including the provision of nonfinancial or financial services, product provision and franchise, and the grant of an intellectual or industrial property right) is a matter of concern for the L. G. B. and the General Agreement on Trade in Services (GATS).

In accordance with Article XX and Article VII of the GATS, the United States has a right to provide services in the field of insurance, reinsurance, and financial services, including insurance and reinsurance services, investment services, and financial advisory services. This right is subject to the provisions of the GATS.

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about the Declaration, the presumption was that their investment policies would nonetheless conform to it. Thus, when the FIRA process became more restrictive beginning in 1980, the U.S. objected to the numerous and legally enforceable requirements being imposed on U.S. firms that were believed to be distortionary. These included local-content requirements, export commitments, requirements to hire specific percentages of Canadian management and labor, obligations to move production facilities to Canada, and obligations to transfer technology and patents to Canada without charge. The U.S. was also concerned about the possible extraterritorial extension of the FIRA process to the review of mergers involving foreign companies which might cause a change in the ownership of a Canadian subsidiary.

When bilateral consultations concerning FIRA reached an impasse, the U.S. initiated a GATT action in January 1982, requesting consultations under Article XXIII with regard to FIRA local-content and export-performance requirements. When these latter consultations turned out to be inconclusive, the U.S. then invoked the disputes-settlement procedure under Article XXIII. The U.S. contended that the local-content requirements were in violation of GATT Article III concerning national treatment of imports and Article XVII relating to the application solely of commercial considerations to government measures affecting trade. The export requirements were purportedly in violation of Article XVIII. In July 1983, a GATT panel concluded that the FIRA local-content requirements were in violation of GATT, but that the export requirements were not covered under GATT. This case will be considered for final recommendations by the governing Council of GATT in the fall of 1983.

It was mentioned earlier that the FIRA review process has been greatly expedited during the past year, following the appointment of a new Cabinet minister and director of FIRA with a more liberal attitude towards foreign direct investment. FIRA is thus presently much less of an irritant in U.S.-Canadian relations than formerly. As previously noted, this change in direction may reflect a variety of factors brought to bear on the Canadian Government in a time of recession, including pressure from the business community in both Canada and the U.S., provincial government pressures to encourage growth and employment, and the efforts of the U.S. Government through various official channels.

Whether the current calm will continue is difficult to say. Much will depend upon the attitudes and objectives of the Canadian Government and its leaders. There is always the risk that FIRA procedures can be tightened once again. Thus, so long as FIRA continues to operate, some firms which might otherwise consider direct investment in Canada may choose not to do so because of the costs and delays involved and the reluctance to adhere to FIRA mandates which are legally enforceable and monitored to insure compliance. Moreover, since FIRA is not required to reveal the reasons for its decisions, firms may have no recourse if their application is not approved. It may be useful therefore for the U.S. to review the possible alternative responses to FIRA decisions that may be detrimental to U.S. interests. I shall return to this below.

National Energy Program (NEP)

The NEP, which was initiated in October 1980, sought to achieve security of energy supply, Canadianization of the oil and natural gas industry, and equity in pricing and the sharing of revenues between the provincial and federal governments. There were several motives
ser in

1. Support amenities related to materializing and market transactions to the NFP

2. Engage in Cogent's, however, around some of the core WMPs

3. Rationing on top by Canadian firms. These plans

4. An increase in shear transactions for foreign transactions and to place a

5. Electric utility. The response in the U.S. Congress was highly

6. Into the test house and space in 1991, which were designed to

7. And other Canadian acquirer activities, and raises were

8. From a number of the sources of this figure had expressed the

9. Of the U.S. firms, adjusted to the $2.9 billion, in existing oil

10. As noted by another

11. Relations and have provided official U.S. criticism, as noted by another

12. Which is most directly affected by the NFP, and investigation

13. I shall concentrate here, according to these activities of the

14. Are discussed in detail and along (1991, 1992) and share

15. The industry's share of the original KL and subsequent arrangements and update in

16. A significant number of larger firms, and an increase in the share of

17. And gas resources.

18. To enhance the production of oil and gas resources.

19. Policy generated by experience and, and material and

20. Concern the Canadian government, or regional committees on

21. Concern the production of oil and gas resources.

22. To enhance the cost of Canadian, from future oil

23. Include:

underlying the NFP. According to Stuntin (1992, pp. 149-99), these
Some of these reactions to the NEP were mentioned above. There was a substantial fall in exploration and production expenditures in 1981 and a significant moving of drilling rigs and skilled personnel out of Canada to the U.S. especially. Further, financing of the takeovers apparently resulted in a sizable depreciation of the Canadian dollar. Citing a Bank of Montreal (1981) study, Scarfe (1983, pp. 44-46) noted that the exchange rate may have depreciated by 1–1/2 U.S. cents between October 1980 and June 1981 due to the takeover activity. Moreover, since foreign currency loans were used to a large extent to finance takeovers, there would be added interest costs and resulting additional downward pressure on the exchange rate ranging between 1–1/4 and 5 U.S. cents, depending upon the assumptions made about the duration and rate of the takeover activities.

Since the advent of the NEP, there has been a marked weakening of energy prices which has necessitated some important changes in the pricing, federal-provincial revenue distribution, and taxation of the energy sector in Canada. These changes have resulted in higher domestic prices to Canadian consumers and lower revenues for both the federal and provincial governments. Because of the complexity of the incentive and taxation systems, it is somewhat difficult to determine what has happened to rates of return to producers. But according to Scarfe (1983), the fiscal changes in the NEP may affect existing production adversely and provide somewhat greater incentives for new, higher cost sources of supply. From the standpoint of U.S.-Canadian relations, the question remains whether any changes will be made in those provisions of the NEP which the U.S. has identified as being most objectionable. These concern chiefly the “back-in” provision and the PIP. The U.S. will certainly continue to make known its displeasure with these aspects of the NEP, and it is conceivable that some changes may be made following the forthcoming election in Canada.

Sectoral issues

In addition to FiRA and the NEP, there are a number of particular sectors in which friction have arisen between the U.S. and Canada. These have involved trade in agricultural products, complaints about subsidies and protectionist actions of various kinds affecting trade in manufactures, and issues connected with production and trade in public goods. Problems have also arisen because of responses to differential deregulation in particular sectors in the two countries. Finally, there are some issues involving extraterritoriality and conflicts of jurisdiction.

A. Trade in agricultural products

Agriculture has long been subject to domestic intervention in the U.S., Canada, and most other countries. Conflicts are bound to arise when domestic producing interests experience some actual or perceived disruption from imports, or when exporting countries pursue different policies which may disrupt market shares.

In terms of bilateral trade in agricultural products, the U.S. has been concerned about Canada’s “fast track” safeguard system which permits imposition of a variable import levy when Canadian producers may be affected adversely by relatively low domestic prices. It is the U.S. view that this system may be in violation of GATT Article XIX, which permits safeguard actions only involving changes in the volume of imports. The system was first used by Canada in October 1982 in
Continuing protection is now central to the administration of U.S.

Interests and the way in which these Interests may apply the system of
action is industrial policy of the appearance of National policies
materials. Import duties may be imposed. This particular
stage of the investigation led to the restriction of a determination that there is
preliminary evidence of dumping by Canadian products. If in the near
there was material injury. The U.S. Commerce Department later found
Canadian imports, and the unit deliberately flooded Preliminary
that the main producing industries that were held in antidumping petition because
in the meantime, and on overreach in U.S., to support in
Canadian preference to which any position to raise the floor for

Continuing action is in particular to support the country, a spirit in
Canadian foreign trade. In particular, the floor for foreign
and to use the final review of evidence, the court's decision,
action to determine if the domestic industry was being injured by imports
U.S. International Trade Commission (ITC) under section 337 of the Trade

In 1929, the Marine Patrol Council initiated an investigation by the
U.S. International Trade Commission (ITC) under section 337 of the Trade

Interests of U.S. and possible subsidies on Canadian exports of steel to

In light of this, the U.S. government should be easy to adjust. In addition, the
these various considerations, but sudden upsurges in imports and changes
Canadian duty and demand on imports. It may be difficult to cut our
to which the law domestic prices a consequence of changes in
the U.S. were having an international impact. This shows how the existing
response to claims from Western Canada in total growth that imports from
B. Subsidies and protectionist actions affecting trade in manufactures

The serious recession occurring in the U.S. and Canada has exacerbated protectionist pressures in various sectors, and some potentially costly actions have been threatened or taken in the U.S. especially. Perhaps the most serious of these involved charges that Canadian softwood lumber exports to the U.S. were being unfairly subsidized because of the comparatively low stumpage prices being paid to the government of British Columbia by private producers for cutting timber on public lands. A countervailing duty action was instigated by U.S. producers and preliminary investigation by the ITC ruled in November 1982 that there might be injury. The Commerce Department then sought to determine the extent of subsidy as the basis for a possible countervailing duty action. It was concluded in March 1983 that any subsidies were "de minimis" and the case was terminated.

The Canadian lumber case is interesting and important for a number of reasons. U.S. lumber producers in the Pacific Northwest had been seriously affected by the weak housing market in the U.S. Imports from Canada may well have made their situation worse, but the chief reasons for their problems were clearly domestic in origin, including being locked into stumpage contracts negotiated in earlier periods when lumber prices were relatively higher. Nonetheless, the U.S. producers instituted a potentially very costly action under U.S. law, given that there was close to $2 billion of trade involved. This is not to say that there is no case to be made against Canadian lumber policy, particularly with respect to bidding practices and the longstanding restrictions on the exports of logs from British Columbia. But these are policies that have been in place for a considerable period of time, and there is no clear legislative authority for challenging them.

Another interesting case involved a countervailing duty action brought in 1982 by the Budd Company of Michigan. At issue was a financing agreement between the Export Development Corporation of Canada and the Metropolitan Transportation Authority (MTA) of New York City, whereby subway cars were to be provided by Bombardier, Inc. of Montreal at a subsidized interest rate. Export-credit subsidies have been a bone of contention between the U.S. and other industrial countries for some time, and it has proven difficult to obtain an international consensus to bring these subsidies under control. In this particular case, the Canadian manufacturer was responding to competitive pressures from other foreign (French) bidders. Yet the action was potentially countervailable under U.S. law. The case in question was never brought to conclusion, however, since the Budd Company withdrew its complaint. The reason may have been that it did not wish to disclose its financial condition in the course of an investigation to determine if there was injury. This is then a further example of the way in which the U.S. system of contingent protection can be used as a technique for harassment of foreign producers, although there were broader issues of export credits present as well.

The preceding countervailing actions and investigations instituted under U.S. law are vivid illustrations of the workings of the system of contingent protection and the resulting harassment that foreign producers may experience. Yet in both of these instances the proceedings were terminated. This suggests that the system of contingent protection does not always or necessarily result in actual
action was taken. In the summer of 1993, legislation was once again
U.S. Congress must consider major legislative and regulatory steps to
commercialize Internet. It was proposed then and again in 1994 that the
decriminalization of a minor the running action was significant to U.S.
U.S. law. Indeed, in 1980, r.s. Porter brought a copyright action
preventing could be recovered in Canada. A section 20(1) action was
had a clear adverse impact on U.S. telecommunications services.
This cost of foreign adversarialism which is directed mainly at Canadians. This
since 1978, Canada has been caught in a regulatory crossfire.
concern involving border broadcasting and copyright renunciation.
setback areas of dilution, protection of works in progress, and
agreements in each country are once common in supporting views and
issues of national policy at the international level. The ongoing
conversation on a national and world level will be the first in particular.
U.S. and Canada have common interests in the development and use
defenses.
Some issues involving transponder (communication and telephone)
there is less need for a transponder. But the issue will likely
time to deal with these matters. Moreover, the issues of dilution
under the dilution provision to cross the U.S. national boundaries. We would
and the fact that the use of dilution rights and other liability and that
there are some very complex issues, which are the in particular.
C. Issues Involving Prostitution Goods.
communicating effect of their Canadian operations.
following complaints by some major drug companies in Canada and
East of the border). This policy is appropriate under Canadian law and a
short period of patent protection realised in Canada and the relatively
prophetic approach has economic U.S. Time after trying to
which is anticipated without procedures. The company's intention of
selling on the floor of the U.S., an appropriate approach under
Canada's own jurisdiction, and the company's intention of
commercializing itself with the anticipated approach in the U.S.,
the extended Canadian customs jurisdiction to 200 miles to the end of the
action of the Canadian Customs. The file was referred to 200 miles to the end of the
the policy of restrictions makes no distinction among supplying countries.
the Canada product is under the Trade Act, in this case, commercial
products to the U.S. may have been adversely affected by retailer
Finally, a national borders, Canada's exports of selected steel
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introduced in the Senate. The issue is now under study in Canada in connection with an official review of the Canadian Income Tax Act, but it is not clear how it may be resolved.

With respect to copyright retransmission, the U.S. has objected to the existing Canadian cable law and broadcast policy which denies U.S. copyright owners compensation for retransmission in Canada of material broadcast by U.S. border stations. The U.S. has compulsory licensing covering copyright retransmission, and there is some sentiment in Congress for prohibiting payments to Canadian copyright owners pending a change in Canadian policy. This issue is at the moment unresolved.

An issue involving national defense concerns the U.S. restrictions introduced in 1982 on the importation of specialty metals in Department of Defense procurement. These metals include titanium, zirconium, nickel, iron-nickel, and cobalt base alloys. Canada sought a waiver which would permit the export of bulk specialty metals on the grounds that they are distinct from defense systems. The argument was that it made sense to view a single North American industrial base for purposes of mobilization and defense, and that the amount of defense procurement was only about 5 percent of total U.S. production. The Department of Defense supported the request for a waiver, and legislation has been obtained to grant it.

U.S.-Canadian relations involving public goods clearly entail many sensitive areas of national concern. Nonetheless, when costly restrictions are introduced that are inimical to economic welfare, it would be desirable to seek accommodations in policies that will mitigate detrimental cross-national impacts and promote joint objectives.

D. Issues of deregulation

In recent years, there has been a significant movement towards deregulation in a number of important sectors in the U.S., including trucking, airlines, banking and financial services, and energy. Deregulation is also occurring in Canada, but probably to a lesser extent than in the U.S. Because of national differences in regulations affecting particular sectors, some problems have therefore arisen between the U.S. and Canada.

With the deregulation of trucking in the U.S. under the Motor Carrier Act of 1980, Canadian trucking firms have been able to operate in a liberalized environment along with U.S. firms. In Canada, a U.S. trucking firm must obtain provincial approval as well as approval from FIRA. U.S. firms have alleged that the Canadian regulatory systems place them at a competitive disadvantage vis-a-vis Canadian firms.

There was also a dispute that arose over air fares when the U.S. denied permission for a Canadian airline to offer discounted fares for certain flights from Canada to the U.S. This was in retaliation for earlier Canadian action which prevented a U.S. carrier from matching a Canadian competitor's fares within Canada.

The complaints of U.S. trucking firms involve the issue of national treatment mentioned earlier, although there is an element of reciprocity present in both this instance as well as in the airline-fare disputes. As differential deregulation occurs in other sectors, it is likely that further bilateral frictions will arise. The procedures and resolutions of the bilateral disputes in the transportation sector may well be suggestive in handling potential problems elsewhere that may occur in the future.
The U.S. and Canada have a tradition of official contacts at all levels and have a shared interest in reducing or resolving friction along their borders.

In the context of bilateral relations, the government may consider the potential benefits of reducing or eliminating certain policies or actions that might create friction or tension between the U.S. and Canada. This could include measures to enhance cooperation and reduce barriers to trade and investment.

The potential benefits of such actions might include:

- Increased trade and investment between the two countries
- Improved economic relations and competitiveness
- Enhanced political and security cooperation

However, any such actions would need to be balanced against potential drawbacks, such as:

- Adverse economic impacts on businesses and consumers
- Strained relations with other countries
- Increased regulatory burdens on businesses

The decision to pursue such actions would depend on a careful analysis of the potential benefits and drawbacks, as well as consultations with stakeholders and other relevant authorities.

The U.S. and Canada continue to engage in ongoing discussions to find ways to reduce or eliminate friction points, with a focus on enhancing mutual understanding and cooperation.

Having reviewed the various sources of friction between the U.S. and Canada, the government may consider additional actions to address these issues.
moderation of the policies. Some credit for these changes should also be attributed to the eventual clarification of U.S. official views and the pursuit of U.S. interests in bilateral dialogue. In any event, the bilateral relationship is currently (September 1983) functioning much more smoothly than was the case a year or two ago.

In order to help resolve future bilateral disputes, the idea of establishing a U.S.-Canada Commission on Trade and Investment might be worth exploring along the lines suggested in Macdonald (1982). As he notes (p.231) in reflecting on previous experience in managing bilateral relations:

"...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 are in politics and refuse to be confined to the Procrustean bed of a single institution. They need more manoeuvrability than a bilateral committee can provide.

Conversely, where an issue involves an immense amount of detail, humble detail, and calls for a high order of expertise and where it entails no major political question, bilateral institutions have been successful."

A commission of this kind would function mainly in a fact-finding role and as a means of promoting conciliation of trade and investment disputes. It would not replace existing multilateral arrangements, although it could be extended to include relations with other important countries or regions such as Japan and the EEC. As noted, a commission would not necessarily be effective when there were important political stakes involved in bilateral disputes, as for example in the cases of FIRA and the NEP. Intergovernmental diplomacy and the resort to multilateral dispute settlement procedures would then be in order.

Turning now to multilateral policy options, they are best designed to complement and reinforce bilateral efforts. Thus, for example, it may be fruitful to pursue multilateral discussions and negotiations to clarify and limit the use of investment-performance requirements. The difficulty is, however, that multilateral efforts may take a long time before agreement can be reached, and even then the agreement may not be effective unless countries are motivated to limit the extent of their interventionist policies. It is nonetheless important for the world economy that there be an effective multilateral framework governing international trade and investment. The U.S. complaint in GATT concerning Canadian local-content and export-performance requirements is an important example of bringing multilateral authority to bear on an issue that is troublesome bilaterally but has implications that go beyond the particular case. This point also applies to other policies that come under the purview of GATT, especially subsidies and countervailing duties, antidumping actions, and government Procurement restrictions. Thus, bilateral and multilateral policy initiatives and responses should proceed in tandem.

A case for unilateral measures can be made when bilateral efforts do not succeed and multilateral efforts are too time consuming or not clearly applicable. As Hufbauer (1981, p. 8) notes: "The art is to design [unilateral] measures that do not overreact, that redress the injury caused, that penalize the offender, and that minimize harm to innocent parties." Clearly this is no easy matter. Unilateral measures include what Hufbauer has called public response, mixed public-private response, and private right of action.

From the U.S. standpoint, public responses include resort to Section 301 of the Trade Act which relates to foreign actions which are damaging to U.S. commercial interests. This was used in the border-broadcasting
mechanisms of protection. A consideration of this concept in the context of the protection of property is also important. The protection of property is an essential aspect of any policy, and the protection of property is a fundamental right that all individuals should enjoy. It is therefore important to ensure that the protection of property is not undermined by any other measures that may be taken to promote the public interest.

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these measures may become politicized or transformed along more protectionist lines, I find them less promising.

References


Footnotes

1 I would like to thank Alan Bearden, William Herkin, Gary Saxenhouse, Steven Watkins, and members of the Research Seminar in International Economics of the University of Michigan for helpful comments on an earlier version of this paper.

2 I might mention here the views of proponents of U.S.-Canadian free trade, such as Wonnacott and Wonnacott (1982), who assert that existing tariffs in both Canada and the U.S. are especially detrimental to Canada. It is argued that the U.S. tariff prevents Canadian manufacturing firms from exploiting economies of scale which might otherwise be realized if their markets could be enlarged. In addition, the U.S. tariff is alleged to impede investment and reorganization by Canadian firms to serve the U.S. market. If free trade were permitted between the two countries, Canada would presumably realize significant benefits. A further benefit might be a reduction in bilateral frictions since Canada would have a greater voice in affecting U.S. trade and investment actions. Not everyone shares this enthusiasm for free bilateral trade, however, since there may be an exaggeration of the gains from higher productivity and of the barriers that supposedly impede the expansion of Canadian manufacturing firms. See, for example, Wilkinson (1982).

3 For details, see especially FIRA (1982).

4 For some useful references concerning FIRA and related issues involving the regulation of foreign direct investment and performance requirements, see Bao (1982a,b; 1983); Dewhirst (1982); Fonheim and Gadbaw (1982); Gotlieb (1982a,c); Hufbauer (1981); Hufbauer and Samet (1982); McCarthy (1982); Safarian (1982); Stocks (1982); U.S. ITC (1982, esp. pp. 120-42; 1983, esp. pp. 144-45); and Wonnacott (1982a,b).

5 In this connection, see Thomas (1983, esp. pp. 29-30) and Gotlieb (1982a, esp. pp. 18-19).
### Table 1
United States Merchandise Trade by Commodity Groups and Areas, 1973 and 1981
(Billions of U.S. Dollars; Exports F.O.B., Imports C.I.F.)

<table>
<thead>
<tr>
<th>Commodity Group</th>
<th>Year</th>
<th>Canada</th>
<th>Other Industrial Countries</th>
<th>D.P.E.C., Other Devel. Countries &amp; Socialist Countries</th>
<th>Total Merchandise Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Exp.</td>
<td>% Imp.</td>
<td>Exp.</td>
<td>% Imp.</td>
</tr>
<tr>
<td>(1) Primary products</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td></td>
<td>2.2</td>
<td>0.3</td>
<td>1.0</td>
<td>0.5</td>
</tr>
<tr>
<td>1981</td>
<td></td>
<td>1.9</td>
<td>0.5</td>
<td>2.1</td>
<td>0.4</td>
</tr>
<tr>
<td>(2) Specialty materials &amp; manufactures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>1973</td>
<td></td>
<td>1.3</td>
<td>0.4</td>
<td>2.0</td>
<td>0.4</td>
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<tr>
<td>1981</td>
<td></td>
<td>1.0</td>
<td>0.2</td>
<td>2.0</td>
<td>0.3</td>
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<tr>
<td>(3) Standard equipment</td>
<td></td>
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<tr>
<td>1973</td>
<td></td>
<td>0.7</td>
<td>0.1</td>
<td>1.2</td>
<td>0.2</td>
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<tr>
<td>1981</td>
<td></td>
<td>0.4</td>
<td>0.1</td>
<td>0.8</td>
<td>0.2</td>
</tr>
</tbody>
</table>
| Source: Adapted from GATT, International Trade, 1981/82, Table A12.
### Table 3
Receipts and Payments on Merchandise Trade and Services for the United States (Billions of U.S. Dollars)

<table>
<thead>
<tr>
<th>Category Year</th>
<th>Canada</th>
<th>Other Industrial Countries</th>
<th>GPEC, Other Dev. Countries &amp; Socialist Countries</th>
<th>Total Trade</th>
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</thead>
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<tr>
<td>(1)</td>
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<tr>
<td></td>
<td>1972</td>
<td>15.6</td>
<td>17.3</td>
<td>17.2</td>
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<td></td>
<td></td>
<td>1981</td>
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<td>1981</td>
<td>15.2</td>
<td>16.4</td>
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<td>(2)</td>
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<tr>
<td></td>
<td>1972</td>
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<td>(3)</td>
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<td>1972</td>
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<td>1972</td>
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<td>1981</td>
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<td>1972</td>
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<td>1981</td>
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<td>1972</td>
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<td>1981</td>
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</tbody>
</table>

### Table 3 (continued)

<table>
<thead>
<tr>
<th>Category Year</th>
<th>Canada</th>
<th>Other Industrial Countries</th>
<th>GPEC, Other Dev. Countries &amp; Socialist Countries</th>
<th>Total Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Area, %</td>
<td>1972</td>
<td>20.0</td>
<td>20.5</td>
<td>44.4</td>
</tr>
<tr>
<td></td>
<td>1981</td>
<td>16.4</td>
<td>14.9</td>
<td>40.5</td>
</tr>
</tbody>
</table>

*Includes international organizations and unallocated.

Date incomplete or not available.

Table 6
Canada's Direct Foreign Investment Position by Industry and Area, Year-end 1972 and 1976
(Billions of Canadian Dollars)

<table>
<thead>
<tr>
<th>Industry</th>
<th>United States</th>
<th>All Other Countries</th>
<th>Total Direct Foreign Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Abroad %</td>
<td>Can %</td>
<td>Bal.</td>
</tr>
<tr>
<td>Dog &amp; Mfg.</td>
<td>1973 0.3</td>
<td>6.6</td>
<td>3.1</td>
</tr>
<tr>
<td></td>
<td>1976 1.6</td>
<td>10.1</td>
<td>5.9</td>
</tr>
<tr>
<td>Steel</td>
<td>1973 4.6</td>
<td>16.4</td>
<td>7.6</td>
</tr>
<tr>
<td></td>
<td>1976 6.9</td>
<td>10.8</td>
<td>4.5</td>
</tr>
<tr>
<td>N.G.</td>
<td>1973 2.1</td>
<td>15.4</td>
<td>7.6</td>
</tr>
<tr>
<td></td>
<td>1976 4.6</td>
<td>16.4</td>
<td>7.6</td>
</tr>
<tr>
<td>Nonferrous metals</td>
<td>1973 0.4</td>
<td>11.0</td>
<td>1.3</td>
</tr>
<tr>
<td></td>
<td>1976 1.1</td>
<td>15.9</td>
<td>3.0</td>
</tr>
<tr>
<td>Wood &amp; paper products</td>
<td>1973 0.6</td>
<td>14.2</td>
<td>1.9</td>
</tr>
<tr>
<td></td>
<td>1976 1.0</td>
<td>11.2</td>
<td>2.6</td>
</tr>
<tr>
<td>Iron &amp; ags.</td>
<td>1973 0.2</td>
<td>5.0</td>
<td>0.4</td>
</tr>
<tr>
<td></td>
<td>1976 0.3</td>
<td>3.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Other goods</td>
<td>1973 0.1</td>
<td>2.3</td>
<td>1.6</td>
</tr>
<tr>
<td></td>
<td>1976 0.4</td>
<td>4.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Other merchandise</td>
<td>1973 0.9</td>
<td>22.3</td>
<td>2.3</td>
</tr>
<tr>
<td></td>
<td>1976 1.5</td>
<td>17.2</td>
<td>3.8</td>
</tr>
<tr>
<td>Utilities</td>
<td>1973 0.4</td>
<td>10.9</td>
<td>0.5</td>
</tr>
<tr>
<td></td>
<td>1976 0.5</td>
<td>6.0</td>
<td>0.6</td>
</tr>
<tr>
<td>Finances</td>
<td>1973 0.1</td>
<td>3.4</td>
<td>2.2</td>
</tr>
<tr>
<td></td>
<td>1976 0.8</td>
<td>9.3</td>
<td>3.7</td>
</tr>
<tr>
<td>Other</td>
<td>1973 0.1</td>
<td>2.5</td>
<td>0.8</td>
</tr>
<tr>
<td></td>
<td>1976 0.2</td>
<td>2.2</td>
<td>1.5</td>
</tr>
<tr>
<td>all industries</td>
<td>1973 3.9</td>
<td>100.0</td>
<td>26.1</td>
</tr>
<tr>
<td></td>
<td>1976 8.9</td>
<td>100.0</td>
<td>28.3</td>
</tr>
<tr>
<td>Area, %</td>
<td>1973 50.1</td>
<td>76.5</td>
<td>25.5</td>
</tr>
<tr>
<td></td>
<td>1976 54.7</td>
<td>79.5</td>
<td>24.6</td>
</tr>
</tbody>
</table>

*Includes beverages in investment abroad; includes vegetable products, animal products, textiles, and nonmetallic minerals in investment in Canada.

Source: Statistics Canada, Balance of Payments Division, Canada's International Investment Position, 1978, pp. 50, 52, 82, and 84.

Table 7
Ownership and Control of Canadian Mining and Smelting, Petroleum and Natural Gas, and Manufacturing Industries, Year-end 1977
(Percentage)

<table>
<thead>
<tr>
<th>Industry</th>
<th>% of Capital Employed Owned in</th>
<th>% of Capital Employed Controlled in</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Canada</td>
<td>U.S.</td>
</tr>
<tr>
<td>Mining and smelting</td>
<td>48</td>
<td>40</td>
</tr>
<tr>
<td>Petroleum and natural gas</td>
<td>48</td>
<td>43</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>57</td>
<td>39</td>
</tr>
<tr>
<td>Beverages</td>
<td>70</td>
<td>29</td>
</tr>
<tr>
<td>Rubber</td>
<td>25</td>
<td>na</td>
</tr>
<tr>
<td>Textiles</td>
<td>71</td>
<td>23</td>
</tr>
<tr>
<td>Pulp and paper</td>
<td>50</td>
<td>39</td>
</tr>
<tr>
<td>Agricultural machinery</td>
<td>43</td>
<td>na</td>
</tr>
<tr>
<td>Automobiles &amp; parts</td>
<td>8</td>
<td>na</td>
</tr>
<tr>
<td>Transportation equipment</td>
<td>62</td>
<td>28</td>
</tr>
<tr>
<td>Iron and steel mills</td>
<td>81</td>
<td>7</td>
</tr>
<tr>
<td>Aluminum</td>
<td>48</td>
<td>41</td>
</tr>
<tr>
<td>Electrical apparatus</td>
<td>35</td>
<td>56</td>
</tr>
<tr>
<td>Chemicals</td>
<td>42</td>
<td>46</td>
</tr>
<tr>
<td>Other manufacturing</td>
<td>53</td>
<td>39</td>
</tr>
</tbody>
</table>

All industries                   | 50     | 40   | 10        | 100   | 43     | 44   | 13        | 100   |

Data not separately available for the U.S. in order to avoid disclosure.

DISCUSSION'S REMARKS

RICHARD G. HARRIS
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The paper discusses the effects of contingent protection measures, particularly in the context of the General Agreement on Tariffs and Trade (GATT). It highlights the importance of understanding the effects of such measures on trade and investment policies. The author argues that the use of contingent protection is important, especially in the context of the current global economic landscape. The paper also addresses the challenge of balancing the need for protection with the goal of promoting free trade.

Comment on the Paper by Robert M. Stern

George E. Harriss

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constitutes 'unfair competition' and 'subsidy' inevitably lead to arguments incapable of resolution given the participants in the argument hold their views in an entrenched manner. The grey area which surrounds the rules and customs of contingent protection gives considerable scope for creative interpretation of contingency legislation, and for initiative on the part of involved interest groups in implementing the procedures designed to determine the occurrence of a "contingency". The problem is that triggering the procedural mechanisms of contingency protection is a matter of bureaucratic, private sector, and political initiative. Given that bureaucracies function as they do the expectation is that contingencies will found to be rather prevalent. This is not a new argument. It is yet another case of the 'rules versus discretion' debate which goes on throughout the discussion of economic policy.

If contingency protection becomes a substitute for tariff protection what is the long run impact on a small open economy such as Canada? Contingency protection by its very nature means that anyone contemplating exporting faces an investment decision under uncertainty with the associated risks and rewards. The central Canadian interest in freer trade between Canada and the United States is that Canadian producers should get access to the large U.S. market allowing them to reap economies of scale in production, distribution and marketing. Contingency protection may seriously undermine the ability of Canadian firms to do so.

Let me try to make the point in analytical terms. It is now commonplace to speak of the conditions of competition as determined by whether a market is contestable or not. In simple terms a market which is contestable is one which over a relatively short period there is freedom of entry and exit. Contestable markets are said to be subject to 'hit and run' entry. At the other extreme a non-contestable market is one where entering the market involves a relatively long lived and irreversible investment--capital committed is industry or activity specific. In the context of international competition across national boundaries it is useful to think of a firm competing from a foreign base as entering the import competing market, and to distinguish this from the market in which the domestic firms within the same industry compete. The difference between the two groups of firms comes from the differences in the nature of the investment decisions involved in selling by the two groups. In particular, it is possible that foreign firms will require a greater level of investment than that required by domestic firms to achieve the same market share, or the opposite may occur. The central distinguishing feature of the foreign market from the viewpoint of exporters I wish to emphasize is its degree of contestability. If it is contestable a foreign firm can conduct hit and run entry when profitable opportunities exist. If it is not contestable, then getting into the
larger markets such as the E.U. where the "firewall" concept of the network of market structures is important. In this market, a significant amount of the total resources are allocated to the presence of contractual procurement. Thus, the presence of contracts can affect the market for a large number ofJOR. The market will usually account for a large fraction of the total costs, and the market will be determined by the market forces and the market structure. To the extent that costs are a significant factor in the market, the market will be determined by the market forces and the market structure. To the extent that costs are a significant factor in the market, the market will be determined by the market forces and the market structure. To the extent that costs are a significant factor in the market, the market will be determined by the market forces and the market structure. To the extent that costs are a significant factor in the market, the market will be determined by the market forces and the market structure. To the extent that costs are a significant factor in the market, the market will be determined by the market forces and the market structure.
foreign product market because of the public good aspect of such investment has with respect to all product lines of the firm in the foreign market. Furthermore, investment in the form of brand image in a small country is often not required. This is particularly true in Canada where consumers are regular recipients of U.S. advertising messages. This mitigates to a significant degree entry costs of a large U.S. firm. Secondly, because the total Canadian market is such a small share of the total world market, or even the North American market, the U.S. firm entering the Canadian market would be risking at most 20 percent of total sales. In a diversified marketing portfolio the risk component attached to the Canadian market would be small. It is clear then that contingent protection by Canada against foreign firms, while it would have the obvious short run effects, would be an ineffective device for inducing long run import substitution. Related is the observation that a great deal of Canadian imports is part of intra-firm trade by MNE’s; it would be very difficult to design contingent protection mechanisms which would work effectively against these imports.

The implications of this analysis are twofold. First, in entering discussions with the U.S. about free trade on either a comprehensive, or or more limited ‘sectoral’ basis, Canada should seek to get assurances that contingent protection by the U.S. will not become the rule rather than the exception. This strikes me as the most difficult aspect of negotiating a Canada-U.S. free trade pact in present circumstances for a number of reasons discussed elsewhere in this volume.

The other point, is that either with or without a free trade pact, if contingent protection becomes prevalent small countries such as Canada stands to lose a great deal in their export markets. Furthermore, for the small country to achieve the same degree of reciprocal protection as in the larger country would require more extensive, or intensive, use of the contingent protection devices than in the larger countries. The danger, in these circumstances, of retaliatory response by the larger country would be great. Contingent protection is clearly an ineffective instrument for a small country. Analogies of contingent protection to conventional tariff protection are not appropriate. Hopefully, both forms of protection between Canada and the United States can be reduced and avoided.
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