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The politics of Trade

Address by Mr. Allan E. Gotlieb,
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at the Financial Post Conference
on U.S.-Canada Trade

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Canada

My subject this evening is the politics of trade, and more specifically of Canada-United States trade.

From my vantage point on the banks of the Potomac, it is chiefly the political forces operating in the United States that enter my range of vision. I shall begin, however, by making a point that is often missed in the debate over free trade in Canada. Listening to the Canadian debate, one gets the impression that the issue is whether we should embrace the United States commercially. In fact, this issue is already behind us. Whether we like it or not, Canada already is deep in the economic embrace of its southern neighbour.

To illustrate the extraordinary extent of this commercial integration, one need only compare the proportion of Canada's trade with the United States, with the proportion of West Germany's trade with the other member States of the European Community. Last year about 80 per cent of Canada's trade was with the United States, while 60 per cent of West Germany's trade was with the 11 other member States of the Community. The proportion of France's trade with the rest of the Community is also about 60 per cent, while the figure for the United Kingdom is somewhat less. If we take a smaller member of the Community, say the Netherlands, the figure is about 70 per cent. These comparisons show that in practical terms the level of market dependence among the member States of the Community is less than the level of Canada's market dependence on the United States.

In the case of Europe, this integration has been effected over a period of 30 years through the application of positive policy measures, such as the elimination of tariffs and contingency protection and the harmonization of competition law.

In the case of Canada and the United States, this phenomenon has occurred not so much because of as in spite of government policy, by the inexorable forces of geography and economics. This process has, of course, been facilitated by the progressive lowering of trade barriers, and tariff barriers in particular, as a result of the seven rounds of multilateral trade negotiations concluded since World War II under the auspices of the GATT. But since the GATT has also reduced barriers with Canada's other trading partners without having nearly as great an effect on bilateral trade flows, we must conclude that it is the geographic and economic forces, abetted perhaps by cultural affinities, that have been at work.

The problem with an integrated market fashioned by economics, rather than by politics and law, is that there is a minimal extra-national legal framework governing that market.

In the case of Canada and the United States, apart from exceptional sectors such as automobiles and defence, the trading relationship is governed only by the GATT. While the progress achieved in liberalizing international trade under the GATT has been

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decline in the value of the U.S. dollar will help U.S. trade, as will a reduction of the U.S. budget deficit and better financial management. But we are, I believe, witnessing a long-term movement towards the administration of trade, driven by fundamental changes in the global balance of economic forces.

Recent studies suggest that the United States merchandise trade deficit in 1990 will still be in the $100 billion range, down from $170 billion this year. The steel, automobile, textile and machine tool sectors will continue to decline, with devastating effects on regional and local economies. At one point during the current year, the United States recorded a net deficit in agricultural trade for the first time in its history. There is now a consensus among economists and administrators that global market conditions require a contraction in American agricultural production. And perhaps most worrying of all, there is continuing uncertainty as to whether America can compete with Japan in semi-conductors and more generally in the next generation of high-tech products.

These economic changes are reflected in the political arena. In earlier decades, the Democrats, the farmers, the unions and the consumers formed the basic free-trade coalition. The Democrats have changed their stance, as have the unions and, increasingly, the farmers. The old coalition has shattered. At the same time, the Republicans tended to pick up the banner of free trade, as the international counterpart of their free-market philosophy. The significance of this development should not be underestimated. As last month's Congressional elections have demonstrated yet again, the Democrats remain, generally speaking, the majority legislative party in spite of President Reagan's phenomenal personal popularity. And the Democrats' electoral base -- the northeast, the south, the minorities, and labour -- is likely to continue the political pressures on the party in the direction of protectionism.

But I do not want to make too much of this relative change in the positions of the parties. Because the pressures for protectionism are driven by objective economic forces, the trend is essentially bipartisan. The Republican advocacy of free trade is now almost invariably qualified by the demand that it be "fair" as well as "free". At the same time, some strong Democratic voices are still to be heard among the free-traders.

Special interests -- including regional, sectoral, failing enterprises, and individual unions -- tend to benefit from protectionism, while the whole of society pays the costs, often out of all proportion to the benefits bestowed on the protected groups. The American system of government, with its division of powers and lack of party discipline in the Congress, is more susceptible to the influence of special interests than is the parliamentary system. Under the Constitution, the Commerce power, which includes power over

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responsible for administering U.S. laws are not entirely free from political pressures and remain attached to a prerogative once attributed to the gentler sex -- the right to change their mind. This is not to say that the U.S. domestic administrative processes are arbitrary. That is not my meaning. What I am saying is that they do not operate in a political vacuum.

As a result of actions brought under such laws, Canadian exporters have had restrictions placed on their exports of fish, shakes and shingles, hogs, sugar, flowers, certain iron and steel products, and, of course, softwood lumber. And we are now under threat of restrictions on brass sheet and strip, salmon and herring roe, uranium, lead and zinc, potash, and electricity.

The third kind of protectionist device consists of Congressional initiatives to rewrite the rules, by product or by country, or through omnibus trade legislation. Frequently, when domestic interests fail to make their case under existing import relief laws, Congressmen will seek to amend the law to guarantee success the next time around.

Ever since U.S. producers lost the 1983 lumber case, there have been many efforts in Congress to rewrite the countervailing duty law so as to ensure that Canadian stumpage practices would be found countervailable. Even as the current case was under consideration in the Department of Commerce, a large group of Congressmen wrote to the Administration warning of the likelihood of remedial legislation if Commerce failed to impose duties on Canadian softwood lumber. Such legislative initiatives seem intended to politicize the international trading environment. They create additional uncertainty for our governments and businessmen and have a chilling effect upon trade and investment in Canada, whether or not the proposed measures are eventually enacted into law.

The fourth element in the protectionist armoury is administered trade: that is, trade administered through some form of quantitative restriction or price setting. Some of these quotas are sanctioned by the GATT. The United States uses them to protect textiles and agricultural commodities such as sugar and dairy products.

Other quotas are imposed under agreements in which foreign exporters or governments restrict exports in return for the suspension or termination of countervailing duty, anti-dumping or escape clause investigations. Examples are the steel restraint agreements concluded with the European Community and other governments since 1982, and the agreement on semi-conductors recently concluded with Japan.

Another form of quota is the so-called voluntary restraint agreement under which a foreign government agrees to impose an export restriction in order to forestall threatened legislative or

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administrative action. The best-known example here is the export quota on autos imposed by Japan in the early 1980s. A variation on the same theme is the restraint on steel exports still exercised by Canada to divert pressures for a formal voluntary restraint agreement.

Yet another variation is found in restraint agreements negotiated, it is said, to protect national security. The recent U.S. agreements restraining the import of machine tools from Japan and other countries are examples of this approach.

A study by a highly respected U.S. economist and former trade official estimates that the proportion of U.S. imports subject to some form of quantitative restriction grew from 8 per cent in 1975 to 21 per cent in 1984 -- and the volume of trade subject to some form of restriction continues to grow.

The shingles and shakes and softwood lumber cases illustrate an important phenomenon: namely, the development of a more aggressive stance by the Administration on trade issues in order to deflect something worse in the way of Congressional action. This has been accompanied by a shift in emphasis from the general to the specific: from pressure for a new MTN round, plus action to lower the value of the dollar, to more targeted actions in trade law cases. While the general approach has not been abandoned, political realities in Washington dictate a greater emphasis on "policeman" actions by the Administration, the "aggressive" pursuit of unfair trade practices.

There has been a good deal of criticism in Canada of the way in which the recent lumber issue has been handled by the Canadian Government. In my view, this criticism is ill-founded and much of it rests on misinformation or false premises. Given the very high volume of trade at risk and the extremely slim prospects of the Commerce Department reversing its Preliminary Determination of Subsidy, it would have been foolhardy of the Government to roll the dice and let the investigation go through a final determination. No responsible government could ignore the handwriting on the wall.

The settlement that has been obtained is not perfect or cost-free, but I am convinced that it is the very best result we could have obtained under the circumstances. The agreement leaves the provinces free to manage their own resources. Relative to the situation that would have prevailed had a countervailing duty been levied, the settlement greatly reduces U.S. intrusion into our forestry management practices. It produces between $500 and $600 million in additional revenues for the provinces, revenues that in the absence of an agreement would have gone to U.S. coffers. And finally, a matter of no small importance, the settlement wipes off the books the dangerous precedent that had been established in the preliminary determination. Given the hand that our negotiators had to play, I believe the agreement represents a considerable achievement.

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In the 100th Congress, a major new effort will be made to recast U.S. trade laws. In the last Congress, the omnibus trade bill passed by the House of Representatives was described by some observers as the worst trade bill since Smoot-Hawley. It will be the basis for the new initiative in the upcoming Congress. The Administration will have to weigh the possibility of a presidential veto or the option of negotiating with the Democratic Congress to moderate or deflect the thrust and impact of the bill.

From the Canadian vantage point, all these factors have brought about a change in emphasis in how we respond to protectionist pressures in the U.S.

Previously we were able to argue that Canada should be exempted from general trade legislation aimed at others because our situation was materially different. This approach is clearly ineffective where we ourselves are the only target of the legislation.

Examining the legislative and trade law actions we faced in the 1983-84 period, as opposed to our experience of the last two years, we find that there have been more trade law cases filed in the past two years; more of them have been aimed at Canadian products; the industries affected have been more important for Canada; and the results have been more negative for us. On the legislative front there has been an increase in the number of bills introduced in Congress targeted specifically on Canadian exports, where previously we were being "sideswiped" by general legislation aimed at other targets.

In terms of defending our interests in the United States, I draw four conclusions from this analysis:

First, instituting new and major campaigns of high-level representations to the Congress and Administration on an issue-by-issue basis is both necessary and important and we must be relentless in the pursuit of our objectives in this manner. But we may be reaching the limits of our capacities in implementing this strategy. In a few instances, we may even experience the law of diminishing returns, if there are backlash effects. When Canada is the primary or only target of these protectionist bills, their sponsors are not inclined to revise them simply because we ask it, no matter at what level we pitch our request.

My second conclusion flows from the first. Our lobbying efforts on protectionist measures in the United States must rely to an increasing extent on the development of alliances with U.S. domestic constitutencies which share some of our objectives. Much of this work has to be done outside Washington, in the form of "grassroots" lobbying. This kind of activity is an important complement to high-level representational efforts in Washington. Our network of

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consulates situated in most of the major regional centres of the U.S. can be helpful in pursuing this work. Again, there are risks and dangers in this approach. We are sometimes susceptible to the accusation of "interference" in U.S. domestic affairs if we are seen to be forging domestic alliances. But when our vital interests are at stake, such risks may be worth taking.

My third conclusion is that Canada cannot afford to ignore even the first faint signs of a burgeoning threat to its trade interests in the United States. We have nothing to gain and much to lose by playing the ostrich.

My fourth conclusion is that the real bulwark against further restrictions on our access to the U.S. market must be found in some kind of institutional framework. It is only within the structure of a binding agreement that we can define the "rules of the game" and ensure that we have an equal voice in making the decisions that are so vital to our national livelihood and well-being.

It would be foolhardy for a country so dependent upon a single foreign market to leave our access to the vagaries of the local and sectional politics that are the bread and butter of the Congress, or to the twists and turns of GATT diplomacy, where Canadian interests may be trampled in the marathon struggles between the economic superpowers.

If the rules are just and impartially enforced, the rule of law can help to restore some balance to the inequalities wrought by differences in size and power. The United States, like all countries, has its special characteristics. One of them, and one that is sometimes a cause of considerable frustration for us, is the legal focus of the U.S. system. We need to work with the U.S. respect for laws and courts. We need to persuade the Americans that it is in our joint interest to establish a new legal framework that will submit our trading relationship to a system of binding rules and dispute-settlement procedures.

In short, we need to create a system of extra-national trade laws to prevent the politics of protectionism in either country from undoing the integrated market already forged by geography and economics. We need the legal framework of a bilateral trade agreement to make trade less political and more predictable. If we can take some of the politics out of trade, we will have both better trade and better politics. We need this on our side of the border, and the Americans need it too.