A Review of Canadian Trade Policy

A BACKGROUND DOCUMENT TO CANADIAN TRADE POLICY FOR THE 1980s

Canada

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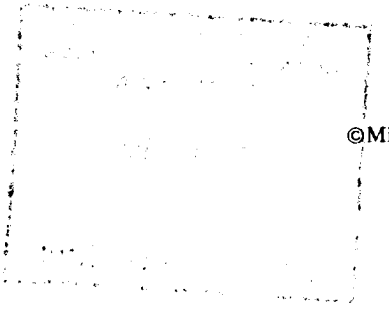

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Foreword

This document was prepared in the summer of 1982 and formed the analytical and factual basis for the Government's intensive review of Canadian trade policy. It was discussed widely with private sector groups and individuals as well as with the provinces. Following consideration of the policy papers which the review gave rise to, the Government believed it would be useful if this document were to be given wider distribution. It was therefore somewhat revised and brought up to date and is now being released.

It is the Government's hope that this document, as well as its companion Discussion Paper, *Canadian Trade Policy for the 1980s*, will stimulate broad public discussion and understanding of the importance of trade to Canada's economic well-being. The Government believes that all Canadians need to appreciate that full and active participation in international markets is the key to Canada's further economic development. Only by selling a range of competitive products around the world can we continue to enjoy the much broader range of imports which are so basic to our standard of living and quality of life. Continued export success will require much greater conscious emphasis on the development of a competitive economy and new markets around the world. This document thus analyzes not only factors in the external environment which will condition Canada's future success as a trading nation, but also the place of trade in the Canadian economy and the interrelationship between trade policy and other economic policy considerations.

In a democracy like Canada, trade policy must have a broad measure of public support. The Government takes satisfaction from the fact that the provinces, many private sector groups, and a large number of individual citizens have taken a keen interest in this project; they have exerted healthy pressure on Ministers and officials alike to develop responsive and responsible trade policies. In the years to come, the Government hopes they will continue to do so, aided by the information and analysis provided by this document. In addition, the Government hopes this review will lead to further study of Canadian trade policy in the universities and various private sector organizations.

Deputy Prime Minister and
Secretary of State for
External Affairs

Minister of State for
International Trade

OTTAWA, August 1983

Summary Outline

A REVIEW OF CANADIAN TRADE POLICY

I. INTRODUCTION

The need for a trade policy framework to further Canada's economic development is examined.

II. INTERNATIONAL TRADE IN THE CANADIAN ECONOMY

This chapter examines the role of trade in the macro-economic management of the Canadian economy, its influence on the structure of the economy, and Canada's trade patterns, including the regional dimensions. It briefly analyses the national economy and provides regional and historical perspectives.

III. ECONOMIC AND INDUSTRIAL POLICY CONSIDERATIONS

This chapter examines the industrial policy framework (e.g., industrial adjustment, industrial innovation, competition policy, and world product mandating) as well as the commercial policy implications of fiscal and monetary policies and investment, transportation and manpower considerations.

IV. SECTORAL PERSPECTIVES

The structural strengths and weaknesses of the various sectors of the economy are considered from an international trade perspective, e.g., resource-based sectors (agriculture, fisheries, forest products, metals and minerals), energy, fabricating and manufacturing industries including automotive, aerospace, surface transportation, petrochemicals, telecommunications, machinery and equipment as well as service industries.

V. THE INSTRUMENTS OF CANADA'S COMMERCIAL POLICY

This chapter reviews the evolution of Canada's tariff policy and of related matters such as customs valuation. It examines the major elements of Canada's import regime (e.g., anti-dumping, countervail, import and export controls) and the nature and significance of international trade rules and how they relate to Canada's commercial policy instruments. It explains the domestic institutional framework for the management of commercial policy, including federal-provincial relations.

VI. FOREIGN MARKET ACCESS AND EXPORT DEVELOPMENT

This chapter focusses on export market development opportunities, priorities and constraints including market access conditions. It explains specific trade development instruments such as PEMD, export financing, trade fairs and missions. It discusses the trade/aid relationship and the significance of industrial and technological cooperation agreements.

VII. THE INTERNATIONAL INSTITUTIONAL AND TRADING ENVIRONMENT

The evolution of the postwar trade and payments system and the principal institutions which make up that system today: the GATT, IMF, OECD, UNCTAD, etc. are considered in this chapter. It describes Canada's contribution to and relationship with these organizations and their relevance to the development of Canada's commercial policy. This chapter also examines international trends and competitive forces at work in the international trading environment. It also contains an assessment of the outlook for the world economy in the 1980s and its possible implications for Canada.

VIII. MANAGING OUR TRADING RELATIONSHIPS

This chapter examines the interrelationship between trade and foreign policy. It focusses on the bilateral and multilateral aspects of Canada's key relationships, the trading opportunities, and the various approaches deployed by the Government to meet challenges and deal with access issues. This covers our relationships with the USA, Western Europe, and Japan, as well as Australia and New Zealand, developing countries and Eastern Europe.

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Chapter I

INTRODUCTION

> Because Canada is one of the least self-sufficient countries in the world her prosperity and her very existence depend on making the most of her own specialized resources, and on trading them as advantageously as possible for her other requirements. Her success will depend not only on her own skill and efforts, but also on the continuation of an interdependent and integrated international system of trade and finance. Everything which tends to restrict the operation of that system, such as barriers to the international movement of population, goods or capital, or the detachment and artificial isolation of large blocs from the world economy on a self-contained basis, reduces the scope for an advantageous international division of labour—the principle on which the existing Canadian economy and standards of living are built.
>
> **The Rowell-Sirois Report**

In the late 1930s, the Commissioners on Dominion-Provincial Relations had fresh in their minds the disasters of the Great Depression. They were struck with the need to animate Canadian economic policy with forward-looking ideas. The past few years have seen economic conditions fraught with similar lessons. In 1983 Canada again needs to ensure that its economic policies are based on the promise of the future rather than the short-term problems of the day.

In *Economic Development for Canada in the 1980s* the government established balanced economic growth and the reduction of inflation as the government's major priorities for the decade. The government outlined its policies and priorities for national economic development and established the framework which will guide its actions in the coming years. In the period following the conclusion of the Tokyo Round of multilateral trade negotiations, it is critical that Canada's approach to trade policy issues remain firmly rooted in the realities of the Canadian economy and the international environment within which Canada must compete.

Canadian trade policies have shown an impressive degree of continuity over the post-war years. They have reflected a number of economic, commercial and foreign policy considerations fundamental to the economic prosperity of Canadians in all regions and to a strong, united and independent country.

The 1980s offer both challenges and opportunities for Canadian trade policy. The prolonged recession, with record levels of unemployment and persistently high rates of inflation plaguing most industrialized countries, created severe strain on the world trading system. Conventional wisdom about the benefits of freer trade was being questioned and tested. Protectionist pressures mounted as did tensions between and among major trading countries.

The structure of the world economy is undergoing a rapid transformation. There has been a pronounced shift in industrial power away from the USA and towards

Japan, Europe and the newly-industrialized countries (the NICs). Despite the recent slump in world oil markets there has been a dramatic shift in wealth, hence purchasing power, to the major oil-producing countries. Technologies are being transferred at a record-pace to low-cost labour developing countries who are increasingly better able to absorb new techniques. New technologies also require faster domestic restructuring and strain the adaptive abilities of industry in the developed countries. In short, the race to sustain competitiveness has accelerated as the growth of the world economy has diminished.

It is against this background that an evaluation of current and future Canadian trade policies was conducted with particular emphasis on the relevance of these policies to domestic economic considerations and to the changing international environment. This paper provides a detailed policy review of the main components of Canadian trade policy and an analysis of the domestic and international opportunities and constraints. It provides the background to the Discussion Paper entitled *Canadian Trade Policy for the 1980s*.

Chapter II

INTERNATIONAL TRADE IN THE CANADIAN ECONOMY

Others chose to live by trade, and were much better off....

William Langland, *Piers the Ploughman*, 1370

Canada is a trading nation. Much of our economic structure can be explained only in terms of our external trade. More than thirty percent of Canada's GNP is generated by our exports of goods and services. At the same time Canada imports a wide variety of both producer and consumer goods which either cannot be produced in Canada or which can be obtained more cheaply from abroad. Massive capital developments have taken place to serve foreign markets. Few countries are as visibly dependent on external trade for the development of their economy as is Canada. Canada does not possess a large internal market, nor does it have preferred access to a larger market through a regional trading bloc. As a first rank producer of commodities like nickel, wheat, and uranium, and as a manufacturing nation, highly skilled in the production of aircraft, automobiles and nuclear power plants, as a major force in world banking and consulting engineering, its prosperity depends on its ability to sell goods and services in many parts of the world, especially in the United States, Western Europe and Japan. Furthermore, Canadians have become dependent on imports of a wide range of both producer and consumer goods to satisfy basic demands at the best possible price. Trade is thus a key factor in the efficient development of the Canadian economy and the maintenance of a high standard of living for Canadians. This chapter will examine the growth of international trade in the past three decades, Canada's place in that trade, and the benefits to the Canadian economy from that trade. It will also provide a regional perspective to demonstrate the importance of trade to all parts of Canada.

The Setting: Evolution of Canadian Trade Policy

In the years immediately before 1867, the colonies that then joined together in Confederation had enjoyed free trade with the United States in primary products. This had been sought by the colonies to offset earlier losses of preference in the British market; it had been negotiated by Britain in 1854 in the belief that it would promote economic viability in these British territories. In 1866 the United States abrogated the Reciprocity Treaty, bringing fears that considerable adverse influence would be brought to bear on Canada's trade and on investment in Canada. Following Confederation, the new nation immediately set about seeking better terms of access to both the United States and British markets.

The results of these efforts were disappointing; consequently, in 1879, Canada adopted the high-tariff policy then in vogue in most trading countries other than Britain. From the outset, Canadian trade policy has thus tended to be conditioned by

developments elsewhere, particularly in the United States and Britain. This is not surprising for a relatively small economy crucially dependent on trade with larger trading partners. In the case of the USA, successive Canadian governments made repeated efforts prior to the Second World War to gain better access to the US market but were consistently rebuffed as the USA from the Civil War to the 1930s followed a trade policy aimed at protecting US industry, culminating in the highly protectionist Smoot-Hawley Tariff of 1930. In the case of Britain, which subscribed to free-trade policies from the repeal of the Corn Laws in 1846 to the 1930s, Canada sought preferential access by suggesting Britain discriminate against non-Commonwealth sources. These efforts also proved largely unsuccessful.

Sir John A. Macdonald's National Policy was aimed at fostering the growth of manufacturing industry in Canada, increasing revenues to finance new transportation facilities to knit this country together, and general economic development. Macdonald also argued that it would retard emigration to the United States, restore prosperity (from the depression level of the 1870s), prevent the dumping of foreign goods in Canadian markets, encourage inter-provincial trade, and provide a bargaining weapon for tariff negotiations with the United States. The system suffered, however, from a conflict between its principal objectives, for it soon became evident that internal development hinged significantly on the ability to compete in export markets. There followed many years of seeking to maintain a delicate balance between measures to expand export trade and those providing protection for home-grown industry. The founding of the Trade Commissioner Service in 1892, long before Canada had its own diplomatic service, reflects this traditional importance of export trade to Canada.

While the National Policy gradually stimulated the development of secondary manufacturing, it did not gain Canada much needed access for both resources and manufactured products into foreign markets. In 1897, in an effort to encourage Britain to grant Canadian goods preferential access and to assist the views of those in Britain advocating preferential free trade within the Empire, Canada granted British goods preferential access and thus ushered in what eventually became the system of Commonwealth preferences. New Zealand and South Africa followed suit in 1903, as did Australia in 1907, by also granting British goods preferential access; preferences were not applied as yet uniformly to the goods of other Dominions. Britain, however, did not reciprocate and thus frustrated the commercial policy objectives of the four new nations. The granting of these preferences, however, did lead to complications with other, emerging trading partners such as Belgium and Germany, trade with which was governed by most-favoured-nation treaties negotiated by Britain a generation earlier. Britain took steps to renounce the applicable treaties so that the preferences could be applied solely to British imports. Nevertheless, Germany, for example, retaliated in 1902 by applying its maximum tariff to Canadian goods.

In 1907 Canada adopted a tariff structure that provided for three levels of duty—preferential, intermediate, and general. British and Commonwealth goods enjoyed the lowest, preferential rate; the intermediate tariff recognized the growing importance of trade with countries other than Britain and the USA, as well as the obligations deriving from the network of most-favoured-nation treaties negotiated by Britain as far back as the seventeenth century; the United States remained subject to

the highest tariff level, despite the fact that it was rapidly becoming Canada's best customer. A renewed effort to obtain reciprocity with the United States resulted in an agreement but was rejected in the Canadian election of 1911. Canadian manufacturers feared that greater access to the US market would be more than offset by increased competition from US manufacturers. By this time Canada had developed a respectable secondary manufacturing base, in part as a result of investment attracted by high tariffs. Canadian goods thus continued to be subject to the highest US tariff level, except for those few raw materials in short supply in the USA.

Following a series of negotiations with the British West Indies starting in 1912, Canada introduced the concept of "bound margins of preference", a prominent feature of the British or Commonwealth preference system in later years. By this system, while the rates could vary, the margin of preference could not, except by mutual consent. It was included in the 1924 trade agreement with Australia by which the two senior Commonwealth Dominions agreed to exchange preferences, but not in a similar agreement with New Zealand in 1932, and only partially in the 1932 trade agreement with South Africa. Meanwhile, Britain began gradually to retreat from its adherence to free trade by selectively introducing a tariff and in 1919 first introduced preferences favouring Commonwealth countries. During the 1920s Canada also continued negotiations with non-Commonwealth countries, notably France, exchanging access to the Canadian intermediate tariff for most-favoured-nation or similar treatment by the other party.

Large tariff increases and other barriers to trade were erected in many countries following the depression of the 1930s, the most notable of which was the 1930 Smoot-Hawley Tariff in the USA and the whole-scale adoption of tariffs by Britain in 1932. The serious international economic strains then existing finally prompted Britain, Canada and other members of the Commonwealth to adopt a systematic, widespread plan of tariff preferences at a Commonwealth trade conference held in 1932 in Ottawa. The system adopted in Ottawa fell short, however, of the hopes of those favouring Commonwealth-wide free trade and discrimination against all others. By the 1930s the pattern of Canadian trade had altered considerably. The United States and Britain accounted for roughly the same quantity of Canadian exports, but the United States had become the principal source of Canadian imports. A trade policy based on Empire-wide free trade had met with only limited success and had become less relevant to the changing trade patterns. In 1934 the United States introduced the Reciprocal Trade Agreements Act and began to enter into MFN agreements through a series of bilateral trade negotiations. Canada decided that therein lay an opportunity to improve the basis for trade with its principal trading partner and entered into bilateral negotiations, as did Britain. A limited agreement was concluded in 1935.

In 1937-38, in return for United States tariff reductions, Canada and Britain further reduced tariffs and removed some of their preferences. Canada also agreed to extend the intermediate tariff to the USA in exchange for access to the US MFN rate and concessions affecting some principal Canadian exports. For the first time since 1866 Canada and US trade was fully restored to a most-favoured-nation basis, with the exception that Canada would retain Commonwealth preferences. Dana Wilgress, one of the architects of Canadian trade policy in the 1930s and 1940s, summa-

rized the situation prevailing before the outbreak of the Second World War as follows:

> The successful outcome of the triangular negotiations of 1938 served to stabilize trade relations with the two chief outlets for Canadian products. A goal had been achieved towards which Canadians had been striving ever since the days of Canada's immaturity as a nation. In reaching this goal Canada had won the respect and high regard of her trading partners. The basis was laid for that partnership, which would take the lead towards the promotion of world trade through multilateralism.[1]

The disruption of the world financial and trading system in the 1930s and 1940s convinced many countries of the need for a fresh start. The USA, Britain and Canada were the principal proponents of a new trading order based on reciprocity, non-discrimination and multilateralism. The result was the General Agreement on Tariffs and Trade, which Canada has strongly supported since its ratification in 1948. The agreement has become Canada's main trade agreement and the basis for the conduct of Canada's trade relations. The GATT is discussed in more detail in Chapter VII. It has provided the forum for continued multilateral negotiations aimed at gradually liberalizing world trade.

In the past few decades the Canadian government has sought to increase output, employment, productivity, and incomes by seeking access to larger markets, by encouraging international specialization, and by providing for a more competitive environment in the Canadian market. In the 1950s, priority was given to seeking reductions in foreign barriers to Canadian exports of industrial materials, foodstuffs and selected manufactured goods. Reciprocal reductions were made at the same time in selected tariffs protecting Canadian secondary industry. In the 1960s, Canada gave higher priority to obtaining improved access for fully manufactured products while the protection enjoyed by secondary industries in Canada was gradually reduced. Multilateral trade liberalization achieved through successive GATT negotiations was supplemented by two important bilateral deals with the USA—the Automotive Products Trade Agreement, and, to a lesser extent, the Defence Production Sharing arrangements. These developments took place against the background of diminishing importance of Commonwealth preferences. In the 1970s additional bilateral non-preferential trade and economic cooperation agreements were concluded with the European Community and with a number of other countries.

An important exception to the general trend in the post-war era of gradually moving towards freer trade occurred in a range of standard-technology, relatively labour-intensive industries, including textiles, clothing, and footwear. Japan, in the first instance, but soon followed by a number of developing countries benefitting from relatively low production costs, achieved unacceptable and disruptive levels of import penetration into the Canadian market (as well as into the markets of other industrialized countries). Special temporary measures of trade protection were, therefore, adopted to provide these industries with time to make the necessary

[1] L.D. Wilgress, *Canada's Approach to Trade Negotiations*, Private Planning Association of Canada, 1963, p.13.

adjustments. This process of adjustment has, however, been slow not only in Canada but also in other similarly affected countries. Special trade measures have on the whole been maintained in Canada and elsewhere, particularly on textiles and clothing, where a formal international arrangement has been in place since the 1960s.

Following the Kennedy Round in the 1960s (the sixth in a series of formal multilateral trade negotiations under the auspices of the GATT), a gradual international consensus emerged that the time had come to contemplate broadly based trade negotiations which would include further multilateral tariff reductions, non-tariff measures (which had taken on more prominence after the Kennedy Round), as well as a systematic examination of the trade needs of the developing countries. These negotiations were launched in 1973 at a Ministerial meeting in Tokyo. By this time Canada had developed a diversified industrialized base capable of exporting a wide variety of products to markets all over the world. Canada's various objectives in the prolonged "Tokyo Round" multilateral trade and tariff negotiations reflected Canada's more sophisticated industrial structure and included the following:

- to reduce further the level of foreign tariffs facing Canadian exports and potential exports;
- to enlarge further the area of trade where Canadian products could enter foreign markets duty free, including the United States;
- to eliminate or reduce non-tariff barriers inhibiting Canadian exports;
- through a liberalization of trade, to enhance opportunities in Canada for investment in and production of more highly processed materials and foodstuffs, as well as fully manufactured goods;
- to make reductions in the level of Canadian tariffs consistent with a more competitive international environment but to limit tariff concessions in areas of particular employment and import sensitivity (such as textiles and footwear);
- to ensure that agreed-upon reductions in Canadian protection would be phased in over a sufficiently long period of time to permit orderly adjustment to the new trading environment; and
- to evolve desirable changes in international trading rules with respect to countervailing duties, anti-dumping duties and emergency action against imports causing injury to domestic producers, while limiting the capacity of foreign governments to act arbitrarily against Canadian exports.

The Tokyo Round was played out against deteriorating general economic circumstances, conditions which convinced participants of the need for a substantial and forward-looking result. Canada played a substantial role in the negotiations and the results will have a significant impact on the further evolution of the Canadian economy. They are discussed in some detail in Chapter V. In the Tokyo Round, attention was concentrated to a greater extent than previously on non-tariff matters and marked a major step in the evolution of the commercial policies of the major industrialized powers, including Canada, from being largely tariff-centred to being

more focussed on non-tariff measures, or dependent on what has been termed a system of contingency protection. Nevertheless, the tariff was subject to intense negotiations and resulted in substantial concessions. At the same time, there remain tariffs that constitute substantial impediments to the expansion of Canadian exports.

All provincial governments participated in preparations for the negotiations and, through a continuing series of domestic consultations, contributed to the development of specific Canadian objectives and negotiating positions. The Canadian government also held extensive and frequent consultations—on a scale unequalled in any previous round of negotiations—with private sector interests concerned—industry, agriculture, fisheries, as well as business, labour and consumer groups.

The results, from Canada's point of view, represented a significant step forward in dealing with non-tariff as well as tariff barriers. New, expanded and more certain export opportunities were opened up which should bring benefits to every part of the country and all sectors of the economy. The Canadian tariff will be reduced for most products, but gradually and to an extent which takes into account the competitive strengths and potential of various sectors. These reductions will also lower input costs for Canadian industry as well as reduce the cost of a broad range of consumer goods. Finally, in further integrating Canadian industry into the world economy and thus reducing the incentives for a branch-plant economy, the Tokyo Round contributed significantly to providing a sound basis, so far as commercial policy is concerned, for the future development of an efficient and competitive Canadian economy in the 1980s and 1990s.

In the case of industrial products, many important concessions were made by our trading partners. The average weighted depth of tariff cut on Canadian exports to the United States, the European Community and Japan taken together is close to 40 percent. The average reduction in the Canadian tariff is comparable. As a general rule, the agreed reductions in tariffs will take place in eight annual steps concluding on January 1, 1987. Once these reductions are fully implemented, tariffs on most manufactured goods in the EC and Japan will be in the order of 5 to 7 percent, while raw materials will, with some exceptions, enter these markets free of duty or at low rates. Aircraft, aircraft engines and parts now enter these countries, Canada, the United States and a number of other countries duty free under a specially negotiated sectoral agreement. For the United States, the average tariffs on manufactured goods will be in the area of 4 percent, although some products such as certain chemicals, textiles and footwear will continue to enter at much higher rates. For the most part, industrial materials will be free or the tariffs will be at very low levels. Of particular importance for Canada, a number of US tariffs covering an important proportion of Canadian exports such as paper products and machinery will be eliminated. Overall, well over 90 percent of current Canadian exports will enter at tariffs of 5 percent or less, and a significant percentage of exports will be duty free, taking account of trade under the Automotive Agreement.

In the case of Canadian tariffs, the average rate on dutiable industrial imports will be reduced to between 9 and 10 percent. Most industrial raw material imports will continue to be free of duty. Thus the overall incidence of the tariff will be in the 4 to 5 percent range. Like other participants, Canada made no reductions—or com-

paratively small reductions—in the level of the Canadian tariffs on such items as textiles, clothing, footwear and ships.

The non-tariff agreements include new agreements on subsidies and countervailing duties, technical barriers to trade, government procurement, import licencing procedures, and customs valuation; a revised agreement on anti-dumping duties; and an understanding on ways in which certain of the general obligations of the GATT should be applied with a view to improving the international trading framework, including the provision of a firmer basis for special and differential treatment for developing countries. In general they bring under better control many non-tariff barriers which have faced Canadian exporters, with greater "transparency" as to the various practices of other governments which can impair access to their markets. Moreover, improved international surveillance and dispute settlement procedures have been agreed to help ensure that the anticipated benefits will in fact be realized.

On the agricultural side, important concessions were exchanged with Canada's major trading partners covering over $1 billion worth of Canadian exports. Of particular significance were the breadth and depth of the concessions obtained from the United States. Agricultural trade also benefited from the agreements on some of the more general non-tariff barriers. Important foreign concessions were gained for certain fish products of benefit to both East Coast and West Coast producers, although these did not fully satisfy Canadian objectives. Finally, improved access has been obtained for Canadian whiskey in the United States, European and Japanese markets.

The cumulative effects of nine rounds of non-discriminatory negotiations (seven under the GATT and two with the United States in 1935 and 1938) have brought about a situation where a wide range of Canadian manufacturers now have an opportunity significantly to increase their productivity and attain levels achieved by their United States, EC and Japanese competitors, in a trading system designed, inter alia, to assist its members to retain their national independence. This has contributed to reducing the practical differences between the two options so frequently debated throughout Canada's history as a nation, i.e., whether or not to seek greater economic integration with the United States in order to obtain greater economies of scale and significant increases in productivity (i.e., a Canada-United States free trade area or customs union), or to retain our national economic independence and somewhat less potential for a productive economy.

The Tokyo Round results, however, left much still to be done and to be achieved. There remain significant tariffs on products of potential export interest in a variety of markets. The Tokyo Round non-tariff measure agreements represent only a start in developing satisfactory discipline and transparency regarding the wide range of measures governments can use to manage the flow of imports and influence the direction of economic development. A number of the agreements specifically mandate further negotiations once experience has been gained in applying them. The increased transition of many OECD economies from being largely goods producing to being service-centred requires a better understanding of the problems affecting international trade in services. The international rules covering trade in agricultural and fishery products are as yet not as fully developed as those covering trade in

industrial products. Thus the further evolution of the Canadian economy in general and Canadian trade policy in particular will continue to be conditioned by developments at home and abroad, and especially by the extent to which improvements are achieved in the trading system.

In sum, trade and trade policy have contributed importantly to Canada's development as a nation and to the building of a modern, diversified economy fully integrated into the world economy. This process has been a dynamic one benefitting from both domestic and international forces. The economic environment of the 1980s will in many respects be a function of the further evolution of this process.

Regional Perspectives

It was the realization that greater economic benefits for Canadians of different regions would result from the integration of regional economic activities into a larger market that led to the creation of the Canadian federal union. A major driving force behind Confederation was the need to create larger markets to compensate for the loss of British preferences and the abrogation by the USA of the Reciprocity Treaty, particularly in respect of lumber, coal, fish and agricultural produce. The realization that the leverage of the regions in securing international trade advantages would be enhanced by combining their resource and market powers is reflected by the fact that the central government has the responsibility for conducting Canada's trade policies and international trade relations. These central responsibilities are exercised primarily through the Canadian tariff, the regulation of trade and commerce, and the authority for conducting international relations and entering into international agreements.

Provincial governments have had a range of economic development and regulatory responsibilities that have effectively engaged them in an increasingly close relationship with the federal government on international trade and tariff matters. These provincial responsibilities relate primarily to natural resource ownership, marketing boards, government procurement and various tax and subsidy measures. The recent constitutional amendments have extended somewhat provincial authority in respect of the development and marketing of natural resources, subject to the overriding responsibility of the federal government for international trade.

As indicated in the 1980 Federal Discussion Paper concerning the securing of the Canadian Economic Union in the constitution, there is a close and dynamic interrelationship between the effective internal operation of the Canadian market and developments in the international market place. "Technological developments, the internationalization of factors of production, the need to get the benefits of greater economies of scale and specialization of production facilities, have generated considerable pressure for larger markets." In order to respond effectively to these international developments and to exploit fully the opportunities offered for the sale of goods and services in the international marketplace, national trade and tariff policies need, of course, to respond to different regional economic and industrial structures and various mixes of producer and consumer interests. The multilateral nature of the international trading framework has been conducive to the pursuit by the

Canadian government of various regional trade interests in the USA, Europe, Japan and other countries in a way that enhances the cohesiveness of the Canadian common market.

The Canadian tariff structure contains many provisions, such as the duty-free treatment of agricultural machinery and oil and gas equipment, which reflect particular regional interests. Various components of Canada's trade agreements with foreign countries also largely reflect regional development concerns. For example, the Canadian government attached major importance to the negotiations in the Tokyo Round of a US commitment to introduce an injury requirement into its legislation in order to limit the scope for US countervailing duties to frustrate federal and provincial regional industrial development programmes involving government financial support.

Atlantic Canada

The Maritimes and Newfoundland have traditionally and naturally looked to the sea. Prior to Confederation the prosperity of the three Maritime Provinces rested upon their fish and lumber exports, wooden shipbuilding and their carrying trade. The implications of steel and steam were as yet only vaguely realized. However, they were determined to make any necessary adjustments and maintain their enviable position in the commerce of the world for fish and timber. In 1866, fish shipments to a variety of markets accounted for over 40 percent of Nova Scotia's exports. In the case of New Brunswick, forest products made up nearly 70 percent of its total exports and half of the ships built in the province were exported.

Resource sectors remain the region's major economic building blocks and the Atlantic provinces continue to rely more heavily on export markets than the Canadian economy as a whole, forest products and fisheries still accounting for almost half of the exports of the region. These sectors hold prospects of further expansion although they are currently going through a difficult period. The forest industry is feeling the effects of soft world markets and stiff competition from the USA while its own supply base is being adversely affected by insect infestations. Efforts to improve the long-term wood supply management and to modernize the pulp and paper mills will be a major factor affecting this important sector in maintaining a strong trade performance.

In the fishery sector, soft demand in the US market, combined with restrictive European import measures, higher energy costs and problems of product quality control create a difficult set of conditions for the industry. However, with the resource base having been largely rebuilt after the extension of fishery jurisdiction to the 200-mile economic zone a few years ago, the longer term prospects for fishery exports are good. There will have to be sustained efforts to diversify export markets and penetrate the markets of Western Europe and various developing countries.

Ports in the Atlantic region handle a substantial volume of Canada's trade, particularly with Europe. Although Atlantic-built ships no longer have a dominant position on the high seas, the offshore energy development projects in the Atlantic and the North provide substantial supply and industrial development opportunities for

the 1980s in the marine and ocean sectors. The rest of the Atlantic manufacturing sector is basically divided between a few large and dynamic industrial complexes, such as those producing passenger car tires, and many small and medium-sized companies in need of government marketing and financing assistance to extend beyond the confines of the regional or local market.

Although a number of mineral resource projects are nearing the end of their available reserves, iron ore in Labrador and zinc in New Brunswick should become a significant source of strength for the further diversification of the industrial and trade structures of the Atlantic region. Similarly, offshore energy developments should contribute substantially not only to reducing the currently large petroleum import bill of the region but also to the overall economic growth of the area. As to agricultural commodities, a high proportion of New Brunswick and Prince Edward Island potato products and Nova Scotia blueberries are now exported and this should continue in the 1980s. However, the prospects for further agricultural development are probably limited to the expansion of a few products to meet demand on the domestic market.

Quebec

During the heyday of the fur trade, the St. Lawrence transportation system was regarded as one of the great natural trade routes of the world and lumber trade and building of wooden ships flourished at and near Quebec City, making it one of the great shipping centres. A large flour-milling industry in Montreal had long been catering to the export trade. Agriculture and forest products then provided over four-fifths of the exports while machinery and tools requiring a high degree of skill for their production were almost entirely imported. Woollen mills, boot and shoe factories, furniture factories, breweries and distilleries thrived on local raw materials and the incidental protection of a revenue tariff.

Today, many traditional activities continue to be important for large segments of Quebec's economy. Basic agricultural production is largely oriented to serving local and regional markets and continues to be an important element in the region's economy. Nevertheless, some products such as pork and milk powder have become significant export earners, a situation which is expected to continue. The forest product industries still account for about 25 percent of manufacturing employment. With the substantial capital investments injected in the pulp and paper industry in response to the federal-provincial modernization programme and with substantially improved access to the US market as a result of the last round of international trade negotiations, the forest products industries are well placed to meet the challenges and to exploit the opportunities of the marketplace in the 1980s, particularly in the USA and Europe. The situation for non-ferrous metals and the iron and steel industries is somewhat gloomy as a result of a weakening indigenous supply base (e.g., copper), health concerns over asbestos and difficult international market conditions for steel. The same situation will prevail for petrochemicals because of its dependence on key petroleum feedstocks. However, the competitive advantages provided by Quebec's advantageous hydro-power situation and duty-free access to the important US market should ensure continued strength in the aluminum sector in the 1980s.

Energy-related factors are expected to remain of importance to the region's economy with continued and potentially expanded exports of electricity to neighboring US states and the reduction of Quebec's dependence on overseas oil.

The textiles, clothing, tanning and footwear industries, which continue to account for over 20 percent of manufacturing employment in Quebec, have been a source of serious concerns for governments over the years. Although the primary textile industry has largely become a capital intensive industry and has demonstrated a capacity to be competitive, the other traditional sectors of industrial activity remain sensitive to import pressures and in need of restructuring and modernization. These needs are central to the mandate of the Canadian Industrial Renewal Board, charged with administering $267 million of government incentives to encourage the modernization of existing plants and to seek alternative viable employment opportunities in affected communities. These industrial renewal measures have set in place the federal government's policy course for the 1980s in these sectors, particularly in Quebec. With respect to the shipbuilding industry, which was one of the main Quebec industries at the time of Confederation, new opportunities will be provided by oil and gas exploration and development off the East Coast and in Canada's Arctic.

Government efforts to revitalize Quebec's industrial base should be significantly assisted by the emergence of new technologies. CAD/CAM (computer-aided design/computer-aided manufacturing) technologies such as micro-electronics and robotics hold prospects for diminishing the threat from low-cost imports. Although these new technologies will put further pressure on the labour market, their extensive and timely incorporation into existing product and production processes will be vital to the development of a strong, efficient, modern and internationally competitive manufacturing structure in Quebec. At the same time, technological and market developments should positively influence Quebec's industrial structure in the years ahead. Further development of some export-oriented advanced technology industries, including urban and railway transportation equipment, aircraft, aircraft engines, electricity-intensive products, telecommunications, avionics and other electronics should make increasing contributions to Quebec's economic development.

About 60 percent of Quebec's exports go to the USA, 20 percent to Western Europe, and 15 percent to developing countries. These substantial trading relationships are not only crucial to the growth of Quebec's economy but they also contribute to the fostering of an outward-looking society with a strong sense of interdependence. There is a growing export potential and interest from small and medium-sized business, although current economic conditions have constrained developments in this direction. The consulting and engineering sector has also developed a strong international presence and reputation, particularly for large resource and electricity development projects in developing countries.

Ontario

The development of markets opened by the formation of the Canadian Economic Union and by the adoption of the National Policy historically played a major role in the development of Ontario's industries. With a diversified resource, manu-

facturing and service base, Ontario's economic development has been closely tied to its capacity to foster industries that can successfully develop domestic markets and compete abroad, particularly in the USA. Domestic markets remain of considerable importance for the strength of Ontario industries and the 1980s will provide substantial opportunities for the further strengthening of national markets as energy-based mega-projects anticipated in different parts of the country are realized. At the same time, the health of Ontario's industries is increasingly influenced by its international trade performance. Over one-third of Ontario's manufacturing is now destined for export, and 75 percent of Canadian exports of end-products (including automotive) originate in Ontario.

To a significant extent, the constraints and challenges facing Ontario's economy are reflected in overall Canadian concerns over the degree of foreign control of domestic manufacturing industries, the level of industrial R&D activities carried out in Canada, the need for foreign subsidiaries to rationalize and specialize their production lines and to have the necessary corporate autonomy to export to world markets. Similarly, the nature and size of the Canadian deficit in trade in end-products is an issue of particular sensitivity and significance in Ontario because of the extent to which imports of end-products compete or are perceived to be competing with existing or potential production capabilities.

Canada-US trade in automotive products is, of course, of overriding importance to Ontario's economy. One of the main challenges facing the province's industrial structure in the 1980s will be dictated by the need to face the changing, increasingly competitive international environment in the automotive sector. This type of industrial renewal challenge extends not only to traditional mature sectors such as footwear but also to a number of other fabricating and manufacturing industries in Ontario. In this regard, the fact that so much of Ontario's trade is with the large US market is not only a source of strength, but also of potential weaknesses because the US market for manufactured products has become a slow-growth market thus underlining the need to diversify export markets.

With a consumer durable-goods sector subject to relatively stagnant demand and in need of significant restructuring, Ontario's trade performance in the 1980s will likely be increasingly influenced by the strength and vitality of its capital-goods and high-technology sectors. In the capital goods industry, the prospects of the machinery and equipment sector stands to be significantly influenced by the realization of the large mega projects planned for the 1980s and its capacity effectively to compete on a full and fair basis with foreign competitors. In addition, the cyclical nature of major capital projects and the importance of scale to justify investment for development of domestic supply capabilities, require these industries to look at both domestic and export market opportunities to maximize their chances of success. Similarly, advanced technology industries in areas such as telecommunications, urban transportation and hydro-electrical equipment, whether based on indigenous or imported technologies, will need to look at both domestic and foreign markets because of the relatively small-size or slow-growth nature of the domestic market. With respect to energy, the future of the nuclear sector will likely remain a source of serious concerns for some years.

Ontario is also a large resource economy. It has a large agricultural sector, which is expected to continue to expand significantly with some items being largely exported (e.g., tobacco and spirits) and to diversify to meet domestic consumption requirements (e.g., soyabeans, wine and fruits and vegetables). Forest products and the non-ferrous metals industries, which account for a major component of resource-based exports, should continue their contribution to the many communities across the province depending on these activities.

Western Canada

The history of economic development in Western Canada is largely dominated by the exploration and development of its abundant resources. A large proportion of these resource products continue to be exported to world markets. Indeed, the selling of Western products to countries of the Pacific was one of the early objectives of the young Trade Commissioner Service at the turn of the century. The handling and shipping of these resource products has also required large storage, transportation and port infrastructure investments.

The heavy dependence of Western Canada's economic growth on resource industries has made many single industry communities vulnerable to the fluctuations of international commodity markets. Thus the continuing importance of government initiatives designed to stabilize world markets for wheat and to diversify export markets for commodities such as wheat, coal and lumber. In addition, Western Canada has strong aspirations for the further processing of its natural resources prior to export and for greater diversification of its industrial structure. This trend is already in evidence with fashion apparel and urban transportation equipment manufacturing in Manitoba, some specialized electronics and steel plating and tubing production in Saskatchewan, petrochemicals and geophysical exploration equipment in Alberta and some specialized electronics and heavy-duty truck manufacturing in British Columbia. In this situation, the preservation of existing market access conditions abroad negotiated over the years and obtaining improved access for such sectors as petrochemicals, forest products, mineral products, processed agricultural and fishery products will remain of considerable importance for Western Canada in the 1980s. Exports of business services such as forest industry consulting and engineering services will probably become of increasing significance to Western Canada.

A number of resource management and infrastructure constraints will be of increasing strategic importance to a strong Western export trade performance in the 1980s. These include the growing constraints upon the transportation system to take to export delivery points major commodities such as grains, lumber, sulphur, potash and coal and growing concerns with soil salinity and erosion. Similarly, much may depend on the prospects of bringing on stream some of the planned resource mega-projects including some possible hydro-electricity exports from Manitoba to the USA.

While the Western economies are strongly export oriented, some sectors are sensitive to import competition. Examples include fruit and vegetable growers and plywood producers in British Columbia, cattle producers in Alberta and some

TABLE 1

CANADA'S TRADE PERFORMANCE, 1965 TO 1981

(percentage shares)

	Total Exports		Manufactured Product Exports		
				Canada/Developed Market Economy Countries	
	Canada/World	Canada/Developed Market Economy Countries	Canada/World	Nominal	Real
				(Current U.S. $)	(1975 U.S. $)
1965	4.3	6.3	3.5	4.2	3.6
1966	4.7	6.7	3.9	4.8	n.a.
1967	4.9	7.0	4.5	5.4	n.a.
1968	5.2	7.5	4.9	5.9	n.a.
1969	5.0	7.1	4.8	5.8	n.a.
1970	5.1	7.2	4.8	5.7	4.4
1971	5.0	7.0	4.6	5.5	4.3
1972	4.9	6.8	4.3	5.2	4.3
1973	4.4	6.2	3.8	4.5	4.2
1974	3.9	6.1	3.4	4.1	3.9
1975	3.7	5.6	3.2	3.8	3.8
1976	3.8	5.9	3.5	4.2	3.9
1977	3.7	5.7	3.4	4.2	4.2
1978	3.5	5.3	3.2	3.9	4.3
1979	3.4	5.1	3.1	3.8	4.3
1980	3.2	5.1	3.0	3.7	4.1
1981	3.6	5.7	n.a.	4.2	4.2

Source: Derived from data in

1) Handbook of International Trade and Development Statistics, UNCTAD, Geneva, 1976 and 1979, 1980 Supplement.
2) Monthly Bulletin of Statistics, Statistical Office of the United Nations, New York, May 1981 and 1982.

apparel manufacturers in Manitoba. These pressures may tend to increase as the Western manufacturing base becomes more diversified. Nevertheless, Western Canada has generally been strongly supportive of freer trade policies for manufacturing industries based on, for example, the importance of obtaining machinery and capital equipment at the lowest possible cost to maintain the international competitiveness of its resource-based industries. This has been reflected in the long-standing duty-free treatment in the Canadian tariff of such items as agricultural machinery and implements and oil and gas equipment. Similarly, Western consumers have long considered that Canadian tariffs and other import-restrictive measures on consumer products such as textiles, clothing and footwear impose a significant burden on them.

The substantial reduction in the level of the Canadian tariff over the years, including the results of the Tokyo Round of trade negotiations, has helped to alleviate the historical Western concerns about the cost of the Canadian tariff. Nevertheless, import restrictions that may, from time to time, be introduced by the government of Canada in support of some manufacturing industries hard pressed by competition from abroad, will likely continue to be viewed by Western Canadians as jeopardizing their export interests abroad, particularly in the Pacific Rim.

In sum, from the early days of Confederation, the various regions of Canada have looked abroad for markets for a large proportion of the output of their resource-based industries: agriculture, fisheries, forest products, metals and minerals. Much of the large infrastructure investment has been directed to the development of the necessary transportation systems and port and handling facilities. Canada is a nation which defies geography. Throughout our history, therefore, the federal government has fostered policies aimed at knitting the country together. Trade policy is no exception. From Sir John A. Macdonald's National Policy to today we have striven to maintain a policy which reflects the interests of the various regions, while remaining national in scope. Fish, for example, constitute less than two percent of our exports — but figure prominently in the economies of individual provinces and are featured prominently among national trade policy objectives. Similar priority is attached for identical reasons to developments affecting trade in agriculture, forest and mineral products. The Autopact was established to provide a stronger footing for a major manufacturing sector in central Canada. Furthermore, the commitments made in bilateral and multilateral trade agreements often provide the basis for coordinating domestic economic policies which would otherwise be pulled to and fro by special interests — thus maintaining consistency of purpose applicable to the country as a whole. A gradual movement towards freer trade has been a consistent policy orientation of successive governments and has proven to be an effective integrating vehicle for Canadian society. A continuing, strong trade performance will not only help sustain economic growth but also can serve to strengthen the economic development potential of different regions and industrial structures across the country.

World Trade 1945-1980

The value of world trade in 1980 reached some $2,000 billion US, a sixfold increase in real terms since 1950. World trade grew steadily in the post-war period, most strikingly during the 1960s, and throughout the period growth in trade outpaced growth in production. The proportion of goods and services which crosses

TABLE 2

CANADA'S CURRENT ACCOUNT TRADE, 1960 TO 1981

(Balance of Payments Basis)

Year	Goods		Trade Balance	Goods and Services[1]		Total Current Account Balance
	Exports	Imports		Exports	Imports	
	(millions of dollars)					
1960	5,392	5,540	-148	7,215	8,448	-1,233
1961	5,889	5,716	173	7,904	8,832	-928
1962	6,387	6,203	184	8,548	9,378	-830
1963	7,082	6,579	503	9,416	9,937	-521
1964	8,238	7,537	701	10,887	11,311	-424
1965	8,745	8,627	118	11,648	12,778	-1,130
1966	10,745	10,102	224	13,600	14,762	-1,162
1967	11,338	10,772	566	15,303	15,802	-499
1968	13,720	12,249	1,471	17,464	17,561	-97
1969	15,035	14,071	964	19,425	20,342	-917
1970	16,921	13,869	3,052	21,932	20,826	1,106
1971	17,877	15,314	2,562	23,051	22,620	431
1972	20,129	18,272	1,857	25,483	25,869	-386
1973	25,461	22,726	2,735	31,776	31,668	108
1974	32,591	30,902	1,689	40,352	41,812	-1,460
1975	33,511	33,962	-451	41,840	46,597	-4,757
1976	37,995	36,607	1,388	47,110	50,952	-3,842
1977	44,253	41,523	2,730	54,103	58,404	-4,301
1978	53,054	49,047	4,007	64,577	69,512	-4,935
1979	65,275	61,157	4,118	79,182	84,144	-4,962
1980	76,772	68,284	8,488	93,615	94,711	-1,096
1981	84,221	76,870	7,351	102,543	107,889	-5,346

[1]Including transfers

national boundaries has more than doubled, from 11 percent of world output in 1950 to 21 percent in 1980. While it is true that growth in world trade and production has virtually ceased in the past two or three years, this discouraging performance is tempered with some hopeful signs. The absolute fall in demand for oil conceals in the total figures a continuing modest increase in trade in manufactured and agricultural products. Nevertheless, the recent slowdown in economic activity has encouraged protectionist pressures; it challenges governments everywhere to contain these pressures and to ensure that the international trading system, which has contributed in large measure to post-war prosperity, remains viable.

The growth in the relative share of international trade reflects the periodic dismantling of tariffs and other barriers since the establishment of GATT, improvements in international transportation and communications facilities, a growing similarity in consumption patterns across countries, and a shift from domestic policies favouring import substitution to those which are more export-oriented. Financial markets have also become more integrated as barriers to capital flows have been reduced, permitting capital to be allocated on a more efficient basis internationally. Such developments have contributed to the expansion of living standards world-wide at an unprecedented rate. They continue to provide a basis for further expansion.

As significant as the absolute growth in trade has been the shift in its composition and in its geographic distribution. The proportion of trade taken up by industrial products and services compared to agricultural products and raw materials has grown steadily. Manufactured goods now account for a much larger share than in the immediate post-war period. Up to the early 1970s, trade grew most rapidly among the western industrialized countries (including Japan), in part reflecting post-war reconstruction, the formation of the EC and other special trading arrangements. This trend has now slowed down, with the most rapid growth being recorded by OPEC countries. Total participation by all developing countries in world trade reached 27 percent in 1980.

Some of Canada's principal trading partners made spectacular gains in their shares of world exports during this period, particularly Germany and Japan. Others, including the USA and the UK, saw their shares in world trade decline substantially. While relative shares changed, all of Canada's main trading partners experienced large growth in the volume of their foreign trade relative to output. For example, the US share of world exports declined from 22 percent in 1950 to 10 percent in 1980, but the role of trade in the US economy increased significantly as exports as a share of GNP rose from around 5 percent to 10 percent in the same period. During this period the EC emerged as the world's largest trading bloc; its internal trade grew especially fast, but even its external trade now equals the combined shares of the USA and Japan.

Canadian Trade and Economic Performance

Two-way trade with the rest of the world has been a major factor in Canada's economic growth throughout its development as a nation. By 1981, Canadian mer-

TABLE 3

RATIO OF MERCHANDISE EXPORTS TO GROSS DOMESTIC PRODUCT

	1965	1970	1973	1974	1975	1979	1980
				(percent)			
United States	3.9	4.4	5.5	7.0	6.9	7.5	8.4
Japan	9.5	9.8	9.0	12.2	11.2	10.3	12.4
West Germany	15.6	18.4	19.6	23.4	21.4	22.6	23.6
France	10.2	12.5	14.3	17.1	15.4	17.1	17.1
United Kingdom	13.3	15.9	17.3	20.2	19.1	22.4	22.0
Canada	15.6	19.5	20.2	21.6	19.6	24.2	25.6
Italy	12.3	14.3	15.7	19.5	18.1	22.3	19.7
EEC[1] (including intra-community trade)	15.2	18.1	20.0	23.8	21.3	23.4	23.6
EEC[1] (excluding intra-community trade)	8.2	9.0	9.5	11.7	10.8	10.9	11.1
OECD	9.0	10.6	12.4	14.9	14.2	15.4	16.5

[1] Adjusted to include all the present members of the European Community.

chandise exports totalled $84.2 billion (or $69.9 billion US) and accounted for 3.6 percent of world exports (Table 1). While Canadian trade was initially oriented towards Europe, particularly Britain, the United States has grown steadily in importance since the end of the first World War, both as a market for Canadian products and as a supplier of goods, especially capital equipment. Slow growth in Britain after the second World War was paralleled in slow development in its trade with Canada. The trade relationship deteriorated further after Britain joined the European Free Trade Association and again when it later joined the European Economic Community. Japan displaced Britain in 1972 as Canada's second largest supplier of imported goods and a year later it became the second largest market for Canadian exports.

The immediate period after the second World War was one of stagnation for Canada's external trade as Canada's overseas customers struggled to recover from the destruction of war and the ensuing serious balance of payments difficulties. This was a particularly serious problem for the United Kingdom. During the recovery period after 1951, Canada's exports grew at an average annual rate in real terms for the decade at about 4 percent. This appears relatively low when compared to the 1960s when an annual average growth rate of over 9 percent was attained. In the 1950s there was major development of Canadian infrastructure, the building of pipelines, the construction of the Seaway and a major expansion of oil, metallic and mineral development, which paved the way for the expansion of exports in the 1960s. While the expansion of trade in automotive goods was a major factor, there was a strong rate of growth of real exports in all major commodity sectors.

In the 1970s, the expansion of Canadian trade was largely the result of an expansion in exports of finished manufactured goods (i.e., inedible end-products). Canadian exports of finished manufactured goods nearly doubled in volume terms between 1971 and 1981, foreign shipments of primary manufactured goods (i.e., inedible fabricated materials) were just over 40 percent above the 1971 level, and exports of "foodstuffs" (i.e., food, feed, beverages and tobacco, including live animals) were almost 40 percent above the 1971 level. As a result of a continuous process of change, Canada by the beginning of the 1980s had a diversified pattern of exports. Inedible fabricated materials and finished manufactured goods have accounted for close to 70 percent of Canadian exports since 1968, compared with some 60 percent in the early 1960s. The relative increase has been the greatest in fully finished manufactured products.

The increase in Canada's exports of fully finished goods has stemmed in part from the rationalization of the Canadian and United States automotive industries resulting from the 1965 Automotive Products Trade Agreement. This was a move designed to create, over a period of time, a free-trade area in automotive products in North America. For Canada this produced exports of $13 billion in 1981 compared with less than $100 million in 1962. At the same time, the rationalization process has also meant strong increases in Canadian imports of automotive goods, to nearly $16 billion in 1981.

Apart from motor vehicles and parts, notable progress has also been made in increasing Canadian exports of industrial machinery and other equipment which in 1981 was valued at about $8 billion compared with about half a billion dollars in

TABLE 4

PRODUCTION AND TRADE OF TWELVE LEADING DEVELOPED COUNTRIES, 1980

	Production[1]	Exports of Goods and Services		Exports of Goods	
	(Billions of $U.S.)	(Billions of $U.S.)	(Percent of GDP)	(Billions of $U.S.)	(Percent of GDP)
United States	2,587.1	260.8	10.0	216.7	8.4
Japan	1,040.0	145.1	14.0	129.2	12.4
West Germany	819.1	225.1	27.5	192.9	23.6
France	651.9	146.1	22.4	111.3	17.1
United Kingdom	522.9	148.5	28.4	115.1	22.0
Italy	394.0	99.5	25.2	77.7	19.7
Canada	253.3	74.3	29.3	65.0	25.6
Spain	211.1	32.9	15.6	20.7	9.8
Netherlands	167.6	89.0	53.1	74.0	44.1
Australia	140.0	25.4	18.1	22.0	15.7
Belgium/Luxembourg	121.1	77.2	63.8	64.6	53.4

[1] Gross Domestic Product

Source: United Nations, *Monthly Bulletin of Statistics*; OECD, *National Accounts of OECD Countries, Volume I, 1951-1980*

1962. Fully finished consumer goods exports (other than automotive products) have also increased strongly in the period since the early 1960s.

A country's international transactions are measured by its payments and receipts for goods and services (including transfers) called the current account, together with short and long-term capital transactions called the capital account. Typically, Canada has had a deficit in its current account, with such deficits generally offset by net inflows of capital. Over the years, the pattern for the current account has generally shown a surplus in merchandise trade—with only two exceptions in the past two decades, 1960 and 1975—and a deficit on transactions in services (i.e., travel, interest and dividends, shipping, etc.) in association with a typical surplus for net transfers, the third but minor component of the account (Table 2).

The role of international trade in a nation's economy is, among other factors, related to its size, the diversification of its production and its level of income. The importance of international trade in the world market economy has increased in the post-war period as exports grew faster than domestic output and imports grew faster than domestic consumption in nearly all countries. This trend of the increasing importance of trade may be illustrated by showing the increase in export orientation, i.e., ratio of merchandise exports to gross domestic product (GDP) over the years (Table 3). For instance, the importance of merchandise exports to GDP (in terms of US dollars) within the OECD increased from 9 percent in 1965 to over 16 percent in 1980. At the same time, the value of Canadian merchandise exports to GDP rose from some 15 percent in 1965 to some 25 percent in 1980.

A country like Canada, in which trade represents such a large proportion of total economic activity, is said to have an "open" economy. Canadian trade in goods and services represents nearly one-third of total economic activity with commodity exports representing approximately one-quarter of the total and commodity imports a somewhat smaller share. Concurrently, service imports by Canada represent some 9 percent of economic activity while service exports are about one-half as large at some 4 to 4.5 percent.

Canada is a medium-size economy, ranking seventh in terms of output among the developed market economy countries in 1980 (Table 4) and eighth in terms of exports of goods. In recent years, the value of Canadian commodity exports has been in the same general range as that of Italy, whereas the exports of the United States, West Germany, Japan, the United Kingdom and France far exceeded those of Canada.

Canada occupies a middle position as far as its reliance on international trade is concerned. As noted earlier, about 29 percent of Canada's production of goods and services in 1980 was exported (Table 4) compared to about 20 percent for the OECD as a whole. Among the seven major industrialized market economies, Canada is the leader in reliance on international markets for its production of goods and services. Some smaller industrialized countries such as Belgium and the Netherlands show a higher ratio than does Canada in their reliance on foreign markets but much of the trade of EC countries is with other members. For instance, in 1980 EC countries exported some US $661 billion, of which US $349 billion was to member countries

TABLE 5

GROWTH IN ECONOMIC ACTIVITY AND TRADE OF INDUSTRIALIZED COUNTRIES, 1963-1980

(annual rate of change in volume)

Region	GNP or GDP		Exports		Imports	
	1963-73	1973-80	1963-73	1973-80	1963-73	1973-80
Industrialized Countries	5	2½	9	5	9	3
Of which:						
United States	4	2	7½	6	9½	2½
Canada	5½	1½	10	2½	11	3
Japan	10½	4	16	9	14½	1
EEC (9)	4½	2	8½	4½	8	3½
Of which:						
France	5½	2½	10½	5½	11	5½
Germany	4½	2½	9	4½	10½	4½
Italy	4½	3	11½	5½	8	2½
United Kingdom	3	1	6	4	7	1½
Memorandum Item:						
World	–	–	8½	4	–	–
Agricultural Products	–	–	4	4½	–	–
Minerals	–	–	7	-½	–	–
Manufactures	–	–	11	5	–	–

Source: International Trade 1980/81, General Agreement on Tariffs and Trade, Geneva, 1981.

and US $312 billion to international markets. Intra-EC trade can to some extent be regarded as similar to inter-provincial shipments in Canada, or inter-state trade in the United States.

Although most studies of a country's trade performance are on the basis of value, increased use of price and volume indexes has led to a greater awareness of this type of analysis. Value is the only measure of importance when dealing with Canada's international payments position, which in turn influences the exchange rate. On the other hand, volume is of prime importance when examining Canadian industry's real growth of output and employment and our competitive position with foreign suppliers in both the domestic and international markets.

The terms of trade are a simple but useful measurement of a country's performance. It is an index or ratio derived by dividing the index of export price by the index for import price. An improvement in the terms of trade follows if export prices rise more rapidly than import prices, or fall at a slower rate than import prices. An improvement initially could mean that a country is better off and more able to pay for import goods than at the beginning of the period. However, a persistence of this pattern could soon lead to a loss of competitiveness, particularly for manufactured products. Such a situation could reflect rising costs of domestic production while imported goods became cheaper. Nevertheless, this measurement is of some importance when assessing the international payments position of a country like Canada. As an example, the world-wide shortage in a wide variety of foods and crude materials caused international prices (usually in terms of US dollars) to soar after 1972.

In contrast to most industrialized countries, Canadian exports are heavily oriented towards resources or resource-based products. Consequently, Canada's terms of trade (based on Canadian dollar prices), moved strongly upward in 1973 and 1974 to a peak of 116 before dropping to around an index (1971=100) of 111 in both 1975 and 1976. Since then the index moved downward to just below 103 in 1978 before moving upward to over 108 in both 1979 and 1980. The recent weakness in international trade, especially for resources and resource-based products, resulted in a decline to an index of 105 in 1981.

Manufactured products, more than any other group, are frequently singled out as indicative of our competitive ability, technological advancement and economic well-being. The continuing interest in the evolving position of Canada's trade in manufactured products is based on the very large share this trade represents both in terms of exports and imports — 70 and 80 percent, respectively. Canadian production of manufactured products rose from $37.3 billion in 1966 to $188 billion in 1981 (Table 7), increasing at an average annual growth rate of close to 11 percent. The market for manufactured products also grew at an 11 percent annual average. Concurrently, employment in Canadian manufacturing industries rose from 1,173 thousand production workers in 1966 to some 1,500 thousand in the years 1978 to 1981. In 1981 it is estimated that some 600 thousand workers in manufacturing were directly employed in output destined for international markets. Input-output data for the year 1977 indicated a multiplier of around 2, so it is fair to say that an additional 600 thousand workers in 1981 owed their employment *indirectly* to export activity associated with manufactured products.

TABLE 6

DOMESTIC MERCHANDISE EXPORTS
PERCENTAGE DISTRIBUTION BY MAJOR COMMODITY GROUP[1]

(1960-1981)

	Food, Feed Beverages & Tobacco[2]	Inedible Crude Materials	Inedible Fabricated Materials	Finished Manufactured Goods (Inedible End Products)	
				Total	Automotive
1960	18.8	21.2	51.9	7.8	1.3
1961	22.0	20.8	48.3	8.8	0.8
1962	20.1	22.0	47.1	10.6	0.9
1963	21.5	21.0	45.7	11.5	1.3
1964	22.7	20.0	43.3	13.7	2.2
1965	20.0	20.7	43.7	15.3	4.2
1966	19.5	19.3	39.8	21.0	9.9
1967	14.8	19.0	38.0	28.0	15.6
1968	12.1	18.5	36.4	32.7	20.6
1969	10.1	17.1	35.7	36.8	24.3
1970	11.4	18.8	35.8	33.8	21.3
1971	12.1	18.8	33.3	35.6	24.0
1972	12.0	18.1	33.4	36.3	24.0
1973	12.7	20.2	33.1	33.8	21.8
1974	12.2	24.6	33.8	29.2	18.0
1975	12.7	24.5	30.4	32.2	19.8
1976	11.4	22.0	32.5	33.8	21.8
1977	10.5	20.3	34.2	34.9	23.9
1978	10.1	16.9	36.7	36.1	24.0
1979	9.8	19.5	37.9	32.5	18.5
1980	11.1	19.8	39.4	29.4	14.7
1981	11.6	18.7	37.6	31.2	16.1

[1] Shares will not sum to 100 percent because of the omission of special transactions which accounted for 0.2 to 0.4 percent of the total over the whole period.

[2] Including live animals.

The relationship of shipments to the Canadian market as expressed by the implicit self-sufficiency of the Canadian market indicates that there was a continuing import gap in this market averaging about 2.7 percent for the period (Table 8). Only in 1970 did manufactured products experience a small surplus (Table 7) and that was due to a set of unusual circumstances consisting of flat demand at home and buoyant demand abroad. In general terms the Canadian implicit self-sufficiency in manufactured products has not shown any dramatic changes that cannot be explained by cyclical demand fluctuations. In 1981, the indicated import gap was only 2.3 percent, a considerable improvement from the 1975 high of 6.4 percent.

The measures concerned directly with trade indicate that exports and imports grew at the not too dissimilar growth rates of 14.9 percent and 14.5 percent per year respectively over the period (Table 7). Both rates are perceptibly above those of production or consumption (Canadian market), thus indicating an increasing trade involvement for manufactured products. This is readily confirmed by the close to parallel increases in export orientation of production and import penetration of the Canadian market over the period. Export orientation rose from 18.8 percent in 1966 to a high of 30.8 percent in 1980 while import penetration rose from 21.0 percent to a high of 32.6 percent in 1979.

As was stated earlier, the *balance of trade* in Canadian manufacturing has been the cause of considerable confusion over the years because of a tendency to confuse end-products with manufactured products. The key manufacturing sectors based on Canada's extensive natural resources of agriculture, fishing, mining (including mineral fuels) and forestry generate large trade surpluses, namely paper and allied products, primary metals, wood products and petroleum and coal products (Table 12). While nearly all the other major manufacturing sectors show a trade deficit, a number of them are rather small. The sector responsible for a major portion of the trade deficit in manufactured products is machinery at some $7.5 billion in 1981 whereas the deficit in transportation equipment (including automotive products) amounted to only $2.7 billion. Other major sectors sharing a sizeable portion of the overall trade deficit in manufactured products were miscellaneous manufacturing, electrical products, textiles, metal fabricating and printing. It must be recognized, however, that the existence of a trade deficit (or surplus) in any individual sector is not *per se* an indication that there are (or are not) problems in that sector.

The implicit self-sufficiency of Canadian manufacturing sectors varies widely. The array shows industries producing export surpluses (food and beverages through to paper and allied products), industries that show a sizeable and persistent import gap (machinery through to rubber and plastics) and those industries that are close to self-sufficiency (whether they trade or not). Between 1966 and 1981 the change in self-sufficiency at the overall level of manufacturing was small. Those industries that produced an exportable surplus, however, strengthened their positions (except food and beverages), but the self-sufficiency in several industries declined thus partially offsetting this gain. Many sectors experienced only small changes in self-sufficiency in the intervening period.

TABLE 7

CANADIAN MANUFACTURED PRODUCTS

(millions of Canadian dollars, percent)

	Domestic Exports[1]	Retained Imports[1]	Trade Balance	Shipments	Canadian Market[2]	Implicit Self-Sufficiency[3]	Export Orientation[4]	Import Penetration[5]
	$	$	$	$	$	$	$	$
1966	7,011	8,074	-1,053	37,303	38,366	97.2	18.8	21.0
1967	8,225	8,886	-661	38,955	39,617	98.3	21.1	22.4
1968	9,842	10,202	-359	42,062	42,421	99.2	23.4	24.0
1969	11,168	11,976	-809	45,930	46,739	98.3	24.3	25.6
1970	12,162	11,709	453	46,381	45,928	101.0	26.2	25.5
1971	12,724	13,188	-464	50,276	50,739	99.1	25.3	26.0
1972	14,502	15,881	-1,378	56,191	57,569	97.6	25.8	27.6
1973	17,749	19,664	-1,914	66,674	68,589	97.2	26.6	28.7
1974	20,588	25,387	-4,799	82,455	87,254	94.5	25.0	29.1
1975	21,149	27,230	-6,081	88,427	94,508	93.6	23.9	28.8
1976	25,756	29,897	-4,141	98,281	102,422	96.0	26.2	29.2
1977	31,057	34,345	-3,287	108,852	112,140	97.1	28.5	30.6
1978	39,244	41,397	-2,153	128,889	131,043	98.4	30.4	31.6
1979	46,105	51,300	-5,195	152,133	157,328	96.7	30.3	32.6
1980	51,388	53,180	-1,792	166,983	168,775	98.9	30.8	31.5
1981	56,450	60,912	-4,462	188,238	192,699	97.7	30.0	31.6
1966-1981 Average Annual Rate of Growth	14.9	14.5		11.4	11.4			

[1] Total exports to total imports less re-exports, customs value basis
[2] Shipments less exports plus imports (apparent consumption)
[3] Shipments/Canadian market
[4] Export/Shipments
[5] Imports/Canadian market

TABLE 8

DEGREE OF POTENTIAL SELF-SUFFICIENCY OF CANADIAN MANUFACTURING SECTORS IN CANADA, 1966-1981

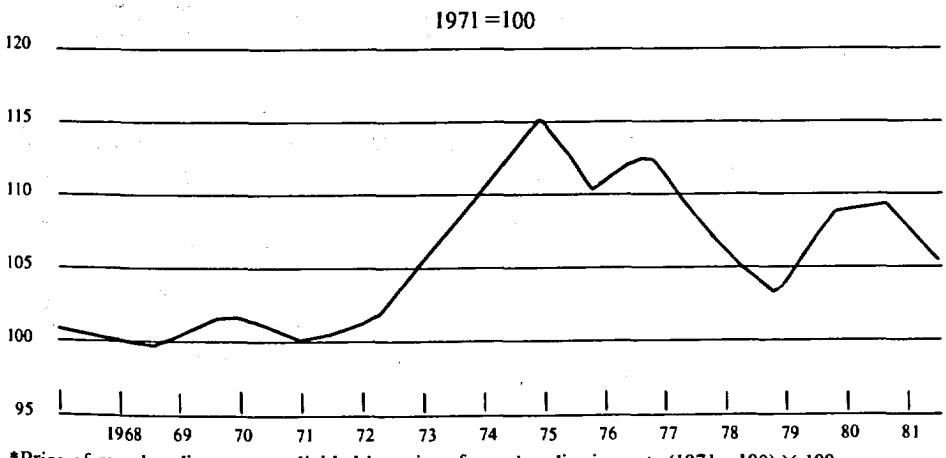
(percent of Canadian market supplied by Canadian production)

Manufacturing Sector	1966-73	1973-80	1980	1981
Food and beverages	102.7	101.4	102.5	104.1
Tobacco products	100.2	99.0	98.9	99.0
Rubber and plastics	86.5	85.2	87.9	90.2
Leather industries	83.4	73.0	74.5	72.4
Textile industries	79.9	77.9	80.5	79.7
Knitting mills	80.0	70.7	73.0	71.1
Clothing industries	97.2	93.4	94.0	92.3
Wood industries	160.2	170.6	185.2	167.4
Furniture and fixtures	97.2	94.4	98.1	97.7
Paper and allied industries	190.4	205.4	225.9	220.6
Printing and publishing	88.1	88.3	88.5	88.6
Primary metal industries	141.2	133.7	146.3	131.7
Metal fabricating industries	90.3	90.7	92.0	91.6
Machinery industries	54.2	62.7	51.6	52.1
Transportation equipment industries	97.1	90.3	88.9	88.8
Electrical products industries	84.2	76.6	77.1	76.9
Non-metallic minerals	91.3	91.5	90.5	91.1
Petroleum and coal products	94.0	103.7	107.1	105.4
Chemical and chemical products	87.9	88.9	95.5	96.6
Miscellaneous manufacturing industries	64.1	57.4	59.5	57.7
TOTAL MANUFACTURING	98.4	96.8	98.9	97.7

Note: "Self-sufficiency" assumes that the production and trade are relatively homogeneous. This means that the "machinery" industries are either producing or are capable of producing what is being imported.

TABLE 9

TERMS OF TRADE, 1968-81*



*Price of merchandise exports divided by price of merchandise imports (1971 = 100) × 100

Source: Statistics Canada; The Conference Board of Canada

TABLE 10

EXPORT ORIENTATION OF MAJOR MANUFACTURING SECTORS IN CANADA, 1966-1981

(percent of production exported)

Manufacturing Sector	1966-73	1973-80	1980	1981
Food and beverages	9.7	10.8	11.6	12.6
Tobacco products	0.6	0.6	0.7	0.7
Rubber and plastics	5.0	9.5	11.2	13.8
Leather industries	5.7	7.7	7.8	7.4
Textile industries	4.8	6.3	8.3	8.2
Knitting mills	2.3	1.7	1.4	1.7
Clothing industries	4.3	5.0	5.9	6.5
Wood industries	43.3	48.2	51.8	47.0
Furniture and fixtures	3.7	6.6	9.7	10.6
Paper and allied industries	50.7	56.0	60.0	59.9
Printing and publishing	1.9	2.9	3.6	3.3
Primary metal industries	46.1	47.7	60.5	54.4
Metal fabricating industries	3.9	6.3	7.0	7.3
Machinery industries	37.8	49.0	51.5	54.4
Transportation equipment industries	60.4	69.3	67.9	68.4
Electrical products industries	13.0	17.2	22.5	24.4
Non-metallic minerals	6.9	9.6	10.7	10.6
Petroleum and coal products	3.7	7.4	11.2	8.9
Chemical and chemical products	15.3	22.8	28.6	29.0
Miscellaneous manufacturing industries	22.2	20.5	25.0	26.5
TOTAL MANUFACTURING	24.3	28.4	30.8	30.0

Note: All values are in current dollars. Trade data are on a customs value basis, Trade of Canada. The trade data have been allocated to industrial sectors according to the 1970 Standard Industrial Classification. Shipment data for 1966-1979 are Census of Manufacturers. In 1980 and 1981 shipments data are derived from Inventories, Shipments and Orders in Manufacturing, Statistics Canada.

Note: Shipments are synonymous with "production".

In summary, Canadian manufacturing industries became more involved in, and dependent on, international trade during the 1966-81 period. This they achieved without a permanent decline in the implicit self-sufficiency in manufactured products. This increased trade involvement, both in terms of exports and imports, is a significant indication of the increase in specialization of production that has occurred as an ongoing process in the Canadian industrial economy over this period.

Note on Intra-corporate trade

A large proportion of international trade, probably 25 percent or more, is conducted through subsidiaries of large parent corporations. This is a reflection of the growing internationalization of business. While short-term patterns of intra-corporate transactions may not fully reflect normal supply and demand considerations, in the longer-term trade, whether intra-corporate or not, is based upon commercial and

competitive considerations. All privately-owned corporations must show profits over the longer term to remain viable. The significance of this intra-corporate trade is much greater in the case of Canada, given the importance of foreign subsidiaries in its industrial structure.

A recent Statistics Canada study indicated that foreign-controlled firms, and particularly US- controlled firms, are responsible for a larger proportion of imports into Canada than domestically-controlled firms. The study found that in 1978, 72 percent of imports into Canada were to foreign-controlled firms (80 percent of these foreign-controlled firms were US-controlled). A large proportion of this trade is estimated to have been intra-corporate. The study also found that the imports of US-controlled firms tend to originate in the USA (87 percent) and that Canadian imports are highly concentrated, with the leading fifty importing enterprises in Canada accounting for almost 50 percent of all imports and thirty-five of these fifty

TABLE 11

IMPORT PENETRATION OF MAJOR MANUFACTURING SECTORS IN CANADA, 1966-1981

(percent of Canadian market supplied by imports)

Manufacturing Sector	1966-73	1973-80	1980	1981
Food and beverages	7.3	9.6	9.4	9.0
Tobacco products	1.1	1.5	1.7	1.7
Rubber and plastics	17.8	22.9	21.9	22.2
Leather industries	21.3	32.6	31.3	33.0
Textile industries	23.9	27.0	26.2	26.8
Knitting mills	21.8	30.5	28.0	30.1
Clothing industries	6.9	11.3	11.6	13.7
Wood industries	9.2	11.7	10.8	11.2
Furniture and fixtures	6.4	11.9	11.4	12.6
Paper and allied industries	6.2	9.6	9.7	11.4
Printing and publishing	13.5	14.3	14.7	14.4
Primary metal industries	23.9	30.0	42.2	40.0
Metal fabricating industries	13.2	15.1	14.5	15.1
Machinery industries	66.3	87.0	75.0	76.2
Transportation equipment industries	61.6	72.3	71.4	71.9
Electrical products industries	26.7	36.6	40.3	41.9
Non-metallic minerals	15.0	17.2	19.2	18.6
Petroleum and coal products	9.5	4.0	4.9	3.9
Chemical and chemical products	25.6	31.3	31.8	31.4
Miscellaneous manufacturing industries	50.1	54.4	55.4	57.5
TOTAL MANUFACTURING	25.5	30.6	31.5	31.6

Note: All values are in current dollars. Trade data are on a customs value basis, Trade of Canada. The trade data have been allocated to industrial sectors according to the 1970 Standard Industrial Classification. Shipment data for 1966-1979 are Census of Manufacturers. In 1980 and 1981 shipments data are derived from Inventories, Shipments and Orders in Manufacturing, Statistics Canada.

Note: Shipments are synonymous with "production".

importing enterprises being foreign-controlled (twenth-six being US-controlled). While many reasons account for foreign subsidiaries having a high propensity to import from parent or affiliate companies (e.g., the parent firm's greater knowledge of home country supply opportunities, desire to maximize its buying power or to attain economies of scale), such reliance on imports may often be to the short-term detriment of actual or potential supply sources of goods and services in Canada that could be equally or more competitive.

TABLE 12

CANADIAN TRADE BALANCE BY MANUFACTURING SECTOR 1966-1981

(million dollars)

Manufacturing Sector	Average 1966-73	Average 1973-80	1980	1981
Food and beverages	232	265	709	1,260
Tobacco products	-3	-9	-13	-15
Rubber and plastics	-170	-458	-551	-480
Leather industries	-82	-282	-374	-475
Textile industries	-413	-873	-1,063	-1,249
Knitting mills	-103	-284	-337	-381
Clothing industries	-40	-196	-244	-331
Wood industries	884	2,443	3,740	3,366
Furniture and fixtures	-23	-96	-45	-61
Paper and allied industries	1,856	4,744	7,929	8,294
Printing and publishing	-212	-475	-719	-813
Primary metal industries	1,097	2,163	4,272	3,427
Metal fabricating industries	-358	-785	-1,017	-1,151
Machinery industries	-1,523	-4,074	-6,864	-7,549
Transportation equipment industries	-188	-1,548	-2,401	-2,843
Electrical products industries	-506	-1,587	-2,196	-2,559
Non-metallic minerals	-131	-280	-444	-465
Petroleum and coal products	-127	296	962	992
Chemical and chemical products	-368	-835	-527	-439
Miscellaneous manufacturing industries	-594	-1,795	-2,609	-2,989
TOTAL MANUFACTURING	-774	-3,671	-1,792	-4,462

Source: Manufacturing Trade and Measures, 1966-1981, Economic Intelligence Branch, Policy Planning, Department of Industry, Trade and Commerce, July 1982.

TABLE 13

GROWTH RATE OF CANADIAN MERCHANDISE EXPORTS

(Average annual percentage changes)

In Current Dollars	1968-73	1973-75	1975-81	1968-81
Total Exports[1]	13.2	14.5	16.6	14.9
Agricultural Commodities	14.2	16.1	14.6	14.7
Non-Agricultural Raw Materials	15.3	25.9	11.4	15.0
Crude Petroleum	27.1	43.5	-3.2	14.2
Other Crude Materials	10.6	2.4	18.1	12.7
Fabricated Materials	11.1	9.6	20.7	15.2
End Products	14.0	11.7	15.9	14.5
Motor Vehicles and Parts	14.5	9.0	12.6	12.8
In Constant (1971) Dollars	**1968-73**	**1973-75**	**1975-81**	**1968-81**
Total Exports[1]	8.2	-5.6	5.8	4.9
Agricultural Commodities	6.1	-6.0	7.5	4.9
Non-Agricultural Raw Materials	9.4	-11.2	-2.5	0.5
Crude Petroleum	20.1	-20.9	-21.8	-7.6
Other Crude Materials	8.9	-11.4	0.2	1.5
Fabricated Materials	5.4	-10.5	7.8	3.8
End Products	11.2	1.1	6.3	7.3
Motor Vehicles and Parts	13.7	2.4	3.6	7.2

[1] Includes re-exports

Source: Statistics Canada; The Conference Board of Canada.

TABLE 14

GROWTH RATE OF CANADIAN MERCHANDISE IMPORTS

(Average annual percentage changes)

In Current Dollars	1968-73	1973-75	1975-81	1968-81
Total Imports	13.5	22.0	14.7	15.4
Agricultural Commodities	15.4	18.9	11.6	14.1
Non-Agricultural Raw Materials	12.3	58.7	15.7	20.1
Crude Petroleum	20.4	87.1	15.6	26.4
Other Crude Materials	10.4	11.7	22.6	16.1
Fabricated Materials	12.0	17.8	16.1	14.7
End Products	14.2	18.2	14.4	14.9
Motor Vehicles and Parts	15.2	16.4	11.7	13.7
In Constant (1971) Dollars	**1968-73**	**1973-75**	**1975-81**	**1968-81**
Total Imports	10.0	2.0	3.2	5.6
Agricultural Commodities	6.6	3.3	2.9	4.4
Non-Agricultural Raw Materials	4.3	-3.6	2.2	2.1
Crude Petroleum	12.5	-7.4	-6.7	0.7
Other Crude Materials	4.2	-14.9	12.8	4.8
Fabricated Materials	9.2	-2.7	3.4	4.6
End Products	11.7	4.2	3.1	6.5
Motor Vehicles and Parts	13.7	8.9	1.7	7.3

Source: Statistics Canada; The Conference Board of Canada.

Chapter III

ECONOMIC AND INDUSTRIAL POLICY CONSIDERATIONS

> After we have paid for defence what we think we must, and have spent on social security what in all the circumstances we think we can, we believe there should be something over to spend on other national purposes. We suggest that some of our increasing national wealth should be used to facilitate adjustments that would make the economy stronger and more resilient; to knit the various parts of the country more closely together; to finance developments that would indirectly promote economic growth and permanently add to the country's assets; to assist regions that may not be keeping pace with the economic progress of the country as a whole; and, finally, to encourage Canadians to participate more fully in the economic growth of their own country.
>
> **Gordon Commission, 1957.**

This chapter examines the relationships of a number of domestic economic and industrial policies to trade policy, particularly as they affect Canada's competitive position. It focusses on exchange rate, monetary, fiscal, investment, competition, industrial, transportation, and manpower policies.

Exchange Rate Policy

Canada has had a floating exchange rate over much of the post-war period, with the present period of floating dating from May, 1970. Under this system, the external value of the Canadian dollar is determined by supply and demand forces in the foreign exchange market. These forces, in turn, depend on the various transactions which Canadians undertake with foreigners: imports and exports of goods, tourist expenditures here and abroad, interest and dividend flows, other types of services such as freight and shipping, and the inflow and outflow of capital.

The floating exchange rate regime is an efficient means of achieving equilibrium in the balance of payments. For example, should the demand for foreign exchange exceed the supply at a given exchange rate, the external value of the Canadian dollar will decline. This promotes balance-of-payments adjustment by making imports into Canada relatively more expensive and our exports relatively less expensive in foreign markets; the excess demand for foreign exchange is eliminated and the balance of payments returns to a more sustainable position. Should the demand for foreign exchange be less than the supply at a given exchange rate, adjustments which are similar in nature but opposite in direction to those outlined above would occur. It is difficult, however, to make general statements about the quantitative impact of exchange rate movements on trade flows. In part, this is because of the length of the adjustment process (which is spread out over several years), that follows a depreciation or appreciation of the currency. In part, it is because the effects depend upon the economic environment in which the exchange

rate change takes place and whether the movement is a reflection of market forces or a policy initiative. Furthermore, there are inherent rigidities in any market economy which inhibit rapid and complete adjustments influenced by such factors as the corporate structure, trading patterns, distribution patterns, etc. Thus, there does not exist a perfectly equilibrating system.

In addition to the direct effects of exchange rate changes on the flow of exports and imports operating through the changes in prices for Canadian-made products relative to foreign ones, there are secondary or indirect effects which typically run counter to the direct effects. For example, an improvement in the trade balance following a depreciation serves to raise employment and output in Canada. This in turn raises the demand for imports and dampens the initial improvement in the trade balance.

For the most part, market induced adjustments are a reflection of the exchange rate playing its usual role of facilitating adjustment in the balance of payments and it is in this context that an appreciation or depreciation is likely to be sustainable and effective in influencing trade flows. This was noticeably the case, for example, in the second half of the 1970s, when there was a large decline in the external value of the Canadian dollar which reflected a deterioration in Canada's international competitive position. For several years prior to 1976, wage and price increases in Canada generally exceeded those in the United States, which accounts for close to 70 percent of our merchandise trade. As a result, Canada's international competitive position was undermined, with adverse consequences for our current account balance. This was reinforced by declines in international prices for many of Canada's export commodities. Adjustment in the exchange rate was delayed, however, by large-scale capital inflows which peaked in 1976. A sizeable and rapid downward adjustment in the external value of the Canadian dollar followed. From October 1976 to February 1979, the Canadian dollar depreciated by some 19 percent against the US dollar and by some 23 percent against a trade-weighted index of Group-of-Ten currencies.

The benefit from the decline in the Canadian dollar came in the form of restoring our international competitive position and facilitating the establishment of a sustainable balance of payments. To some degree this is reflected in developments in Canada's merchandise trade balance; from a deficit of $0.5 billion in 1975, the merchandise trade balance improved to a surplus of $8.5 billion in 1980. The gains were particularly noticeable in manufacturing, where exports expanded at a rapid pace while imports were restrained. The difficulties of the automobile industry in recent years, however, obscure this picture to some extent.

On the other hand, an exchange-rate change which is imposed rather than flowing from the balance of payments itself is unlikely to have any permanent effect on trade flows and is not an appropriate means for achieving commercial policy objectives. This is because such a change creates disequilibrium in the balance of payments rather than correcting it. A new, lower exchange rate would either be forced up by the market or would generate domestic price increases which would reverse the relative price effects of the exchange rate change. The latter could result, for example, if monetary policy were used to manipulate the exchange rate downward. Finally, it should be noted that deliberate action to force the exchange rate down in

order to gain a competitive advantage would run counter to international commitments and would encourage retaliatory action by other countries.

Our major trading partners, like ourselves, have an international obligation not to follow predatory exchange rate policies. As a practical matter, most frictions occur when a country introduces trade restrictions in order to bolster a currency which otherwise would have been over-valued. Such measures were more common under a system of pegged exchange rates than they are today.

Canadian exchange rate policy, under the present floating rate regime, has been to allow the exchange market to play its role of promoting adjustment in the balance of payments. There has been no attempt, by the authorities, to achieve or maintain a particular exchange rate. While remaining committed to a floating exchange rate, the Government does intervene in the foreign exchange market with a view toward maintaining orderly trading conditions, thereby facilitating Canadian international trade and finance. In addition to intervention, monetary policy has been used to moderate exchange rate fluctuation to some extent; the relationship between monetary policy and trade is discussed in the next section of this chapter.

Apart from day-to-day volatility in the exchange rate, which intervention is designed to dampen, there has been concern in some quarters that the uncertainty associated with longer-lasting and more pronounced exchange rate movements could have a depressive effect on the volume of international transactions. Yet international trade continued to be a buoyant feature of the world economy during the 1970s. For the OECD countries as a group, the ratio of exports or imports of goods and services to GNP increased during the past decade, even after allowing for the effects of higher petroleum prices. Concern with exchange rate variability has been more pronounced in Europe than in Canada, and this has largely been a reflection of the greater volatility in recent years of these currencies relative to the US dollar. Nevertheless, practically all recent empirical studies of the influence of exchange rate variability per se on the volume of trade, including studies carried out at the International Monetary Fund, have failed to uncover any statistically significant effects. Indeed, efforts to maintain an exchange rate which is no longer appropriate to underlying economic conditions is likely to prove more disruptive of international commerce than are movements in the rate.

Both exchange-rate movements and tariff changes affect the competitive position of Canadian industry. At first sight, in view of the variability of exchange rates over the past decade and the progressive lowering of tariffs in the post-war period, it is tempting to think that tariffs remain of little consequence. Exchange rate changes, however, affect the competitive position of export industries and import-competing industries in an across-the-board manner, while tariffs, which are not uniform across all imports, affect the structure of relative import prices and the relative position of import-competing firms and exporting firms relative to other domestic and foreign firms. Thus, whatever the level of the exchange rate, tariffs still have an effect on relative prices of goods and services and consequently on resource allocation.

Monetary Policy and Trade

Monetary policy can play a constructive role over the medium and longer term in supporting Canada's trade performance by promoting a return to reasonable over-

all price stability; this helps safeguard and improve Canada's competitive position and the ability of markets to allocate resources efficiently. The use of monetary policy to manipulate the exchange rate, however, will yield at best only a short-term advantage and would run counter to the more basic and longer-term contribution which monetary policy can make.

Since the mid-1970s, monetary policy has been conducted within a medium-term framework with the basic objective of reducing inflation through controlling the rate of monetary expansion. In implementing this policy, the Bank of Canada has set target bands for the trend rate of growth of money — narrowly defined as the public's holdings of currency and demand deposits at chartered banks. Over the years, the target bands for monetary growth have been progressively reduced. The Bank of Canada does not adhere to the target bands in a slavish way; it has always held that monetary growth could occasionally move outside the target bands without violating the intent of the policy or compromising its principal objective.

Monetary policy has been used, to a limited degree, but most noticeably over the past three years, to dampen erratic movements in the exchange rate. However, as in the case of direct official foreign exchange market operations, the authorities have attempted neither to establish a particular exchange rate nor to prevent the exchange rate from moving when fundamental factors appeared to dictate otherwise. Monetary policy initiatives in this area have been related to short-term financial pressures, primarily from abroad. The course followed by the authorities has been to allow some of the impact of these pressures to fall on domestic interest rates and some to fall on the exchange rate, avoiding an extreme in either direction.

Underlying the attention paid to the exchange rate in the conduct of monetary policy has been a concern with the asymmetrical impact that sizeable and rapid temporary declines in the rate could have on the course of inflationary pressures in Canada. For the most part, since targets have been adopted, there has not been a conflict between the Bank of Canada's concern with the exchange rate and the target bands, and there has been no conflict with the Bank's objective of containing inflationary pressures.

A number of observers have suggested that monetary policy could be used deliberately to manipulate the exchange rate down, thereby giving Canadian exporting and import-competing firms a competitive edge. As suggested in the previous section, such a policy has little chance of success and Canada has an international commitment not to engage in competitive depreciations. It is through its control over the rate of monetary expansion that the Bank can influence the course of interest rates and the exchange rate. The rate of monetary expansion would have to be stepped up in order to lower interest rates and thereby the exchange rate. However, an acceleration in the rate of monetary expansion would facilitate an acceleration in the rate of increase of prices, with a decline in the exchange rate abetting the increase. The gains in competitiveness, due to a lower exchange rate, would be short-lived as prices in Canada would rise.

In the short-run, before prices have fully adjusted, the effects of monetary expansion on the trade balance are not completely clear. While a reduction in domestic interest rates would put downward pressure on the exchange rate thereby working

to improve the trade balance, it would also encourage domestic demand, particularly investment and consumer durable expenditures, which would work to reduce the trade balance. The resolution of these short-run effects is difficult to determine; however, in recent years, the long-term price effects, which ultimately dominate, appear to come to the fore more quickly than in the past. The balance of evidence strongly suggests that an exchange rate which is imposed, either by direct intervention or indirectly through the use of monetary policy, rather than flowing from the balance of payments itself, is unlikely to permanently affect trade flows or achieve commercial policy objectives.

The weak pace of world economic activity over the past few years is attributable, in some measure, to the height of interest rates and the resulting economic slowdown has placed strains on the international trading system and encouraged protectionist pressures. High interest rates are in part an offshoot of the existing non-accommodating monetary policies being pursued in most industrialized countries. Inflationary expectations and large budgetary deficits are other major causes. Canada continues to support the non-accommodating macro-economic policies being followed by most countries, while recognizing that the weak pace of economic activity engendered by such policies in the short-run is leading to increased pressures on the trading system. In view of such risks, we have supported attempts at further dialogue in both the GATT and the OECD Group on Positive Adjustment (with the latter being specifically charged to examine the interactions between the macro-economic environment and the trading system). It needs to be recognized, however, that over the medium to longer term, pressure on the trading system will be even greater if demand management policies are not sufficiently firm and consistent to bring about the permanent lowering of inflationary expectations necessary to sustained growth. This will unavoidably involve interest rates which are considerably above historical averages.

From another perspective, some Canadian exporters have argued that high interest rates are inhibiting their ability to compete on world markets. However, an exporter's overall competitive position is determined by a variety of factors, including production costs, of which interest rates are only one element. It should be noted that the weight of interest costs in total costs varies considerably from one producer to another. For the most part, producers in other countries are in a similar situation. Additionally, exchange rate movements would offset, to a large degree, sudden changes in the underlying relative costs of production among countries. Accordingly, there would seem to be no justification for singling out a particular element of cost as worthy of relief, especially as relief for one category of costs such as interest costs would be discriminatory, costly relative to potential benefits, and inefficient from a resource allocation standpoint.

Foreign buyers of Canadian goods and services are also affected by the high level of interest rates in the world. Under these circumstances some governments have used subsidized export financing to achieve a competitive advantage which has in turn led to a proliferation of similar programmes. The OECD Export Credit Arrangement was negotiated as a set of ground rules to limit the distorting effects of competitive subsidization of export credits. As most countries have recognized the trade distorting effects and waste of resources involved, it can be expected that

efforts will continue to reduce further the element of subsidization allowed under the current Arrangement. The Canadian Government operates, through the Export Development Corporation (EDC), a responsive programme to ensure that Canadian exporters are not placed in a disadvantageous position as a result of subsidized export financing provided by other governments. This programme has proved to be increasingly costly.

Fiscal Policy

One of the major developments in most industrial countries since the 1930s has been the increased responsibility assumed by governments for the allocation of resources in their economies, for managing the overall level of economic activity, and for bringing about changes in the distribution of income between different segments of society. Taxation, particularly personal income and corporate, has been one of the important tools used by governments to achieve these objectives. Domestic corporate taxation does not normally have explicit commercial policy objectives. However, to the extent that domestic taxes may not be neutral between sectors or between foreign and domestic goods and services, and to the extent that foreign and domestic tax rates are different for the same traded goods, post-tax relative prices may change, thus influencing trade and investment flows. For example, accelerated depreciation allowances for the secondary manufacturing sector clearly have a direct impact on both investment in that sector as well as on the competitiveness of the firms able to take advantage of these influences.

Corporate income tax influences Canadian trade patterns in at least three distinct ways. First, it has a direct effect insofar as it affects prices of goods produced in Canada. Second, there may be output effects due to the influence of corporate tax on the allocation and efficient use of resources. Third, it may affect the location of industry, both interregionally and internationally, and, consequently, Canadian trade patterns.

In looking at the question of the corporate tax effect on prices (and therefore on trade flows) two factors are important: the incidence of corporate tax, i.e., the degree to which the corporate tax can be passed on to the consumer; and Canadian corporate taxes relative to the corporate taxes of our trading partners.

Regarding the incidence of corporate income tax, it is widely held that corporate tax is largely shifted and that, at least in theory, the corporation pays little, if any, tax, i.e., corporate tax becomes a cost of doing business. If this hypothesis is true, we must conclude either that the tax has been entirely passed along to consumers in the form of price increases or that it has been shifted backwards to labour, or possibly to some combination of both. If we assume that all the corporate income tax is reflected in higher output prices, the question then arises as to the impact of such price increases on the competitiveness of Canadian industry, both in the domestic market and the export market. The higher the corporate tax element included in prices, the less competitive are Canadian products with imports and with competing goods in export markets. There is, of course, an upper limit on how much the cost of the corporate tax can be passed on through higher prices; as consumers switch from high-cost Canadian products to imports or substitutes, production declines, unem-

ployment increases, and trade is adversely affected. To regain its market share, the Canadian industry, all other things being equal, would have no alternative but to absorb some or all of the tax. In this situation, i.e., where the tax is not passed on in the price of the product and is paid from funds which would otherwise be available to the firm as profits, the net result would be a reduction in the availability of funds for new investment in plant, research, etc., or for the payment of dividends.

In this connection, certain tax practices have been introduced over the years with a particular view to their impact on trade and investment. Probably the most important of these has been the DISC (Domestic International Sales Corporation) established by the USA to enable its firms to defer the payment of domestic income tax on their earnings from exports in excess of the level in a base period. Partially as a response to the DISC, Canada made a substantial reduction in the corporate tax rate applying to secondary manufacturing in order to offset the effect of the DISC as an incentive to US firms to supply the Canadian market with goods from the USA through a DISC rather than produce the goods in Canada. The DISC has been the subject of examination under GATT dispute settlement provisions and found to be inconsistent with US GATT obligations (any future similar system is prohibited under the GATT Subsidies/Countervailing Duties Code), and the US Administration has indicated it is considering amendments to the legislation.

Although it is beyond the scope of this paper to attempt a comparative analysis of Canada's corporate tax system with that prevailing in other countries, it is clear that taxation policies can have significant indirect effects on commercial policy goals and objectives. Lower corporate taxes in Canada than in other jurisdictions can be a positive factor influencing the decisions of foreign firms to locate here. Furthermore, as tariffs are progressively lowered, corporate tax rates become relatively more important in determining competitiveness, and trade policy considerations need increasingly to be taken into account in setting tax policy. In this connection, a comparison of aggregate corporate income tax as a percentage of corporate profits between Canada and the USA over the period 1972-77 shows that Canada has had a lower corporate tax rate; hence, Canadian producers at present are probably not at a competitive disadvantage with firms in the USA as a result of Canadian tax policies.

However, the Canadian export business community has expressed the view that "there is little in Canada's taxation policy which caters to export operations. . . ." In reports to the Export Trade Development Board, private Canadian consultants have identified a number of corporate and private tax disincentives and the Board is undertaking a study of Canada's tax system.

The impact of direct and indirect tax measures on trade has been clearly recognized for many years, and this is fully reflected in the GATT. Article III of the GATT provides for national treatment on internal taxation measures and the GATT Subsidies/Countervailing Duties Agreement, in an annex identifies a number of tax practices as illustrations of prohibited export subsidies.

Indirect taxation policies can also affect trade and investment. The GATT requires that such taxes be imposed on a non-discriminatory basis, i.e., domestic products are taxed at the same rate as imported products and thus are neutral. In practice, however, there can be distortions. For example, the current basis for levying

federal sales tax on imports into Canada is the duty-paid value of the goods, whereas domestically produced goods are subjected to the tax on the manufacturer's selling price. It has been claimed for a number of years that this system gives an advantage to imports as the value for duty of imported goods does not include freight costs and other costs implicitly included in the sales tax base for domestic goods. Proposals are currently being examined to address this problem. Similarly, provincial indirect taxes may affect international trade. For example, a few years ago Ontario imposed a differential rate of sales tax as between imported and domestically produced automobiles. In the light of the reaction of our trading partners, Ontario withdrew the differential element of this tax.

Investment Policy

With certain major exceptions, Canada generally follows a policy of government non-intervention in the investment process. By and large, private sector decisions on the location, type and level of investment in activities producing goods and services are market-based, and firms are usually able to make desired investments through the application of retained earnings or through the injection of new debt or equity capital. However, where investments are considered to be desirable or necessary in order to meet broad economic development objectives (e.g., to eliminate regional disparities, to attract new industry, to strengthen the international competitiveness and export performance of Canadian industry, or to facilitate structural adjustment), federal and provincial governments in Canada have instituted a number of fiscal, economic, and non-financial measures designed to encourage investment in particular activities or regions.

Federal measures include tax incentives and grants, loans and loan guarantees which are dispensed through federal departments such as Industrial and Regional Expansion or through special agencies or crown corporations. Some of these programmes, such as those managed by the Cape Breton Development Corporation or the Canadian Industrial Renewal Board, are directed at certain regions or industries — while others are available nationally to all industries. Investment incentive programmes vary at the provincial level, but generally include the provision of technical assistance such as information and financial assistance in the form of subsidies, loan guarantees and participation in share capital.

Historically, opportunities for investment in Canada have usually been greater than available savings from Canadians. Consequently, Canada has been a large importer of foreign capital, both in the form of new foreign debt and equity capital (direct foreign investment) and in the form of reinvested earnings by foreign-owned firms already established in this country. In these circumstances, capital inflows were encouraged by both federal and provincial governments as they stimulated levels of industrialization and development that could not otherwise have been achieved. At the same time, the relatively high rate of foreign investment resulted in levels of foreign ownership and control of certain sectors of the Canadian economy, much higher than those experienced in most other industrial nations. For example, according to the most recent Calura data (for 1978), 47 percent of Canadian manufacturing industries, about 40 percent of mining and smelting, and about 65 percent of petroleum and natural gas industries are controlled by residents of other countries.

As early as the 1950s, the level of foreign ownership in Canada became an important issue of public policy concern. In response to this concern, general measures were introduced to provide safeguards aimed at ensuring that certain vital national interests were protected and maintained. These included legislation or regulations covering key sectors of the economy, i.e., banking (1967), other financial institutions (1970), insurance (1964), broadcasting and communications (1968) as well as direct government participation in transportation, nuclear energy, broadcasting and, more recently, oil and natural gas exploration and production. Other specific measures introduced to facilitate and encourage the growth of profitable Canadian-controlled businesses included the establishment of the Canada Development Corporation.

The Foreign Investment Review Act (FIRA), adopted in 1973, constitutes the major legislative response to public concerns about the high percentage of foreign ownership. The purpose of the FIRA, however, is not to discourage or prevent foreign investment, but rather to ensure that its attendant benefits do in fact accrue to Canada. Under the Act both foreign takeovers and new foreign-owned businesses in Canada are allowed, provided a "significant benefit" to the country can be demonstrated or anticipated.

The most recent response to foreign ownership is the National Energy Programme. Its policy is intended to promote increased national participation, ownership and control in the domestic petroleum industry and to ensure a more equitable distribution of wealth arising from energy development.

There are no regulations on outward direct investment transactions or retransfers from Canada. The bulk of this investment has been directed to the United States and United Kingdom, countries which generally welcome direct investment but which also restrict or prevent foreign investment in certain sectors for national security or economic policy reasons. In the United States, for example, restrictions prohibit direct investments by non-resident aliens in enterprises engaged in intercoastal shipping, domestic radio, telegraph, television, and domestic air transport. Other restrictions exist on investments by aliens in enterprises engaged in coastal shipping, mining on Federal lands, hydro-electric power production, the utilization or production of atomic energy and in the Communications Satellite Corporation. In the UK, it is generally understood that the British government would be unlikely to welcome the acquisition of a substantial interest in or control of a UK company regarded as vital to the national economy. Restrictions on foreign direct investment in certain key sectors exist in most other OECD countries. Some, such as Australia, have a form of screening mechanism similar to FIRA.

Canadian policies regarding inward and outward investment are influenced and regulated to some extent by various multilateral codes and conventions that provide guidelines to both investors and host governments after a foreign investment has taken place. Within the OECD, Canada has subscribed to the Code of Liberalization of Current Invisible Operations and to the Declaration on International Investment and Multinational Enterprises. The Declaration is more important in terms of its effect on investment policies. At the time Canada adhered to this Code, the government indicated that it would continue to retain its right to take measures affecting

foreign investors given the uniquely high level of foreign ownership in Canada. A third OECD Code to which Canada did not adhere governs the liberalization of capital movements. Canada decided not to adhere to this Code in 1961 in part because it was largely oriented to circumstances in Europe. Canada maintained liberal conditions and did not wish to commit itself to further liberalization at a time when many European countries practised exchange controls. Interestingly, while this code provides for certain investor rights after an investment has been established in a host country, it does not appear to include the broader privileges usually associated with the right of establishment. In the UN context, negotiations are underway on two codes relating to multinational enterprises, the Code of Conduct for Transnational Corporations and the Code on the Transfer of Technology. It is not apparent that either Code will have a significant impact on Canadian investment policies.

Investments, including domestic capital formation through the application of retained earnings and domestic and foreign debt and equity borrowings, are a prerequisite for economic growth and development. To the extent that Canadian investment policy encourages or discourages investment in Canada, this policy has a direct impact on Canada's commercial policy. For example, investment policy can lead to increased industrial efficiency by providing increased competition and improved technology. It can also increase production and employment, reduce imports, increase exports and stimulate growth in less developed regions. Domestic investment, however, may be more successful than foreign investment in meeting certain broad development objectives because MNEs sometimes organize operations in a manner that may conflict with the attainment of national objectives. For example, the parent corporation may attach onerous export, procurement, licencing or franchising conditions to the operation of their foreign subsidiaries. Subsidiaries may also be affected by home country laws such as strategic export controls, fiscal policy measures or anti-trust laws.

Some of Canada's *investment incentives* and *assistance* programmes also have a direct and indirect effect on Canada's international *trade position.* Applicants for grants and loan guarantees under the Regional Development Incentives Act, for example, must provide Canadian manufacturers with a reasonable opportunity to supply eligible machinery and equipment where they are competitive in performance, price and delivery date. Similarly, FIRA is also required to take into account the impact of foreign investment applications on the level and nature of economic activity in Canada, including trade.

Recently, the United States has intensified its complaints about *trade-related investment issues* linked to investment in Canada, and more particularly, about Canadian "content requirements", "export performance requirements", and "limitations on distribution activities". The US government believes these alleged requirements and limitations are contrary to the national treatment provisions and/or to other provisions of the GATT and entered into consultations on this matter with Canada. Canada agreed to the establishment of a GATT panel whose report will soon be considered by the GATT Council. Generally, we have sought to link any examination of trade-related investment incentives and disincentives, including so-called performance requirements, to an examination of the trade-distorting behavior of MNEs and home governments and of the reasons why capital-importing countries feel obliged to implement investment screening and monitoring programmes.

To the extent government investment and incentive programmes operate to reduce production costs, they may be viewed as subsidies and, as such, subject to international rules in this area, specifically those of the GATT and of the Code on Subsidies and Countervailing Duties. While subsidies other than export subsidies (which are prohibited) are generally recognized by the GATT Code as legitimate instruments for the promotion of social and economic policy objectives, there is an obligation not to use such subsidies so as to cause injury or serious prejudice to the interests of another signatory. If they do, the Code provides remedies.

Competition Policy

Competition policy is one of the oldest and most fundamental instruments of Canadian economic policy. Its basic objective is to protect the effective operation of the Canadian market economy based on the premise that generally a market system will give better results in terms of economic and industrial performance and growth than any alternative systems of industrial organization. Canada's competition policy is founded in the *Combines Investigation Act*, a set of laws designed to ensure that competition in the Canadian economy, whether of domestic or foreign origin, should remain strong enough to keep markets in Canada working effectively, to encourage firms to produce products which have a comparative advantage, to innovate and adapt innovations developed at home or abroad, and to pass on to consumers the benefits of such innovations.

Competition policy laws play an important role in preventing or reducing artificial barriers to trade and commerce in the domestic economy and in this regard Canada's competition and trade policies are strongly complementary and mutually reinforcing. The small size of the Canadian market relative to the markets available to most of its major trading partners has meant that competition policy law in Canada has had to accommodate the need for firms in many industries to grow large relative to the size of the market in order to attain the economies of scale necessary to be efficient and internationally competitive. As a result, concentration in Canada is greater in some sectors, especially the distributive trades sector, than that of most of its major trading partners. In such circumstances, public policy has had to rely to a substantial degree on the presence of foreign competition to preserve an effectively competitive environment over a range of Canadian industries. As tariff and non-tariff barriers have been reduced in the post-war period and markets have become more integrated domestically and internationally, domestic firms have received the necessary impetus to make their operations more efficient, to become more specialized and innovative and internationally competitive. On the other hand, competition policy, by preserving a competitive environment in the domestic economy, has facilitated the movement toward freer trade by playing an important role in maintaining effectively working markets domestically.

The Combines Investigation Act consists of provisions dealing with conspiracy, mergers and monopolization plus a number of provisions dealing with specific anti-competitive practices such as resale price maintenance, predatory pricing, misleading advertising and several marketing practices capable of being used in an anti-competitive manner in specific circumstances (e.g., refusals to deal and tied selling arrangements). The design and enforcement of the various provisions of the Act have always been conditioned by Canadian economic realities. Thus Canadian competition policy

laws have focussed more on behavioural issues and less on structural issues than is the case with US anti-trust laws. For example, mergers which would result in extremely high levels of industrial concentration and which would be prohibited in the United States, are permitted in Canada where they do not result in competition being reduced to the detriment of Canadians. Similarly, monopoly is permitted under Canadian law, but anti-competitive abuses of monopoly positions are prohibited. Finally, combination agreements among Canadian firms are permitted except where such agreements would unduly lessen competition.

The Combines Investigation Act explicitly exempts export consortia from the application of the conspiracy provision of the Act except where such agreements would have adverse effects on Canada's export trade or would unduly lessen competition in the domestic market. The Director of Investigation and Research in his annual report of 1980-81 identified a set of standards of conduct in respect of export consortia which would ensure compliance with the Act.

The state of foreign competition has always been one of the most important elements in the enforcement of the Combines Investigation Act. Under Canadian law, judgements about the state of competition and thus the need for application of the law, are generally based on the concept of an identifiable market. The courts, in defining the market and in determining competitive effects, recognize the role that foreign competition plays in providing competitive alternatives for producers and consumers. Furthermore, in recognition of the important connection between competition policy and trade policy, the Combines Investigation Act gives the Governor-in-Council the authority to reduce or remove tariff protection where he is satisfied anti-competitive practices are being facilitated in Canada by the existing levels of tariff protection. However, this provision has never been relied upon in fact.

The anti-trust law of the United States is applied extra-territorially in a number of instances. The United States takes the general position that it will apply its anti-trust laws extra-territorially where the anti-competitive conduct in question is adversely affecting competition in US markets. Canadian competition policy law is not applied extra-territorially. In order to apply Canadian law at present, the anti-competitive activities in question must at least in part have been carried out within Canadian jurisdiction. The extra-territorial application of US anti-trust laws can have effects in Canada which may or may not be in the Canadian public interest. In recognition of this, the Combines Investigation Act contains a provision allowing the Restrictive Trade Practices Commission to prohibit Canadian firms from implementing measures required as a result of a law in force in other countries where such measures would adversely affect trade or commerce in Canada without compensating advantages. Serious international problems have arisen in respect of the extra-territorial application of laws in this area, and there is a recognized need for more effective international cooperation and coordination in the application and enforcement of competition policy laws.

The usefulness of some degree of cooperation between the enforcement agencies of Canada and the United States was recognized many years ago. An informal Anti-trust Notification and Consultation Procedure between the two countries was developed (the Fulton-Rodgers Understanding) in 1959. In 1969, following discussions between the Minister of Consumer and Corporate Affairs and the Attorney General

of the United States, a joint statement was released which reaffirmed the Antitrust Notification and Consultation Procedure of 1959 and extended cooperation in the light of a 1967 OECD Council Recommendation.

In 1979, the OECD Council recommended "cooperation between Member countries on restrictive business practices affecting international trade" in terms of notification by a member country undertaking an investigation of restrictive business practices or legal proceedings to any country whose substantial interests are involved; coordination of member countries' action to remedy the harmful effects of restrictive business practices which affect international trade; and exchanges of information.

Cooperation and consultation between the governments of the USA and Canada in respect of international anti-trust matters has continued at the ministerial level through successive administrations. The two governments are currently close to agreement on the principles of a consultative mechanism for pursuing this issue. Similary, in respect of Canada-EC anti-trust matters, there is an arrangement for the exchange of information where feasible and consultations when necessary.

The Combines Investigation Act also contains a special provision designed to prevent conspiracies entered into abroad by the parents of Canadian subsidiaries from being implemented in Canada where such agreements would unduly lessen competition in Canada. The conspiracy provision prohibits similar agreements among Canadian and foreign firms. These provisions help to ensure that international trade is not made the subject of artificial barriers to the free flow of goods and services.

The major outstanding issue in respect of Canada's competition policy and its relationship to trade policies is the competition law reform programme initiated some ten years ago. Under existing proposals, for example, specialization agreements among firms and mergers would be allowed even if they would otherwise be illegal under the existing provisions, if they would give rise to significant real cost economies. Furthermore, structural adjustments and agreements among firms which could not otherwise be supported from a public policy viewpoint, would be allowed where accompanied by tariff reductions or duty remissions sufficient to maintain reasonably competitive conditions in Canadian industries.

Industrial Policies

A fundamental dimension of the government's economic development priorities for the 1980s is industrial renewal through modernization, rationalization and the creation of alternative employment opportunities. The success of these efforts will be a factor critically important to Canada's trade performance during this decade. In addition, the economic development policy framework stresses the need to exploit the strong innovative capabilities of Canada's human and technological resources and further the development of exports of advanced technology and high productivity goods and services in those areas where Canada has or can develop excellence internationally. These policy objectives underline the importance of achieving improved productivity performance in order for the Canadian economy, particularly in Ontario and Quebec, to experience a strong international trade performance.

With respect to resource-based sectors, the government's economic development policy objectives for the 1980s emphasize major opportunities ahead for the development of the rich bounty of Canada's natural resources across the country and for their further processing in Canada. Resource and infrastructure development projects across the country create an occasion to strengthen further the supply capabilities of the related resource-based machinery, equipment and service sectors, all of which have already demonstrated a capacity to compete in world markets.

In order to meet these objectives, industrial, fiscal, regional and trade policy instruments must be mutually supportive so that benefits can be derived from participation in major projects on a continuous basis.

Resource Upgrading

Almost a decade ago, in July, 1973, the Canadian government announced a policy framework to encourage processing of Canadian renewable and non-renewable resources prior to export whenever such processing would be internationally competitive and compatible with the development of a sound industrial structure. This policy stemmed from the concern that a high proportion of Canada's exports of a wide range of natural resources to world markets is in relatively unprocessed form, even when it would appear that Canada has a comparative advantage in shipping in a more processed form but is inhibited from so doing by artificial, non-market constraints.

Adding value through further processing prior to export can facilitate forward integration of Canadian manufacturing industries, provide opportunities to mitigate regional disparities within Canada (e.g., zinc smelting in New Brunswick, asbestos products in Quebec, and copper smelting and refining in British Columbia), and generate spin-off demand for new industrial construction, as well as machinery, equipment, or auxiliary services. Location in Canada of one or more additional steps in the vertical integration of a resource industry provides a greater attraction for such activities as research and development, product design, and engineering, which might otherwise be located outside Canada.

Trade barriers in foreign countries, especially the larger industrialized countries in Europe, and Japan, are a significant disincentive to further processing of Canada's resource exports, particularly as tariffs escalate between the less-processed and more-processed stages of production. A higher tariff on, for example, copper bars and rods, has made it more profitable to ship copper ores and concentrates, even though the production of rods and bars would increase Canadian jobs and value-added. One of Canada's major objectives at the Tokyo Round of multilateral trade negotiations was the reduction of foreign trade barriers in resource-based products, specifically in the non-ferrous metals and forest products sectors. For this purpose Canada proposed sector negotiations aimed at eliminating or reducing to the greatest extent possible all the barriers that affect trade in the various forms of a particular resource product. Sector negotiations were also felt to be the most appropriate context in which to consider demands from other countries for greater international discipline to govern exports of natural resources.

Although many of our trading partners were not prepared to cut tariffs in these sectors to the extent proposed by Canada, a number of Canada's objectives for these

sectors were achieved. The US tariff reductions in forest products, in effect, fully responded to the tariff-cutting component of the Canadian proposals. In addition, the USA made major concessions of importance to Canada which resulted in the reduction of tariff escalation on more highly processed non-ferrous metal products. In other major markets, the Tokyo Round resulted in some significant reductions in effective tariff protection accorded to processing activities, but left intact other trade barriers to upgrading of Canadian resources prior to export.

The opportunities for achieving further processing of Canada's resource exports have also been pursued in various bilateral discussions. The Japanese government, for example, in the face of declining self-sufficiency, security of supply concerns, environmental problems, and increasing energy prices, has recently expressed renewed interest in the possibility of importing resources from Canada in more processed forms. A Canada-Japan Working Group on Resource Processing has been established to examine the potential in this area, including the possibility of Japanese investment in Canadian processing facilities.

The economics of processing, of course, are not only affected by foreign trade barriers or the industrial policies of major resource importing countries. For example, the relative costs of processing in Canada and the relative costs of transporting raw and finished products have not always been in our favour. The international structure of Canadian resource industries has also resulted, in many cases, in foreign-owned corporations being integrated backwards from home-based processing facilities into Canadian resource extracting activities and in Canadian-owned corporations being integrated forward into foreign markets.

Economic Renewal

The progressive restructuring of a number of manufacturing sectors is of strategic importance for strong and healthy Canadian economic development in the highly competitive international market place. Industrial renewal involves both the phasing down of less efficient activities and efforts to respond to new or emerging market opportunities. As stated in *Economic Development for Canada in the 1980s*, industrial renewal

> must both reduce the pressure for costly support to less competitive industries and at the same time provide alternative employment opportunities in higher productivity and higher wage sectors. When governments are called upon to support uncompetitive industries and firms to protect employment, all Canadians must share these costs. Unchecked, these constraints on the economy's productivity growth undermine Canada's trade competitiveness. When new investment opportunities are realized, when labour is employed more productively and efficiently, the benefits are shared by us all and Canada's trade competitiveness is enhanced.

In a broad sense, as industry responds to competitive changes such as emerging product, service or market opportunities or pressures from new suppliers, it is continuously engaged in a process of adjustment. This process occurs in all sectors as prod-

ucts pass through the life cycle from the idea stage through development, identification and exploitation of new markets, to the phasing out of products and processes that have become obsolete. Indeed, firms which do not adapt and respond to change, face stagnation and decline. Most industrial adjustment occurs smoothly in the normal course of business life within the industry or the region. During the 1960s and 1970s, however, some Canadian manufacturing industries began to experience increasing difficulties in successfully responding to the challenges of industrial restructuring. These industries were engaged in labour-intensive and/or standard technology activities for which comparative advantage was rapidly shifting towards Japan and, later, to the emerging newly industrialized developing countries. Many of these industries (e.g., textiles, clothing and footwear) are mature sectors concentrated in Quebec and Ontario. Towards the end of the last decade some of the traditionally stronger sectors, such as the automotive sector, began to face similar difficulties. In addition, international energy developments leading to substantial price increases have forced significant industrial adjustment and contributed to a shifting of relative industrial strengths and opportunities between various regions in Canada.

When circumstances warranted, Canada has had recourse to various import relief instruments or measures under its international trade agreements' rights and negotiated or imposed restrictions on imports into Canada. This has been the case, for example, for clothing and footwear. Such actions against imports are designed to provide assistance to the industries and communities concerned so that they can modernize and rationalize existing production capacities and find more rewarding and competitive activities for the labour, industries, and communities concerned. Furthermore, temporary border protection enables the pacing of industrial restructuring in a way that smooths out the process and avoids unreasonable social and community dislocations. A number of complementary funded programmes have been introduced to assist capital, labour and communities to adjust to changing competitive circumstances and improve the efficiency with which capital and human resources are allocated within Canada. The Industry and Labour Adjustment Program (ILAP) and the Canadian Industrial Renewal Board (CIRB) are two major recent initiatives designed to help Canadians to meet positively the demanding challenges of these "downside" aspects of industrial renewal in the 1980s.

The other aspect of the industrial renewal and adaptation process is the capacity of domestic producers in different regions to take advantage of new, emerging opportunities at home and abroad. This capacity is significantly influenced by the extent to which innovative technology is applied and the new electronics revolution is fully used. Commercial application of fundamental R&D, new or improved materials, production processes, products and systems, are the keys to improved productivity, efficiency and international competitiveness. While innovation is most often thought of in terms of advanced technology (e.g., aerospace and electronics), innovation in fact permeates both advanced and standard-technology industrial activities. Innovation in production process through numeric control, robotics and other elements of computer-aided design and computer-aided manufacturing (CAD/CAM) will be vital across a wide range of industrial activities. With the electronics revolution underway, Canada's industrial innovation performance in the 1980s will be a factor crucial in determining Canada's success in both domestic and international markets. Similarly, the use of electronics to handle data will have a significant impact on

improved efficiencies and effectiveness in service industries. For example, management support systems that integrate the modern capabilities of data sources, mathematical models and computers into potent management tools will further enhance the competitiveness of firms in fields such as architecture, data processing, consulting engineering, law, insurance, finance and business consulting services. Based on these considerations, industrial innovation was identified as one of the main industrial development priorities of the government's economic development policies for the 1980s. Thus, industrial innovation must also be a key element of Canada's trade policies for the decade.

To date, Canada's innovation performance and the industry's response to the technological challenges have not made the best use of Canada's human, capital and natural resources. While there are outstanding examples of Canadian innovation in a number of major sectors such as aerospace, electronics, urban transportation equipment, telecommunications, and nuclear power generation, much of the manufacturing sector fails to exhibit either the willingness or the capacity to undertake industrial innovation. Canadian firms, with some exceptions, are technological followers with limited indigenous R&D capabilities, relying on foreign sources for new technology. To some extent this level of industrial innovation can be traced back to a lower R&D effort in Canada compared with other major industrialized countries. Innovation may be a costly and risky process for many Canadian-owned small- and medium-sized firms. Furthermore, they may not have the resources necessary to undertake major R&D programmes leading to new products that could be exploited internationally. Similarly, Canadian subsidiaries frequently do not have the necessary incentives to innovate beyond adapting the technology provided by the parent multinational to the requirements of the Canadian market. Over the longer term, however, the key to strengthening the manufacturing sector's performance and reversing the deteriorating trade deficit in manufactured products lies in the commercial application of R&D, i.e., ensuring that innovation responds to major market needs.

The nature and magnitude of the challenges posed by industrial adjustment and innovation will require the pursuit of mutually supportive domestic and international policies if Canada's international competitive position is to be strengthened. Exports should be expected to become an increasingly significant dimension in corporate decisions. Such firms should be encouraged to make the necessary and substantial investments in products and production processes in areas of Canadian comparative advantage. Liberal and secure access to foreign markets will therefore be more important than ever for the attainment of industrial development objectives over the next decade. Conversely, the effects of the new electronics revolution cannot be stopped at the border and, in order for Canadian manufacturing, resource processing, and service industries to have access to competitive new technologies developed by the new electronic revolution, there will be a need to maintain access conditions to the Canadian market as open as possible. Imports of technology either through industrial purchases, licencing arrangements, or in the form of capital equipment not competitively available in Canada, will also likely continue to provide an important instrument to foster industrial innovation and increase the productivity of Canadian industry.

Corporate Structure including Small Businessess

Many of Canada's secondary manufacturing sectors have historically had a high degree of foreign ownership, usually involving large multinational enterprises. This has been induced in part by Canada's past commercial policy, including tariff and foreign investment policies, which were aimed at the creation of a diversified manufacturing capability in a relatively small domestic market. The presence of foreign-owned subsidiaries in many sectors has resulted in the Canadian economy exhibiting many of the structural characteristics of a branch plant economy: sub-optimal scale production, lack of specialization, truncated operations, and limited indigenous R&D and innovation capabilities. As such, many subsidiaries are relatively high-cost producers, oriented to the domestic market, with little export potential and relying on foreign product and technology development. Moreover, these subsidiaries are often not well positioned to take advantage of new opportunities for further growth, especially in export markets.

The high degree of foreign control in the manufacturing sector also manifests itself in the nature and composition of trade between Canada and foreign countries, particularly the USA. A large proportion of exports and imports are intra-corporate transactions which, by their nature, tend to be much less determined by market or arms-length considerations. Canadian subsidiaries tend to import goods from their parent or affiliates abroad instead of sourcing from the domestic market and do not always have the same freedom or incentive to export to world markets. This has historically contributed to a relatively lower level of international competitiveness in much of the secondary manufacturing sector, in turn contributing to Canada's large deficit in manufactured products.

These weaknesses in the secondary manufacturing sector are a continuing cause for concern as international competitive pressures increase, while at the same time Canadian tariff levels decrease as part of international trade negotiations. Indeed, the gradual reduction in tariff levels has removed much of the original incentive to build branch plants in Canada and thus the search for other incentives to attract such plants and put existing subsidiaries on a more competitive footing. In addition, as newly industrialized countries emerge as potent competitors in standard-technology sectors and as they pursue industrial development in more technologically advanced sectors, advanced industrial economies are focussing on the knowledge-based and technology-intensive sectors as the prime potential source of economic growth and employment, and implementing new industrial adjustment policies for the traditional manufacturing sectors.

At the same time, multinational enterprises tend increasingly toward internationalization of business operations. Such enterprises are reorganizing and restructuring their operations on a specialized basis in order to take advantage of economies of scale on a world-wide basis, reduce costs, and eliminate transnational duplication. This is leading to intra-corporate transactions across national boundaries, for example in the establishment of materials/component supply networks, that may not accord with the host government's perceptions of what is required to meet its domestic industrial development objectives.

There have been a number of important efforts by the Canadian government and multinational enterprises to deal with the structural problems facing Canadian industry. The Canada-US Auto Pact, for example, implemented a North American product rationalization arrangement which provided for free trade in autos and original equipment and parts and for cost reductions and improvements in production efficiencies through the exploitation of plant scale and specialization. Although this approach has increased production levels, improved efficiencies, and created employment, the strategic decision-making and R&D functions have remained largely in the hands of the multinational parents, leaving the Canadian subsidiaries more exposed to technological and structural changes such as those currently sweeping the industry world-wide. There have been a number of production rationalization agreements in other sectors such as colour TVs and front-end loaders based on duty remissions.

Similarly, various government policies and programmes have encouraged the acquisition of world-product mandates by Canadian subsidiaries. Indeed, world-product mandating is the logical outflow of an environment where tariffs have been reduced to their lowest historical levels and their encouragement has gone hand in hand with tariff reductions. The potential of the world-product mandate approach was recognized and advocated in the 1975 guidelines on multinational enterprises' corporate conduct in Canada. World-product mandating typically involves a specialized responsibility granted to a subsidiary by a parent for a particular product or product line for world markets. While a product mandate can take a variety of forms, when fully extended it normally provides a subsidiary with full and exclusive responsibility for R&D, design and engineering, production, marketing and management for a product world-wide within the total parent organization. Companies such as Pratt and Whitney, Black and Decker, Litton, Garrett, and Westinghouse, are good examples of Canadian subsidiaries successfully building on world-product mandates within their multinational parents' organizations. In some sectors such as aerospace, the potential for world-product mandating has already been largely fulfilled.

The acquisition of a world-product mandate builds upon existing relationships within multinational enterprises and their strength in international markets so as to improve industrial capabilities and performance in Canada. Changing the role of a Canadian subsidiary to gear up for the world market rather than the small domestic market provides the opportunity to specialize in a more limited line of products and to increase and optimize the scale of operations, thereby improving manufacturing efficiency and reducing costs. In the face of increasing international competition, the Canadian subsidiary through its mandate is better able to withstand international competition and prosper as a separate entity.

Where the product mandate provides for autonomy and responsibility for R&D, the Canadian subsidiary is better equipped to pursue innovation opportunities and to develop new and spin-off products than if it simply relied on its parent company to allocate production to it on some rationalized basis. Since innovation will be so important to the viability of manufacturing firms in the 1980s, pursuing world-product mandates will clearly provide a major corporate instrument for existing subsidiaries to reorient their current operations toward a greater pursuit of innovation. With a product mandate the Canadian subsidiary will be better able to deal with changing international market conditions and to exploit emerging opportunities.

Adopting the specialization route in world-product mandates carries with it the realization or decision that other product lines could not be produced as efficiently in Canada. As part of the overall rationalization process, a new and more efficient cost base is created for selected export-oriented products, while other product lines are withdrawn to other facilities in the multinational organization. To fill in the resulting gap in the product line for the domestic markets, subsidiaries concerned (as well as competing companies) may be expected to increase imports of some products or components. In aggregate terms, as Canadian manufacturing firms specialize in export-oriented production lines, overall imports of end-products may be expected to increase at least commensurately. Acquiring the world-product mandate also carries with it some risk, as specializing in a narrower range of products exposes the subsidiary to the uncertainties of those markets. Thus the mix of products granted to the subsidiary and their relative export-market potential and success will determine the overall effect on the trade balance of the firm.

The experience of firms which have pursued their own product mandates sheds some light on the potential benefits that might be expected: substantial export-led sales growth, employment increases, substantial export earnings, new capital investment, R&D activities, and reductions in import content. Experience also tends to suggest that the fuller and more autonomous mandate seems to offer the prospects of a more secure and stable future for a branch plant than if the mandate were limited to intra-corporate plant rationalization. The latter improves cost-efficiency and short-term competitiveness but the full mandate provides greater autonomy and capabilities, and fewer constraints on the pursuit of opportunities.

World-product mandating is a rather specialized approach and its current and potential future application lies primarily in the technology-intensive secondary manufacturing sectors such as aerospace, automotive, electronics, electrical equipment, and machinery. The effective use and expansion of world-product mandating by subsidiaries in Canada depends significantly on the existence of liberal and secure access to international markets, as the security of access is a particularly important factor in the decision of a multinational corporation to allocate a mandate to a Canadian subsidiary. Of course, there are also a host of technical, managerial, and cost considerations, as well as a variety of governmental industrial policy and programme instruments which may be brought to bear in such decisions, including in certain cases, funded programmes or government procurement contracts.

International trade is important for many small and medium-sized Canadian owned firms. Although their share of total Canadian exports of manufactured products and services is inevitably modest (less than one percent), it is estimated that over one-third of small business manufacturers ship directly to foreign markets. A large number of small businesses also provide inputs to large exporting firms in the form of various components and services and thus significantly depend on the international competitiveness of these firms.

Small-sized manufacturing companies tend to become export-oriented when they reach a certain "critical size" (from $2 to $5 million in total sales). At that stage of their growth, the ability successfully to penetrate export markets or to sell to large multi-national firms become critical tests of their competitiveness, entre-

preneurship and technological excellence. The supply opportunities generated for smaller entities by the more autonomous subsidiaries of large foreign corporations are a key factor in ensuring the growth of small- and medium-sized firms to the critical size which seems necessary for independent export ventures.

Small- and medium-sized firms have some inherent strengths in competing for international markets, including their ability to respond quickly to changing demand and to supply to custom-made requirements. However, small businesses often lack good information on export opportunities, conditions in foreign markets and the requirements for selling abroad. With management often being their scarcest resource, assessing complex and time-consuming information is key to the trade performance of these firms. In this regard, much of government export marketing assistance such as PEMD is largely geared to the needs of the small business community. The ongoing efforts to deliver these programmes on a regional basis should be of considerable further assistance to them. Similarly, export financing assistance may be a determinant in the ability of small-and medium-sized companies to make export sales and to sustain the effort financially. These aspects of small business operations are discussed further in other parts of this review of trade policy, particularly in the section dealing with export market development.

Industrial and Regional Benefits

Approximately one-half of the projected $250 billion to be invested in mega-projects in Canada over the next two decades is related to hydrocarbon development and petrochemicals, and another one-third to electrical generation and distribution. This dominance of energy-related mega-projects suggests that international developments, particularly those related to energy, will be a major determinant in their realization. Indeed, falling oil prices have already affected the profitability and timing of energy-related major projects in Canada, Mexico, the USA and the North Sea.

Despite these uncertainties, and the likelihood that the total value of mega-projects may be lower than originally anticipated, such investments both in Canada and abroad will, nevertheless, provide a major stimulus to growth in Canada over the next two decades and will present new opportunities for Canadian industry in all regions. These opportunities will result in increased demands for the output of existing firms and industries, technological developments and requirements for new, technologically-advanced products, and greater exports. A number of Canadian industries are well placed to supply domestic mega-projects with such diverse products as compressors, generators, resource extraction and processing equipment, pipe and tubular steel products, vessels and equipment, and other inputs.

Mega-projects will generate opportunities both to strengthen existing Canadian capabilities and to widen the industrial base. For example, the realization of such projects requires Engineer-Procure-Construct (EPC) firms of sufficient scale to assume overall responsibility for the largest capital projects. Increased activity in engineering services and construction in Canada should not only expand Canadian capabilities but should provide the necessary base for increased exports of services to countries involved in large-scale projects.

Similarly, activities associated with mega-projects should enhance Canada's technological capabilities and result in new technologically advanced products and

production processes to respond to the challenges of the difficult technical conditions or environment surrounding some of these projects. Indeed, the successful completion of many major projects will hinge upon innovations yet to be made and solutions yet to be found to present technical production problems. For resource-based equipment, the introduction of such technological advances should further enhance Canadian competitive strengths in the supply of this equipment at a time when the production of resource equipment incorporating mature standard technologies is gradually shifting to developing countries and the Canadian market opportunities for standard technology will be diminishing.

Realizing the maximum possible degree of industrial benefits from mega-projects in Canada does not necessarily mean that the share of mega-project demand supplied by domestic machinery and equipment producers will be much higher than the historical average of 60 percent Canadian content. The very magnitude of these new opportunities relative to the existing capability of Canadian suppliers and the imperatives of economies of scale suggest that it would be unrealistic to expect a greater degree of Canadian content. Indeed, the range of domestic production has already been reduced as a result of the specialization and rationalization of the Canadian machinery industry which has occurred in the past two decades to achieve greater efficiency and productivity.

A number of the domestic opportunities presented to Canadian suppliers have an essentially "one-shot" nature rather than the promise of sustained demand into the future. This can work to the advantage of Canadian machinery producers who have tended to specialize in custom-made machinery rather than off-the-shelf items, but a short-term increase in domestic business may not justify investments in increased capacity unless additional and continuing export business is available. In these circumstances, a major long-term benefit generated by domestic mega-projects will stem from their role as a catalyst to the development of new, more technologically advanced products and EPC services for export, solidly rooted in Canada's natural resource strengths.

Clearly there is a close and dynamic interaction between the development of goods and services required by mega-projects, related domestic industrial benefits objectives, and export market access. The effective pursuit of Canada's industrial, regional, and trade policy objectives will require the early identification of projects of potential interest to Canadian industry, and a set of mutually supportive industrial and trade development measures to ensure that these opportunities can be effectively seized by competitive Canadian firms. The export of goods and services developed in Canada in response to the demands of domestic major projects will be of central importance in securing lasting industrial benefits. This will require appropriate supportive export development measures such as PEMD and the encouragement of consortia to manage and construct turnkey projects abroad aimed at exporting resource-based machinery, equipment and services.

As over 20 percent of total projected investment in Canada over the coming decades is expected to be in mega-projects, the decisions of firms active in these projects will increasingly influence the nature and scope of industrial growth and technological development in Canada, as well as the product mix of exports. In this

context, foreign ownership of existing large-scale EPC firms may be a constraint on the industrial and regional benefits from mega-projects available to Canadian firms. Foreign-owned companies tend to rely on their existing network of suppliers, many of which are located in the home country, rather than on competitive but often untried Canadian suppliers, thereby increasing imports. This tendency to source abroad is further compounded by the offering of export financing by foreign countries at concessional rates or tied to procurement of capital goods in the country of export, which unfairly and adversely affects the sourcing of large capital acquisitions in such areas as shipbuilding, oil rigs and heavy electrical equipment industries.

In response, the Canadian government has adopted several measures aimed at ensuring that Canadian-based firms receive "full and fair" access to major capital projects. For example, the industrial benefits provisions of the Canada Oil and Gas Act are designed to ensure that Canadian suppliers are provided a "full and fair opportunity to participate on a competitive basis in the supply of goods and services" for projects on Canada lands; mega-project guidelines were announced in August 1981 setting out requirements for participation by the private sector to ensure that the government's industrial and regional development objectives could be achieved; and the creation of an Office of Industrial and Regional Benefits (OIRB) and a Committee of Industrial and Regional Benefits (C-MIRB) to work with major project sponsors, suppliers, other governments and other federal departments was aimed at ensuring that Canadian-based suppliers do, in fact, receive full and fair access to all major capital projects throughout Canada.

Such government measures have raised concerns abroad, particularly in the United States, on grounds that they could lead to domestically directed procurement by project sponsors and constitute a barrier to US exports to Canada. Indeed, the distinction between the incentive to "shop Canadian" (i.e., ensuring full and fair access for Canadian firms) and the decision to "buy Canadian" which rests with private project sponsors is not readily accepted by our major trading partners. These questions may therefore be a major aspect of the management of Canada's trade policy and relations in the 1980s.

The effectiveness of the government's policy with respect to industrial and regional benefits from mega-projects will also be significantly influenced by the extent to which domestic producers of capital goods are provided effective and timely protection against injurious unfair import competition from practices such as dumping and concessional export financing in the domestic market, and the extent to which Canadian operators have access to financing at competitive rates. The modifications to the Canadian import regime being considered by Parliament will be particularly relevant and important to the health of domestic industry.

In respect of major defence-equipment procurements, it has been Canadian practice to require commensurate regional and industrial benefits. For example, in the procurement of the long-range patrol aircraft and the new fighter aircraft, the industrial and regional benefits took the form of either production in Canada of certain items used in the aircraft or in "offset" contracts not related to the purchased item. Other countries have developed similar practices and have, in some cases, sought offsets deriving from their purchases of Canadian defence equipment. In gen-

eral, buyers requesting countertrade (offsets, counter purchase, co-production, etc.) as a condition of purchase are motivated by a desire to acquire new technology and production while simultaneously reducing the foreign exchange drain involved in the purchase.

This area involves a delicate balancing of complex industrial, regional, technical, and trade considerations. It is a fact of international trade that in the defence sector countertrade is being increasingly sought, including in areas where Canada is in a position to export some of its indigenous advanced-technology products. It is an open question, therefore, whether this practice has outlived its usefulness.

Transportation Policy

From the very beginning of its nationhood, Canada has extensively relied on a vast transportation infrastructure to solidify its political and economic development. Despite its large land mass, harsh climate and rugged terrain, the country has effectively responded to the challenge of creating a highly-developed, multi-modal transportation system.

The building of a transcontinental rail system, the Trans-Canada Highway, interprovincial oil and gas pipelines, pan-Canadian airline services and the St. Lawrence Seaway represented enormous undertakings for the country and stand as symbols of the achievement of one of the fundamental objectives of the Fathers of Confederation — the extension and consolidation of the Canadian common market from coast to coast. In addition to the east-west linkages provided by the transportation system, demand for Canadian goods in foreign markets has resulted in large-scale transportation linkages with the United States and the world at large. Transportation equipment industries have also been developed to service domestic and foreign markets and currently employ close to 200,000 people.

The large dependence of the economy on exports in the post-war period has required the formulation of policies to ensure that Canadian goods are rapidly transported to international markets at competitive costs. Huge volumes of resource-based products (e.g., grains, minerals, forest products), processed goods (e.g., pulp and metals) and manufactured products (e.g., automobiles, newsprint, machinery, consumer goods) are moved by rail, air, ship and truck to distant markets.

Transportation is one of the priority areas in Canada's economic development because of its vital contribution to our export trade. To this end, the government has committed major expenditures over the next four years to develop the infrastructure for new grain and coal terminals at Prince Rupert, to expand the Robert's Bank terminal at Vancouver to improve our coal shipping capacity, to improve port handling facilities at Montreal, Saint John and Halifax, and to stimulate other major investments such as modernization and expansion of the western rail system. These projects will play an important role in removing current capacity constraints in the transportation system and strengthening Canada's international competitive position.

There is a further transportation bottleneck that plays a determining role in Canada's trading position which relates to the rate-setting system for all modes of transportation. Transportation costs can range up to 50 percent of the landed cost of

bulk commodities and from 10 to 30 percent for manufactured and semi-fabricated products. In those cases where the rate structure is regulated by the Canadian Transport Commission, sensitivity needs to be exercised in stemming the inflationary impact of freight rate increases.

With respect to shipping rates, which are controlled by private conference lines, concern has arisen over the continuation of relatively high freight rates, including broker surcharges, on general cargoes despite world-wide recessionary conditions. On the other hand, dry bulk cargo rates have fallen. The impact of unfavourable freight rates is also increasing as a result of unilateral protectionist measures adopted by several developing countries, notably in Latin Ameria, which require exporters to utilize the services of the former's national merchant marine fleets. Proposals in the United Nations Conference on Trade and Development by the developing countries to eliminate flags of convenience and institute bilateral cargo sharing arrangements would also have a negative impact on shipping freight rates by reducing competition.

Human Resource Policy

There is a close relationship between trade and manpower policies. Indeed, all nations have historically viewed trade as a key mechanism to generate and maintain employment in their primary resource and industrial sectors. The GATT makes explicit reference to this fundamental objective in its Preamble which states that the signatories recognize "that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment ..."

In Canada's case, the National Policy of 1879 launched a process whereby trade policy contributed importantly to the creation of a developed manufacturing sector which stimulated employment opportunities for thousands of Canadians by means of the tariff. As rapid industrialization proceeded, new markets were required for the output of competitive Canadian firms. The liberalization of world trade under GATT auspices in the post-war period resulted in wide-spread gains for Canada in industrial and resource employment and ensured the continued livelihood and prosperity of Canadians working in the agricultural sector.

Since the 1960s, competitive pressures from imports into Canada — together with rapidly changing technology, shifts in consumer demand, rising energy costs and other inflationary developments — have required widespread restructuring of production facilities entailing the closure of unprofitable operations and the opening of more viable lines of production. Government intervention over the years to assist labour adjustment in such cases has been forthcoming in the form of a large variety of labour market programmes, notably early retirement pensions for displaced workers; retraining, relocation and job search allowances; and unemployment insurance.

Where the adjustments have threatened to occur at a pace too rapid for the economy and the labour force to absorb or have been the direct result of injurious international trading practices such as dumping and foreign subsidization or disor-

eral, buyers requesting countertrade (offsets, counter purchase, co-production, etc.) as a condition of purchase are motivated by a desire to acquire new technology and production while simultaneously reducing the foreign exchange drain involved in the purchase.

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derly marketing, the government has introduced import relief measures consistent with its GATT rights. The chief trade policy instruments used by Canada in this regard are import licencing, quotas, anti-dumping duties, surtaxes, and bilateral restraint agreements.

While Canadian trade policy in the 1980s will continue to provide the needed support for employment creation and manpower adjustments, a much more profound role will be required of it in support of the evolutionary changes brought about by the upgraded quality of Canadian employment and the higher skill levels of Canadian workers. The government's economic development policy framework for the 1980s emphasized that the dominant realities in the decade ahead of continued expansion of the resource-based industries and the revitalization of industrial capacity towards specialized international competitiveness will transform existing production and assembly line jobs and create others with higher skill and training requirements. Labour market and educational policies will thus be needed to ensure that Canadians with the necessary skills and professional qualifications are available to meet the requirements of the economy and that adequate facilities are provided for re-educating and retraining adult workers to permit them to take full advantage of emerging new employment opportunities.

In this context, Canadian trade policy will be challenged as never before vigorously to pursue access abroad and undertake improved marketing programmes for the output of our high technology and growth industries. Foreign government practices restricting competitive Canadian exports of advanced-technology products and services in the area of telecommunications, electrical equipment, micro-electronics, aerospace, computer, office automation, petrochemical and biotechnology sectors are seriously constraining the achievement of Canadian government objectives of upgrading the occupational skill levels of the labour force by building upon its areas of international strength.

From a broader perspective, the international competitiveness of Canadian industries is significantly influenced by the industrial relations climate prevailing in Canada. Labour-management tensions and work stoppages have unduly disrupted the productive performance of the manufacturing, transportation and public services sectors with attendant adverse consequences for Canada's export performance and reputation as a reliable supplier. Thus the importance of a stable industrial relations climate involving fuller cooperation among labour, business and government for the achievement of Canada's export potential.

Chapter IV

SECTORAL PERSPECTIVES

If we consult history, we shall find that in most nations foreign trade has preceded any refinement in home manufactures and given birth to domestic luxury. The temptation is stronger to make use of foreign commodities which are ready for use and which are entirely new to us than to make improvements on any domestic commodity, which always advance by slow degrees and never affect us by their novelty. The profit is also very great in exporting what is superfluous at home, and what bears no price, to foreign nations whose soil or climate is not favourable to that commodity.

Thus men become acquainted with the pleasures of luxury and the profits of commerce; and their delicacy and industry being once awakened, carry them onto farther improvements in every branch of domestic as well as foreign trade; and this perhaps is the chief advantage which arises from a commerce with strangers . . . . Imitation soon diffuses all those arts, while domestic manufacturers emulate the foreign in their improvements, and work up every home commodity to the utmost perfection of which it is susceptible. Their own steel and iron, in such laborious hands, become equal to the gold and rubies of the Indies.

David Hume, 'Of Commerce', in *Essays Moral, Political and Literary.*

The Federal Government paper *Economic Development for Canada in the 1980s* emphasized the need for government policies to support the strengthening of the international competitiveness of Canadian producers and their abilities to market their products and services at home and abroad. Increasing world demand for Canada's metals and minerals, agriculture, fishery and forest products, as well as energy and energy-based products, offers substantial opportunities in the 1980s for the further development of resource-based industries in different parts of the country. Opportunities should also be grasped for making more progress in achieving the further processing of resource products prior to export. For other manufacturing and service sectors the expertise and advantages, already achieved or potential, offer opportunities in selected world markets for a range of advanced-technology and high productivity exports.

The following sections examine the main structural strengths and weaknesses of Canadian industries, the main competitive challenges and opportunities facing these industries at home and abroad for the 1980s, as well as some of the main constraints which will need to be overcome for the realization of these opportunities. This overview covers agriculture, fisheries, forest products, metals and minerals, energy, petrochemicals, major manufacturing industries and services. Over 78 percent of Canada's production, 88 percent of imports and exports, and 96 percent of manufacturing jobs are thus examined from an international trade perspective.

TABLE 15

MANUFACTURING SECTORS[1] (1980) IN THIS CHAPTER

Sector	Shipments ($ Million)	Employment	Imports ($ Million)	Exports ($ Million)
1. Primary Metals; Metal Fabricating; Non-Metallic Mineral Products[2]	27,200	345,000	6,700	9,500
2. Forest Products[3]	22,900	248,000	1,100	12,800
3. Food Processing	28,300	245,000	2,200	1,800
4. Fish Products	1,500	37,000	300	1,300
5. Petrochemicals	4,200	13,000	1,200	1,200
6. Machinery and Equipment	8,600	141,000	10,900	3,800
7. Electrical Equipment	4,900	70,000	1,800	600
8. Automotive	14,700	106,000	13,500	10,800
9. Urban Transportation Equipment[4]	200	1,000	0	100
10. Aircraft	1,800	40,000	1,800	1,600
11. Shipbuilding & Ocean Industries	1,000	25,000	600[5]	500
12. Electronics	4,300	64,000	4,900	2,000
13. Textiles, Clothing & Footwear	9,900	207,000	2,700	700
TOTAL, SECTORS 1 to 13	129,500	1,542,000	47,900	46,700
TOTAL MANUFACTURING INDUSTRIES	166,000	1,614,006[6]	54,700	52,900

[1] Excluding raw (unprocessed) products in the mineral, forest, food and fish sectors
[2] Shipments and employment are 1979; Data excludes mining shipments (10,500), employment (86,000) imports (3,100) and exports (5,900)
[3] Excludes logging — 54,370 employees in logging
[4] 1980 Lowest year for shipments since 1976 (orders on hand will increase shipments to 400 million in 1982 and 600 million in 1963 and triple the work force)
[5] Much of this does not appear in import statistics, since it includes rigs and other vessels operating more than 12 miles offshore
[6] Establishment Survey

Agriculture and Food Processing

Canada continues to enjoy a productive agricultural economy. There are now approximately 300,000 farms in Canada, employing about 480,000 people. Since 1951, the number of farms has fallen by half while the farm population has dropped from 21 percent of the total labour force to approximately 4 percent now. This reduction in the farm labour force and the increased size of the remaining farm businesses has been accomplished by the substitution of labour by capital, making agriculture one of the most capital-intensive sectors in the Canadian economy.

The largest sub-sector in agriculture is the cattle industry, accounting for 23 percent of total farm cash receipts of $15.3 billion; followed by wheat (19 percent), dairy products (13 percent), hogs (9 percent) and poultry and eggs (7 percent). Ontario is the largest agricultural producing province, with 28 percent of total farm cash receipts in 1980, followed by Saskatchewan and Alberta (20 percent each), Quebec (14 percent), Manitoba (9 percent), British Columbia (5 percent) and the Maritimes (3 percent).

TABLE 16

DOMESTIC EXPORTS — TOP FIFTY COMMODITIES — 1981 (000's)

Commodity category	1979	1980	1981
1. Passenger automobiles & chassis	4,377,228	4,686,935	5,421,750
2. Natural gas	2,889,054	3,983,850	4,370,050
3. Newsprint paper	3,221,778	3,683,690	4,325,517
4. Wood pulp & similar pulp	3,083,262	3,872,960	3,820,159
5. Motor vehicle parts, except engines	3,661,823	3,010,716	3,634,671
6. Wheat	2,180,282	3,861,715	3,728,003
7. Lumber, softwood	3,820,849	3,264,515	2,912,468
8. Trucks, truck tractors & chassis	2,734,413	2,445,141	2,904,489
9. Petroleum & coal products	1,885,278	2,324,316	2,642,020
10. Crude petroleum	2,404,582	2,899,099	2,504,968
11. Precious metals, including alloys	954,771	2,066,570	1,883,415
12. Aluminum, including alloys	917,967	1,533,193	1,466,920
13. Iron ores & conc.	1,354,046	1,241,282	1,465,338
14. Fertilizers & fertilizer material	987,301	1,253,763	1,343,218
15. Other telecommunications & related equipment	655,963	932,200	1,262,364
16. Organic chemicals	704,766	923,860	1,183,313
17. Coal & other crude bitumin. substances	835,277	933,831	1,146,950
18. Electricity	729,234	773,035	1,122,575
19. Other inorganic chemicals	839,651	947,197	1,063,691
20. Office machines & equipment	641,583	739,048	873,502
21. Barley	528,319	404,167	842,955
22. Sulphur	206,592	543,427	809,558
23. Other iron & steel & alloys	539,925	556,993	784,988
24. Drilling, excavating & mining mach.	228,379	318,050	762,029
25. Aircrafts engines & parts	409,733	489,050	707,598
26. Nickel & alloys	576,329	818,552	694,538
27. Copper & alloys	612,629	998,835	689,306
28. Other special transactions-trade	166,210	228,118	670,707
29. Other end products	518,583	970,529	649,207
30. Motor vehicle engines & parts	817,649	455,415	640,147
31. Aircraft parts, except engines	412,429	658,830	632,575
32. Metal fabricated basic products	556,684	552,508	617,497
33. Meat, fresh, chilled or frozen	410,298	499,994	601,044
34. Asbestos, unmanufactured	652,596	631,117	574,714
35. Nickel in ores, conc. & scrap	335,686	446,754	533,320
36. Syn. rubber & plastics materials	367,254	468,261	512,957
37. Copper in ores, conc. & scrap	547,897	600,674	498,284
38. Plate, sheet & strip, steel	407,302	580,328	494,744
39. Other equipment & tools	356,452	401,334	493,846
40. Zinc, including alloys	362,076	428,512	485,349
41. Other motor vehicles	363,712	325,838	483,094
42. Rapeseed	631,446	421,901	464,520
43. Fish, fillets & blocks, fresh or frozen	394,757	407,299	460,758
44. Aircraft complete with engines	183,337	255,522	456,401
45. Other gen. purpose industrial mach.	346,047	398,529	451,760
46. Precious metals in ores conc. & scrap	317,954	646,796	433,140
47. Shellfish	462,753	359,672	426,248
48. Other metals in ores, conc. & scrap	401,433	536,871	420,779
49. Other transportation equip.	267,667	284,233	407,747
50. Primary iron & steel	111,236	234,743	398,094

Statistics Canada — External Trade Division

The output from Canadian farms and raw and semi-processed imported products provide the basic inputs for the food processing and manufacturing industry. Adding value to basic farm products is an important objective of the development strategies of both the federal and provincial governments. With shipments at around $25 billion in 1979 (16.7 percent of all manufacturing shipments), the food processing industry is Canada's largest secondary manufacturing industry. Meat packing is the largest sub-sector, followed by dairy processing with shipments valued at $7.6 billion and $3.8 billion respectively in 1979. In all, the food manufacturing sector has about 4,700 establishments employing a relatively stable level of over 230,000 people. Unlike other manufacturing sectors, food processing is distributed across the country in proportion to population.

Despite some climatic constraints, the production capacity of the agricultural sector far exceeds the needs of the domestic market. In 1981, exports at $8.8 billion exceeded agricultural imports of $5.6 billion by $3.2 billion. Currently, exports as a percentage of Canadian farm cash receipts amount to over half (compared to less than a third in the USA). The USA, Japan and the EC account for almost half of Canada's agricultural exports (split roughly equally), the USSR and China for a further quarter, and the developing countries for most of the balance.

The cornerstone of Canada's agricultural export effort is the grain and oilseed sector, which in 1981 accounted for 60 percent of Canada's total agricultural exports (wheat $3.7 billion in 1981, barley $843 million, rapeseed $465 million and flaxseed $226 million). Although unprocessed grains and oilseeds, largely from the Prairie provinces, dominate, exports are also important for a wide range of products across Canada. For example, pork and beef exports in 1981 amounted to $550 million (largely from Quebec, Ontario and Alberta) and exports of fresh and processed fruits and vegetables were valued at $384 million (mainly Ontario, British Columbia and the Maritimes).

The maintenance and expansion of exports are vital to the future growth of Canadian farm incomes. At the same time, about two-thirds of agricultural imports consist of products that are also produced in Canada and there is obvious scope for competitive firms capturing an increased share of the domestic market. In this regard, the importance of maintaining a first-rate research capability is illustrated by the recent development of new varieties of corn and soybeans which have expanded the growing areas for these crops. This has already resulted in a shift from a net import to a net export position for corn and a significant increase in self-sufficiency in soybeans. However, the greatest potential for increased domestic market participation on a competitive basis lies in the fruit and vegetable sector.

The Agri-Food Strategy ("Challenge for Growth") was announced by the Minister of Agriculture in July, 1981. The theme of the Strategy is that there is a bright future for the food and agriculture sector, provided the constraints to increased production and improved marketing can be overcome. The Strategy looks at the next 20 years and identifies roadblocks to achieving the full potential of the agri-food system, along with the possible solutions. It is estimated that Canada could increase its agri-food production by two-thirds by the turn of the century, double the current dollar value of agricultural production and increase employment by 170,000 jobs. A three-

pronged approach is proposed involving market development, mission-oriented research, and supply-base improvements.

In terms of market development, the Agri-Food Strategy stresses the importance of developing new commercial export markets and maintaining ones for the commodities in which Canada has or can develop a competitive advantage. Legislation was recently passed by Parliament to establish a Canadian agricultural export Crown Corporation to be known as Canagrex. In addition, the Strategy notes that there is a potential for Canadian agriculture to capture an increased share of the domestic market.

Although there is considerable scope for domestic market development, the fact remains that, if Canadian agriculture is to realize its production potential, export expansion for many products is critical given the relatively small size of the domestic market. However, increasing Canada's dependence on foreign markets will mean that we will become more vulnerable to the non-tariff distortions which permeate agricultural trade. These distortions do not reflect so much the difference in agricultural support *techniques* as the differences in the *level* of support between developed market economies. In past GATT negotiations, Canada has negotiated reductions and harmonization of its agricultural tariffs with those of the USA for products traded both ways, with the resultant international contractual commitment of bound rates. The results of tariff negotiations with the EC and Japan, however, have been much less significant, though there are some important tariff items in these markets bound to Canada, such as the duty-free binding on rapeseed. Overall the tariff regimes of Japan and the EC are much less significant as determinants of market access for agricultural products. The absence of meaningful international disciplines on non-tariff measures remains, therefore, the major obstacle to Canadian exports to these markets. In addition, the existence of subsidies and export credits as features of the domestic agricultural policies in the EC and other developed countries adversely affects Canada's exports to third markets.

The fact that these non-tariff trade measures are deeply rooted in domestic agricultural programmes has meant that relatively little progress has been made in liberalizing agricultural trade. Successive rounds of GATT negotiations, while relatively successful in reducing agricultural tariffs, have so far had more modest success in dealing with the key problems of non-tariff import barriers (e.g., import quotas or variable import levies) and export aids, particularly direct export subsidies. This reflects the inherent reluctance of governments to constrain their flexibility in terms of domestic agricultural policies and programmes to respond to the social, political and economic imperatives of their respective countries. Improved international disciplines will be required to deal with the serious distortions to trade in agricultural products and thus prevent drifting to more autarky in individual agricultural policy regimes.

With the exception of those products under domestic supply management, Canadian agricultural production is subject to world price competition, and is particularly influenced by market developments in the United States. In order to reduce the wide price fluctuations which existed previously in Canada in the dairy and poultry sectors, manufacturing milk, eggs, turkeys and chickens are subject to

domestic supply management programmes supported by import controls. The GATT permits the use of import controls in support of domestic supply management programmes, recognizing the need for controls on imports when domestic production is subject to quantitative limitations. However, the level of import quotas is subject to certain GATT disciplines including the requirement that the ratio of imports to domestic production must be no less than that prevailing in a representative base period.

The following paragraphs outline the opportunities and constraints specific to the most important Canadian agricultural and food sub-sectors: grains and oilseeds, meat, dairy products, fruits and vegetables, and food processing and beverages.

A number of studies in recent years have attempted to project the likely demand for *food grains and oilseeds* by the mid-1980s and by 1990 or the turn of the century. In some instances, trade levels projected for 1985 have already been equalled or surpassed. While the results differ in degree and emphasis, the general consensus is that demand will continue to increase throughout the 1980s, although possibly at a slower pace than during the 1970s. Supply and demand are expected to be in closer balance and there will be greater volatility in the market as production is extended to areas more subject to major fluctuations because of climatic and other factors. Production is expected to increase but at a rate which it is estimated will not always close the gap between supply and demand. An important feature of international trade in this sub-sector is that it is often pursued on the basis of government-to-government negotiations rather than through normal commercial channels.

Growth in demand for feed grains may be stronger than in the case of wheat and oilseeds as various countries upgrade their consumption habits with increasing economic development. In the case of food grains, an increasing proportion of trade will be directed to the developing countries and for many of the latter the gap between requirements and indigenous production capability is likely to widen. Thus the 1980s will likely see increased demand opportunities but also increased competition for markets, while volatility may be more of a factor in the trading activities of the major exporters. By 1985 world trade should exceed 100 million tonnes for wheat and be approaching the 140 million level for coarse grains, compared with current levels of 93 and 104 million tonnes. Trade in oilseeds should be around 40 million tonnes.

With anticipated increases in world demand for grain, a substantial constraint facing the Canadian grain industry will be its ability to increase production and provide the supplies necessary to enable Canada to maintain its traditional share of an increasing world market. A major factor will be the assurance of returns that are adequate to enable producers to increase acreage and yield. With the frequent fluctuations in supply and demand and the consequent impact on prices in this sector, the adequacy of returns to producers is always at issue. Other factors affecting producer returns include rising production costs due to high energy prices and interest rates, as well as pressure on the land base and water resources.

Despite considerable government investment in transportation facilities for this industry (hopper cars, rail line rehabilitation), the capacity of the transportation system to move grain to export position remains an issue, particularly in Western Canada. With the forecast increase in rail movements of bulk commodities west-

ward, the railways have indicated the need for massive capital investment to increase rail capacity; the recently announced proposals to change the statutory rate structure for grain are intended to facilitate this investment.

A major constraint to increased exports is the trade distorting policies or practices of other countries. Some importers, such as the EC, employ import measures which severely limit the quantity of imports. There are also other non-tariff distortions such as the grain purchasing policies of some countries which favour particular suppliers. Of particular concern are the export subsidies of the EC and their impact on trade in third markets. The EC has continuously increased its exportable supplies of wheat over the last decade from 7 to 14 million tonnes, which is then exported in competition with lower-cost producers such as Canada and the United States. Similarly, the USA sells large quantities of wheat, flour and feed grains on long-term concessional credit terms of up to 40 years at interest rates as low as 2 percent.

Exports of high-quality grain will continue to form the basis for Canada's marketing strategy for major destinations (e.g., USSR, China, UK, Japan, Brazil and potentially other Asian and Middle Eastern countries). Emphasis should also be placed upon exports in further processed forms where opportunities exist as well as increases in production and exports of medium-quality grain to fit a particular segment of the world market, and to diversify Canada's grain export offerings. Canola oil and meal as well as barley malt are the main processed products with export opportunities. Major markets for barley malt are the USA and Japan. Considerable potential is foreseen in South America, Africa, South-East Asia and the Caribbean. Markets for canola and end-products exist in the EC, Middle East and Asia with potential for significant expansion of these markets as well as in areas such as the USSR, China, South America, Mexico, the USA and Eastern Europe. In relation to medium-quality grains, emphasis will be placed upon alternative grains to the high-quality red spring wheats such as feed wheats, soft white wheats and winter wheats. With the recent increases in corn production, Canada has become an exporter of corn, and this role is likely to expand.

The Canadian *cattle and hog industries* operate as an integral part of a North American livestock economy. Trade is duty-free or subject to very low tariffs. As a consequence, Canadian cattle and hog prices are largely determined by those in the USA which has a livestock sector roughly ten times the size of Canada's.

Approximately 10 percent of Canada's beef production is exported and about 10 percent of our domestic requirements are imported. Most beef exports go to the USA and there is also a significant two-way trade in live cattle. The bulk of North American beef supplies originate from grain-fed cattle produced in feed lots. In contrast, the international beef market is dominated by less expensive grass-fed beef, largely from Oceania and South America, but also increasingly from the EC which has shifted from a major net importer 10 years ago to being the world's second largest beef exporter, second only to Australia.

Canada's trade in pork is significantly larger than that in beef with up to 25 percent of production being exported, mainly to the USA and Japan. Imports come mainly from the USA but recently Canada has enjoyed a significant trade surplus with the USA in fresh and frozen pork and live hogs. Trade in live hogs and pork is duty-free between Canada and the USA and both countries export to a Japanese

market protected by a minimum import price system. North American pork exports to offshore markets are subject to subsidized competition from the EC (mainly Denmark), particularly in Japan. International trade in pork is small relative to beef, with Japan and North America (mainly for canned hams) being the two largest import areas.

The demand for beef and pork is highly correlated to consumer incomes. The recent stagnant economic growth in North America coupled with historically high inflation rates has meant that both sectors have been subject to a severe cost-price squeeze, although profitability has improved recently as a result of higher livestock prices and reduced grain prices.

Although Canada and the USA operate in a North American livestock economy, both countries are increasingly being influenced by the world meat economy in which government intervention is becoming almost as significant as in the international dairy sector. The beef sector was particularly distorted during the mid-1970s when the EC and Japan virtually embargoed beef imports and the USA restricted beef imports under its Meat Import Law. The resulting diversionary pressure on the only remaining "open" market — Canada — resulted in record imports at a time of record domestic supplies. This situation caused increased domestic pressure for the introduction of laws similar to those in the USA — the Canadian Meat Import Act came into force early in 1982.

During the 1980s, Canada is expected to maintain its position as a small net exporter of beef (including live cattle trade) and a continuing net exporter of pork. However, the recent poor economic situation in the industry has prompted many producers to question the adequacy of the existing production and marketing system and has led to increased interest in supply management. Adverse cost-price relationships have led a number of provinces to introduce their own stabilization and/or income assurance programmes for the meat sub-sectors.

Of all the agricultural sub-sectors, *dairy products* is the one most subject to government intervention internationally. The Canadian dairy industry is a highly regulated industry with production of both fluid milk and milk for the manufacture of dairy products subject to provincial or federal production quotas and prices for fluid milk and industrial milk set on an administered basis. This sector has experienced a dramatic adjustment over the past decade with a decline in the number of dairy farmers from 120,000 in 1970 to about 50,000 today. While farms producing fluid milk are distributed throughout the country, largely on the basis of population, cheese and butter production are heavily concentrated in Quebec and Ontario.

Exports represent a small proportion of domestic production, consisting of skim milk powder, evaporated milk, whole milk powder and cheese; there is little or no trade in fluid milk. Imports are subject to controls under the Export and Import Permits Act and are comprised largely of cheese which is limited by a 45 million pound global quota (60 percent of which is allocated to the EC).

In 1981, Canada imported over $1 billion of fresh and processed *fruits and vegetables*, excluding tropical and citrus products. Exports, e.g., apples, potatoes, onions and carrots, amounted to nearly $400 million and are of considerable significance to particular regions, for example in the Atlantic provinces.

As a result of the implementation in 1979 of the Tariff Board recommendations that Canadian fresh fruit and vegetable seasonal tariffs should be generally increased when Canadian supplies are available and eliminated in the off-season, the Canadian industry is well placed to capture an increased share of the domestic market. The effect of increased tariff protection, increases in transportation costs from the major US/Mexican production areas and the appreciation of the US dollar have all continued to improve the prospects of both the fresh and processed Canadian fruit and vegetable sector. (In contrast, during the late 1960s and early 1970s, when the Canadian dollar was at or closer to par and Canadian tariffs were lower, the industry often requested emergency import surtax protection against abnormally low priced imports from the USA and to a lesser extent Mexico. There has been a sharp reduction in such requests in recent years).

There are many products for which increased domestic self-sufficiency could be achieved on a competitive basis, including fresh peaches, fresh and frozen broccoli, canned peaches, asparagus, spinach, fresh grapes, celery, onions, tomato paste, pears and cauliflower. In this regard, there are already programmes in place which have made, and could continue to make, substantial contributions. An excellent example is the Fruit and Vegetable Storage Construction Financial Assistance Programme which has been in place to a greater or lesser extent since 1973. This programme contributes to the cost of building fruit and vegetable storage in order to lengthen the marketing season for perishable commodities. Since 1979 the programme has contributed just over $13 million of assistance to the construction of $40 million worth of storage facilities. The result is a lengthening of the storage season which has enabled a consistent supply of good quality and reasonably priced Canadian produce to be available on the domestic market for a longer marketing season. These and similar developments can also improve Canada's export capabilities. As transportation and storage costs increase on both sides of the border, Canada's competitive advantage in supplying adjacent regions in the USA is likely to be enhanced.

Unlike general manufacturing, *food processing* is located across the country, roughly in proportion to population. Proximity to primary inputs as well as to population centers are the main factors in determining plant locations. Transportation costs in many of the less capital-intensive processes outweigh the advantages of economies of scale stimulating processing facilities close to final markets. Consequently the processed food industry is of considerable regional importance in terms of employment.

The Canadian food and beverage industry is essentially domestically oriented. While trade is more important for some sub-sectors than others, on average exports account for approximately ten percent of total output. Historically, domestic growth has been the result of increasing population and a greater demand for more sophisticated or intensely processed products. As population growth has slowed and the market for processed products matured, the expansion rate has slowed. Projections of domestic market expansion are currently as low as one percent annually. If the industry is to grow it will need to look to greater exports.

Constraints to increasing exports vary considerably from sub-sector to sub-sector. Processed foods range from commodity items such as frozen or canned fruit and

vegetables to highly formulated products. Market potential for commodity items is extremely price sensitive, while other non-tariff barriers are more important constraints for formulated products. Labelling requirements, additive restrictions and packaging sizes have been identified as some of the problems limiting access to certain markets. Developing countries, in an effort to conserve foreign exchange, frequently have greater import restrictions on processed food items than on commodity food items.

Given the general constraints, export potential also varies depending on the subsector. Some industries, particularly bakeries and soft drinks, are very sensitive to transportation costs and are geared almost exclusively to serving local markets. Export potential for these industries is extremely limited. Other sectors show much greater potential.

One of the more promising sectors is frozen fruit and vegetables which has shown a dramatic increase in exports in recent years, from $7.5 million in 1970 to $54.6 million in 1980. The short-term outlook for this sector has been affected by high interest rates. Firms are unwilling to carry large inventories and consequently will only pack sufficient quantities to meet commitments made before the start of the season. This, coupled with a reluctance to invest in increased capacity, has hampered the industry from expanding to its full potential. Frozen french-fried potatoes, corn, peas, and blueberries have been identified as having the greatest export potential.

The brewing industry is expanding its export trade to the USA to capitalize on the growing demand for specialty beers (premium, light, etc.). Distillers are traditional exporters, but export growth has recently been static and no appreciable change is forecast. Changing consumer tastes and a general trend away from hard spirits towards "softer" alcoholic products have been identified as two reasons for the slowdown. Growth potential for the wine industry lies more in domestic than export markets. A major limiting factor is that while there is a rapidly increasing domestic demand for white wines, much of the current vineyard acreage is planted in varieties suitable to red wine production and changing varieties is a lengthy and costly process.

Imports of processed foods and beverages excluding fish have increased in importance in the 1970s. This situation reflected our need to import certain products of tropical origin, a rationalization of world production of certain products (e.g., coffee preparations) and a growing sophistication on the part of Canadian consumers who have become more open to non-traditional foods. However, substantial growth in the last 2-3 years in Canadian exports of semi-processed and processed food products have resulted in a substantial narrowing of the trade deficit in this sector.

Fish and Fish Products

Export sales of fish and fish products have long been the main source of industrial activities and revenues for many Canadians on both the Atlantic and Pacific coasts. Concerns over access to foreign markets have been a constant feature of Canada's commercial policy going back to pre-Confederation days, when access to

he important US market was threatened by the abrogation of the 1854 Reciprocity Treaty. Canada has now become the world's leading exporter of fish and fish products, accounting for approximately $1.5 billion worth of export sales. This represents 30 percent of total domestic production; Canada's dependence on world markets may increase further as the Atlantic catch rebounds following the rebuilding of the fish stocks within the 200-mile offshore limit, and as the impact of Pacific salmon enhancement programmes is gradually felt.

The most important development affecting patterns of world production and trade in fisheries products in the last decade has been the extension of exclusive fisheries jurisdiction over the 200-mile economic zones. Some traditional fish producing countries (such as Canada, USA, Iceland, Norway, and Peru) have been able to increase production and considerably expand exports. For example, the US industry, with substantial support from government, is moving to exploit a larger share of its own huge resource by expanding and introducing more sophisticated technology. New suppliers (such as Mexico, Chile, Argentina, India, Thailand, Indonesia and South Korea) are also emerging as a result of control of larger fisheries resources.

While traditional producers in Western Europe and Japan are endeavouring to exploit their own economic zones, they have experienced declining catches due to a loss of access to distant-water fishing grounds and depletion of their own resources. Most of these countries are experiencing difficulties in using their vessels to catch their deficit requirements; they must either buy from countries with exportable surpluses, such as Canada, or negotiate agreements to obtain catch quotas. A number of these countries have strengthened their domestic regulatory regimes which control access to their markets to enable a smooth adjustment process for their industries and to protect their industries' share of their domestic market.

The Canadian fishing industry on both the Atlantic and Pacific coasts is currently facing serious structural and financial difficulties arising from, inter alia, a cost-price squeeze caused by depressed markets, increasing operating costs and technological obsolescence. The situation of the Atlantic industry was the subject of a Task Force study and an Inquiry conducted by Dr. Peter Pearse concerned itself with the Pacific Coast industry. These reviews will clearly condition the policy framework for the future of Canadian fisheries and government trade and marketing policies to be pursued in the 1980s. However, it is equally clear from the high degree of export orientation of the Canadian fish industry that developments related to export markets will be a major factor influencing the capacity of the industry to maximize its potential contribution to Canada's regional and industrial development.

The export volumes and product mix to a significant extent reflect the Canadian resource picture and the level of landings. Looking at the Atlantic resource picture, it appears that there will be a sizeable increase in the supply of cod stocks and there is already potential for sizable increases in landings of redfish, squid, mackerel and hake. Pacific production of fish, except herring, has remained fairly stable over the past three decades but the composition of the catch has changed. Analysis indicates that salmon stocks are increasing and could be more than double the harvests of recent years as a result of effective enhancement and stock restoration programmes. Herring stocks generally appear to be healthy; and, with the exception of halibut and a few minor species, Pacific groundfish are in good condition.

The most important items in Canadian exports have been frozen groundfish (in blocks, fillets, or whole and dressed), shellfish and canned fish products. Exports of all broad species groups have increased substantially in recent years, but the product mix has been changing. Of course, export markets are not equally important for all species and for the different forms of fish products. For example, 70 percent of Pacific salmon is exported (some 44 percent in the form of frozen salmon to Japan) but canned salmon is primarily for the Canadian market. Some 60 to 70 percent of the groundfish landed on the Pacific Coast is sold in Canada, because groundfish, other than halibut, are of much lower value and hence not sold in distant markets.

The USA continues to be the single most important market for Canadian fisheries, particularly for groundfish (cod, haddock, ocean perch and flatfish) and continues to grow in absolute terms. However, in the last decade, the share for the USA in total Canadian fisheries exports declined substantially from 72 to 56 percent. In the case of Western Europe and Japan, their shares increased significantly to about one-fifth and one-tenth respectively in 1981 (the EC share was as high as 32 percent in 1980 and 19 percent for Japan in 1979). The rest of Canadian fish exports go to Australia and New Zealand, Eastern European and developing countries. These countries, particularly in Africa and the Middle East, offer potential long-term prospects for Canadian fisheries because of the importance of fish as a source of protein, but a good deal of product and market development work will be required.

Effective and coordinated use of various trade promotion activities will have to be continued and strengthened if Canadian fish products are to make a real impact on the world marketplace. There are various government instruments including trade fairs, incoming and outgoing trade missions, the food component of the Program for Export Market Development, export financing, trade advertising and consumer promotions, and other government support services such as the Trade Commissioner Service. These instruments will become of strategic importance for the fishery industry if it is to continue to grow in the highly competitive international environment of the 1980s. Indeed, the Canadian fisheries industry can no longer catch the fish and then start looking around for a place to sell. More than ever before, the success or failure of the Canadian fishing industry will be influenced by its ability to penetrate new markets with quality products that will obtain a top price.

Despite considerable expansion of fish exports since the extended economic zone was applied, the Canadian fish industry has not kept pace with major competitors in terms of quality consistency and technological advancement. Consistent high quality fish products and improved product mix will be of crucial importance for successfully penetrating new markets, particularly in situations where resource availability (cod, redfish and herring) may exceed potential markets. Similarly, further upgrading of Canada's product mix to improve sales to higher-priced processed fish markets will be required to meet the new export opportunities. At the moment many small plants are geared to low-value, price-sensitive cod blocks and lack the facilities and the technology to produce for the top end of the markets.

Access conditions to foreign markets continue to be seriously impeded by a variety of governmental measures including tariffs, minimum import price systems, quantitative restrictions, licensing, state-trading, discriminatory trading arrange-

ments (including preferential tariff arrangements) and unduly restrictive health and sanitary regulations. In a situation where Canada will have large exportable quantities of fish in the 1980s and where access conditions to markets, particularly in Europe and Japan, continue to be a major constraint to the realization of Canada's export potential, the objective of maintaining and securing improved access will clearly continue to be a matter of priority. Dealing effectively with these measures will become increasingly important as countries, whose domestic fishing industries are experiencing a difficult adjustment process arising out of the extension of national fisheries jurisdictions, are under pressure to restrict imports. The pursuit of improvements in market access conditions will need to be a priority objective for Canada in various fora which could include international trade negotiations, international industrial cooperation endeavours and negotiations concerning access for foreign vessels to fishing rights in Canadian zones.

Forest Products

The forest products industry is one of Canada's leading industrial sectors in terms of sales, employment and export earnings and is the economic mainstay of numerous single industry communities across the country. All regions have a significant stake in the industry. For example, half of British Columbia's industrial production and exports are accounted for by forest products; in Quebec, the forest industry is the largest manufacturing sector, generating one quarter of manufacturing employment. The value of total Canadian shipments in 1981 exceeded $22 billion, of which about half was exported, primarily to the USA, Europe and Japan.

The Canadian industry comprises three structurally different groups. There are the generally efficient, export-oriented producers of pulp, newsprint and lumber; these three products combined account for almost 60 percent of total industry shipments and for over 85 percent of total exports, making Canada by far the world's largest exporter of these products. There are those sub-sectors such as plywood, waferboard and certain paper grades which sell in both domestic and export markets. The remaining, comprising most other paper and wood products, has historically been primarily oriented to the domestic market.

The forest products industry can be expected to continue to make a major contribution to the economy. World demand for pulp and paper products is anticipated to grow at about three percent per year over the next decade. Strong growth is expected in bleached kraft pulp, for which Canada accounts for nearly half of world exports, and to a lesser extent in newsprint, where Canada's share is about two-thirds. Growth in world demand for groundwood specialty papers will be substantially higher than for standard grades of newsprint, and Canada, with a comparative advantage in these products, is well placed to expand production and exports. World demand for softwood lumber, for which Canada accounts for about 40 percent of world exports, will also grow, but more slowly, at about one percent per year.

Canada is in a good position to supply a significant part of the incremental growth in world markets, particularly to Western Europe and Japan, both of which are facing a growing reliance on imports to meet domestic requirements. The USA,

however, is becoming more self-sufficient in Canada's major export items, based on new capacity located in the low-cost Southern States and to a lesser extent in the Pacific Northwest, and will be Canada's major competitor in the 1980s both in North America and abroad. At the same time, the USA is the prime target export market for many of Canada's high value-added products such as groundwood specialties, fine papers, particleboard, waferboard and millwork. Moreover, increasing competition is expected in European markets from Scandinavian newsprint and within Europe and Japan from the growth of production in the Southern hemisphere.

Canada is well placed to meet this foreign competition and to capture the development opportunities in the 1980s but this will require action by the Canadian industry and support from both levels of government aimed at strengthening and expanding the resource base; improving the technological and supply capabilities of the forest products industry; ensuring liberal access for Canadian forest products in foreign markets; and, identifying and exploiting the export market opportunities created by improved terms of access and Canadian supply capabilities.

The emerging world *timber* supply constraint is one of the major factors bearing on the evolution of the world industry. World timber supplies are increasingly strained in the northern countries, especially in those long-fibre softwood species which are most in demand. Softwood plantations in the Southern hemisphere have not done as well as expected and tropical hardwood forests are being denuded at alarming rates. Timber supplies are constrained in Canada as well. While low-grade hardwood stocks are abundant and under-utilized, softwood stocks are almost fully allocated and utilized in most regions across the country. Increased investments will have to be made in regenerating and managing cutover forest lands to strengthen and expand Canada's exportable resource base. Past practice has been inadequate and it is evident that current supplies are less than what seemed evident even a few years ago. While regeneration of cutover land will have an impact on timber availability only in the longer run, better forest protection and increased access to currently marginal resources would expand the timber reserve in the short term. In addition, in certain regions with a high proportion of mature timber, it is possible to increase the annual allowable cut immediately through more intensive forest management (regeneration, stand improvement).

While no major short-falls in Canada's wood supply are forecast for the 1980s, some serious regional resource supply problems are already apparent. Much of the current stock of under-utilized softwoods is inaccessible. The industry has an increasing proportion of over-mature wood which is of low quality and expensive to process. The proportion of large diameter timber available to the wood products industry is decreasing, with the result that mills, in order to increase productivity and derive maximum volume and value from log inputs, will have to incorporate the latest advances in electronics scanning and computer assisted controlled systems and develop new products that utilize lower grade material. These problems are of particular concern to the sawmill and plywood industries where the value of final product and production costs are sensitive to log quality but are of less concern to the pulp, and more recently the newsprint, industries for which current capital investments have been geared, in part, to allow mills better to utilize wood residues and lower quality timber.

In order to remain internationally competitive, increased emphasis on industrial innovation will be required to contain costs, to deal with timber, energy and other supply side constraints and for rapid and aggressive exploitation of new market opportunities. To a large extent, the maintenance of Canada's strong position in world markets for forest products will depend on a larger, more effective role for the development and commercial application of new technology. In addition, export potential will also depend upon further structural improvements and productivity gains, in those paper and wood product groups in need of further modernization and restructuring, in order to be competitive, both at home and abroad.

The historically strong market position of the *newsprint* industry was threatened in the 1970s when years of under-investment combined with the need for pollution abatement and adjustment to rapidly rising energy prices, began to have an impact on its competitiveness. This situation is largely being rectified through major capital infusions, encouraged by the Federal-Provincial Pulp and Paper Modernization Program. Public expenditures totalling over $500 million are expected to generate between $3 and $4 billion in private sector investment on facilities improvement by 1984-85. Consequently, the newsprint industry is in a good position to enter the 1980s on a fully competitive basis, although major increases in capacity in North America and Scandinavia will tend to reduce rates of capacity utilization over the next few years from the high rates evident in 1980-81. The competitiveness of *other paper* sectors such as groundwood specialties and fine papers has also been strengthened with recent capital investments.

Canada's productive capability in *chemical wood pulp* accelerated during the 1960s and early 1970s with the development of the new pulp industry in the interior of British Columbia. Canada is now the world's largest exporter of chemical pulp and the absence of major new capacity from current investment plans by northern hemisphere producers indicates that this product will continue to command significantly higher prices and greater profits. However, the very large size of mills required to meet world competition and the attendant large requirement for wood and for capital will tend to direct investment towards groundwood based products which offer combined advantages of lower capital cost per ton of product and higher levels of wood utilization.

The competitiveness of newsprint, pulp, and lumber producers was also enhanced during the 1970s through a greater integration of logging and manufacturing operations. Wood residues produced as a by-product of wood product production now account for almost one-half of the total fibre used for pulp production in Canada. The lumber, pulp and newsprint portions of the industry have become highly integrated in both Western and Eastern Canada resulting in reduced fibre costs, increased economies of scale, and improved efficiency. Opportunities for further vertical integration of pulp and paper production in Canada are emerging.

Certain paper and wood product sectors which have traditionally been oriented to a protected domestic market are beginning to undergo significant adjustment and restructuring, partly as a result of reduced Canadian tariffs in the Tokyo Round of trade negotiations and of new export opportunities opened up by foreign tariff concessions on that occasion. With the limited size of the Canadian market, exports are required to capture economies of scale and permit restructuring into more efficient lines of production. The prime target market for these high value-added prod-

ucts is the USA, in view of high distribution costs and the need to maintain close customer-supplier relations. Substantially reduced US tariffs were achieved during the Tokyo Round on such products as printing papers, waferboard, and industrial particleboard, all of which are potential growth sectors in the Canadian industry. The industry is already responding to this changed environment through, for example, the construction of two large integrated fine paper mills in Canada and conversion of some less competitive grades such as unbleached kraft wrapping paper to more viable product lines.

There is virtually tariff-free trade in lumber, pulp and newsprint between Canada and the USA, while trade in many grades of fine paper is now very substantially liberalized. Preserving this access will be an important factor in the capacity of Canadian producers to reap the full benefits of rationalization and specialization. It will be especially important to protect this access from unwarranted and protectionist recourse to the US system of contingency protection. In addition, the increasing competitive pressure from the USA on Canadian industry will make access to offshore markets such as Japan, the EC and other countries important for the 1980s. For example, the 10 percent Japanese tariff on imports of planed whitewood lumber (spruce-pine-fir) is a major constraint to developing a Japanese market for lumber from the BC interior. The non-acceptance of Canadian softwood in the Japanese plywood standard also precludes full penetration of this market. Every opportunity to remove these impediments to Canadian exports and long standing causes of frustration in Canada-Japan trade relations must be carefully exploited. Similarly, as Scandinavian newsprint producers gain duty-free access to the EC, and EC producers find it increasingly difficult to meet this new competition, there may be significant protectionist pressures on European governments to take action that could impair Canadian access under the present duty-free tariff quota. While Canadian access is protected under the GATT, there may in future be pressure to renegotiate the quota.

In respect of export marketing activities, the Federal-Provincial-Industry Cooperative Overseas Market Development Programme for wood products (COMDP) contributed significantly in the 1970s in gaining Japanese and European acceptance of the Canadian timber-frame method of construction and related product standards, thereby enlarging the market for BC wood products. Canadian grades and sizes of lumber have been incorporated in many foreign building codes and related product standards, and there is a greater international recognition of BC supply capabilities. Offshore exports have increased from $227 million in 1973 to almost $1 billion in 1980, and further gains are anticipated. A similar approach may be necessary for the development of nascent export experience by the eastern Canadian lumber industry, whose current offshore marketing activities are fragmented and uncoordinated but show considerable promise for the future. In addition, eastern Canadian producers are confined to a more limited product range than BC producers due to the size and species of eastern timber. Market development efforts to encourage greater Canadian exports of higher value-added products such as millwork and converted paper products to the USA, Europe and elsewhere are also required if export opportunities are to be fully captured.

Similarly, industrial cooperation activities with the EC and Japan proved useful during the 1970s. In the pulp and paper sector, emphasis has focussed on interna-

tional opportunities for joint ventures and the exchange of technical and market intelligence. Continued mutually advantageous opportunities for industrial cooperation are anticipated for the 1980s and must be effectively exploited.

Metals and Minerals

Throughout Canada's history, mineral exploration, development, mining, milling, smelting, refining, processing and fabricating activities have been a major industrial development strength. These activities have also been a major generator of freight and cargo activities at Canadian seaports, the Great Lakes and the St-Lawrence Seaway, of foreign exchange earnings, as well as employment in many communities across Canada. The development of export markets for the metals and minerals industry has over the years been a priority concern in the conduct of Canada's trade relations with many countries, particularly the USA, Japan and Western Europe. In this regard, the government recently published a strategy paper for the metals and minerals sector.

Canada is the world's largest exporter of aluminum, nickel and zinc and one of the major producers and exporters of such resource products as asbestos, molybdenum, gypsum and platinum. In 1980, exports of metals and minerals exceeded $15 billion, 20 percent of total Canadian exports; Canada also imported minerals totalling $3 billion (e.g., bauxite, coal and iron ore) mainly for use in the iron and steel and aluminum smelting industries. With such a large volume of trade activity it is clear that the growth and health of many communities across Canada are heavily influenced by the international marketplace and by developments affecting the terms and conditions of access to foreign markets. At the same time, with 85 percent of these exports in the form of crude materials and primary metals, it is not surprising that the industrial diversification and regional development aspirations of different regions and many communities across the country are closely tied to the prospects of raising the level of processing of these resources in Canada prior to export. Thus, pursuit of the opportunities for further processing of resources and the removal of foreign market access constraints to such processing in Canada is a continuing priority of federal and provincial policies.

The 1960s and 1970s saw an erosion of Canada's overall share of several world mineral commodity markets. This is explained largely by the emergence of new competitors in developing countries for whom exports of resource commodities are important foreign exchange earners and represent major industrial development opportunities. Over the short to medium term, the world markets for metals and minerals point to continuing substantial surplus production capacity with resulting difficult industrial adjustment for some domestic operations and communities. For example, current depressed market conditions for iron ore have resulted in a number of significant lay-offs and plant shut-downs such as the concentrator and pellet plant in Sept-Iles, Quebec. In the longer term, the supply/demand balances should be restored as economic recovery occurs, but slower international rates of economic growth will likely result in only modest growth of world consumption of metals and minerals.

Canadian producers may be expected to remain a major factor in international mineral commodity markets, particularly for nickel, copper, zinc and aluminum. Similarly, Canada may be expected to become an important factor in the world thermal coal market, as its abundant domestic reserves of low-sulphur thermal coal are developed in response to substantial demand in overseas markets.

In aggregate, the Canadian resource supply base would appear to be adequate to support the Canadian mineral industry well into the next century although this may not be the case for every commodity and every region. Canada's relatively favourable resource base, combined with its reputation as a politically stable and reliable supplier of resource commodities, should assist Canadian producers in maintaining their shares of world markets. Indeed, although overall world supplies for most major minerals are relatively abundant in present economic circumstances, major industrialized countries remain heavily dependent on imports of industrial raw materials and concerned about ensuring stability and security of their supplies. Canada is also generally in a favourable position in the world in terms of cost competitiveness insofar as existing production is concerned.

Looking to the future, a growing proportion of Canada's new mining prospects are in remote areas where substantial new and costly infrastructure is required. At the same time, however, the concerns about the mining of deep-sea nodules as a threat to Canadian land-based nickel, copper and cobalt producers are unlikely to materialize in the 1980s, in light of the unproven state of nodule extraction technology and the massive R&D expenditures required to develop it on a commercial basis. Only substantial price increases for nickel, cobalt and copper, far beyond those projected by most forecasters, would make such deep-sea mining commercially viable and a threat to Canadian producers during the 1980s.

Other factors which could affect Canada's trade interests include the significant costs associated with environmental controls required to address the problems of acid rain. Indeed if an acid rain strategy is developed and implemented, existing non-ferrous smelter operations in Central Canada would have to undertake substantial capital expenditures to reduce sulphuric emissions and find market outlets for sulphur-based products. These costs could only be partially offset by lower labour and energy costs and increased productivity through modernizing existing production capacity. The effects of these domestic developments on the long-term viability of the Canadian industry must also be considered in the context of possible developments abroad in response to environmental or health factors which could adversely affect Canadian exports. A current example is the case with regard to the regulations on manufacturing and use of asbestos and asbestos-containing products in the EC.

Canada's performance in terms of non-ferrous primary metal processing prior to export has been below its potential. In contrast to many resource supplying countries, Canada's exports of non-ferrous metals in crude as opposed to more processed forms have increased substantially since the 1960s, particularly in respect of copper, lead and zinc. This has resulted from the bringing on stream of new mines in British Columbia, the Yukon and the Northwest Territories in the late 1960s and early 1970s to meet the mounting requirements of Japanese and European smelters and a consequent growth in Canadian base-metal mine production far beyond increases in non-ferrous smelting and refining capacity.

Foreign tariffs and non-tariff measures have been a factor constraining growth of Canada's non-ferrous smelting, refining, and processing industries. It has been a high priority of successive Canadian governments to have these trade barriers removed or substantially reduced for primary metals and a wide range of semi-processed and processed products. Significant gains were made in the Tokyo Round of trade negotiations in liberalizing trade of processed and downstream mineral products. However, in respect of primary metals, progress was mainly limited to aluminum ingots which will be moving duty free between the USA and Canada by 1987. In these circumstances and in light of the considerable industrial and regional development significance of further processing policy objectives, the preservation of existing market access conditions and further reductions in foreign barriers to resource upgrading should remain a high priority for Canada's trade policy on non-ferrous metals in the 1980s.

Developing countries are expected to continue to be major competitors for the Canadian non-ferrous metal industry in world markets, providing major industrial customers with a possibility of fostering security of supply through greater diversification of sources of supply, including through the use of official aid programmes. Some of the institutional and trading arrangements, such as those between the EC and many African countries, and the related regional commodity stabilization arrangements — the so-called Stabex — need to be understood in that light. Such measures will increase the competitiveness of the LDC metal and mineral suppliers vis-à-vis Canadian producers in the 1980s, particularly as these arrangements are supplemented by various preferential tariff-free access schemes into European, Japanese and North American markets for downstream products from developing countries. Nevertheless, industrialized countries will continue to be concerned about developments in mineral-producing LDCs which tend to detrimentally affect security of supply.

Developing countries should offer opportunities for Canadian industry to invest abroad, to provide consulting and engineering services as well as mining equipment and machinery. In striving to realize their industrial policy objectives in metal and mineral development, developing countries encounter many problems that Canadian 'know-how' could help to resolve — training professional and skilled personnel, attracting private investment capital, installing extensive infrastructure, improving management capability, and overcoming technological backwardness. In these areas, Canada is well placed to assist developing countries because of our position as a major mineral producer and world leader in exploration, mining and metallurgical technology. Although this may result in increased competition for Canada in world commodity markets, it is reasonable to expect that mineral resources around the world are going to be developed, whether or not Canadians participate in their development.

Canada's *steel* industry has been a strong performer over the years, relative to its international competitors. Its strength has been achieved by gearing production capacity to average (rather than peak) Canadian forecast demand, and by constructing modern, efficient, state-of-the-art-technology plants at times when international competitors were utilizing less efficient, obsolete facilities. This has enabled the industry to enjoy high capacity utilization rates, with imports satisfying peak

requirements and exports, primarily to the United States, increasing during cyclical troughs. Nevertheless, the current surplus of steelmaking capacity on a world-wide basis poses a serious threat to Canadian steel producers not only in the domestic market but also in the important US market. Canadian companies are facing a fiercely competitive international environment heavily influenced by the fact that as much as 75 percent of world capacity is government-owned or controlled and by the heavy capital cost of facilities. Steel has become an increasingly sensitive issue in international trade, particularly among developed countries, as the extensive government involvement has led to practices of incremental pricing, dumping and subsidization of production and trade. This situation has not only disrupted domestic markets, but has also led to the institution and application of special restrictive border procedures in both the EC and USA. These trade problems are exacerbated by extensive recourse to restrictive government procurement practices such as in the USA where many states have adopted "Buy America" policies.

In the medium to longer term, it is likely that there will be a gradual retrenchment of iron and steel production capacity in both the USA and EC. However, supplies from developing countries, particularly Korea and Brazil, could significantly increase to a level accounting for one fifth of world capacity by the end of the century. The restructuring of European steel industries could benefit Canadian producers if it results in a reduction of disruptive unfair competition both on domestic and export markets and if it further includes constraint on the use of concessional export financing.

The *metal fabricating* industry is a crucial element in the forward/backward linkages between manufacturing and the resource-based industries. This important sector, providing employment of almost 200,000, has traditionally not been very trade oriented — with about 14 percent of production currently exported and 18 percent of domestic consumption being filled by imports. There have been some signs of serious structural weaknesses in this industry as a result of fragmented production, low levels of technology and obsolete plants and equipment. Pressures to rationalize production have been mounting as import competition intensifies. These pressures have been accentuated by the downturn in the automotive industry and in the North American economies in general. Over the longer term, however, Canada's steel fabricating industries, and to a lesser extent aluminum, seem to be reasonably well positioned to pursue market opportunities including those provided by the major projects anticipated in Canada's resource sectors.

Energy

Energy represents a significant element in Canada's commodity trade. The value of Canadian energy exports was $12.6 billion in 1981, or 15 percent of total merchandise exports and imports were valued at $9.6 billion, or 12 percent of total merchandise imports. The majority of Canada's energy exports go to the United States, including oil, natural gas, electricity, uranium and radio-active elements and isotopes. In recent years, Japan has also become a significant destination and it is now the largest market for Canadian coal exports, taking 10.5 million tonnes in 1981. Japan is also the third largest market for Canadian uranium exports, following the United States and the United Kingdom.

TABLE 17

CANADIAN ENERGY EXPORTS BY DESTINATION AND VALUE IN 1981

($ million)

Commodity	United States	Others	Total
Crude Oil	2,607	8	2,615
Petroleum Products	2,245	368	2,613
Natural Gas	4,370	–	4,370
Coal	7	1,030	1,037
Coal Products	25	3	28
Electricity	1,123	–	1,123
Uranium			
a) Radioactive Ores and Concentrates	152	26	178
b) Radioactive Elements and Isotopes	382	290	672
Total	10,911	1,725	12,636

Petroleum and coal constitute the major part of Canadian energy imports by value. In 1981, Canada imported 30 million cubic metres of crude oil and almost 4 million cubic metres of petroleum products, for a total import bill of $8.6 billion. Canada also imported 15.5 million tonnes of coal and coal products, with a total value of $928 million.

The pattern of Canadian oil import trade has been changing in recent years. The volume of crude oil imports has declined steadily since 1974, and may continue to decline throughout the 1980s. The geographical source of Canadian crude oil imports has also changed. In 1971, Venezuela provided almost two-thirds of Canadian imported crude and other OPEC countries provided almost all the remainder. By 1980, Saudi Arabia had become the largest source, supplying 38 percent of Canadian imports while Venezuela provided only 30 percent and other OPEC countries 11 percent. Perhaps most significantly, non-OPEC countries (mainly Mexico) supplied 21 percent of Canadian crude imports in 1980. This shift in pattern is largely due to market factors, including changes in the availability of supply.

Canada's imports of coal come almost entirely from the USA, largely for thermal generation of electricity in Ontario, part of which is in turn exported to the USA. It is expected that these imports will continue for the rest of this century, as high transportation costs will tend to inhibit large movements of western Canadian coals into Ontario. About 40 percent of coal imports are used by the iron and steel industry.

Canada's trade in energy commodities throughout the remainder of the 1980s will be conditioned by trends in domestic and international supply and demand and by government policies. The energy supply and demand projections incorporated in *National Energy Program: Update 1982* represent a useful point of departure in analyzing future trade opportunities. Projections of future energy supply and demand are, of course, subject to considerable uncertainty, and must be based upon several assumptions regarding economic and population growth, energy prices, geological prospects, and supply, demand and income elasticities.

Under current projections for the Canadian market, there will be a reduction in total *crude oil* demand from 284 thousand cubic metres (1.8 million barrels) per day in 1980 to 233 thousand cubic metres (1.5 million barrels) per day in 1990. Domestic supply will gradually decline from 245 thousand cubic metres (1.54 million barrels) in 1980 but rise again in the late 1980s reaching 233 thousand cubic metres (1.47 million barrels) in 1990. Thus, current projections foresee steadily declining oil imports, but no net exports of crude oil from Canada before 1990. These supply projections are based upon relatively conservative assumptions regarding production from the east coast and northern frontier areas and relatively high consumption patterns. In the period before 1990, crude oil exports are likely to be primarily of two categories: exports of heavy crude oil which Canadian refineries are not equipped to process and crude oil exported to the United States under exchange arrangements.

Current projections indicate that the domestic supply of marketable *natural gas* in Canada may increase from 73 billion cubic metres in 1982 to 102 billion cubic metres in 1990. Domestic demand during this period is projected to increase from 47

billion to 66 billion cubic metres. Thus, over the period 1982 to 1990, some 290 billion cubic metres of natural gas is potentially available for export.

TABLE 18

POTENTIAL NATURAL GAS EXPORT CAPABILITY

(million cubic metres)

Year	Domestic Demand	Supply	Export Potential
1982	46.8	73.1	25.6
1983	47.8	81.3	32.6
1984	49.8	86.3	35.3
1985	52.7	91.7	38.0
1986	55.6	97.1	40.5
1987	58.4	98.3	38.9
1988	61.1	99.5	37.4
1990	66.4	101.7	34.4
Total	438.6	729.0	290.4

In addition, the development of proven natural gas reserves in the Arctic Islands may be commercially feasible in the not too distant future. Proven reserves in the Arctic Islands are estimated by industry to total 635 million cubic metres, and a much smaller level may be sufficient to support the construction of a project to deliver gas to southern markets by liquified natural gas (LNG) tanker. However, the economic and technological feasibility of such delivery systems remains to be demonstrated.

Considerable uncertainty also surrounds the marketing of Canadian gas exports. Exports to the United States were only 57.5 percent of licenced volumes in 1981 and are currently about 56.5 percent. While the reduced percentage takes since 1979 in part reflect the fact that new licences have been issued, it is also due to competitive circumstances in the traditional market areas for Canadian gas in the United States and the action of US regulatory authorities at the federal and state levels.

Future export market prospects over the medium-term are dependent upon several factors. The demand for natural gas in the USA is not expected to grow significantly because of conservation and increasing use of coal and fuel oil by industrial and utility boilers. In the next few years, the supply from currently producing domestic gas reserves may depress market conditions for Canadian gas, which is higher-priced than most US domestic supplies. Beyond 1985, however, there may be a sharp decline in gas produced in the lower 48 states and it is unlikely that supplemental supplies from other sources (e.g., Alaska, Mexico, LNG) will be available in sufficient quantity to meet total demand without a significant increase in price or shift to other energy forms. The possible deregulation of US gas prices may affect the market for Canadian gas if the higher prices for gas generally will place gas in a more difficult competitive position relative to other fuels. This general condition will vary by market region and pipeline. Certain areas of the United States, and in particular the Pacific Northwest area traditionally served by Canadian gas, are likely to experience continuing weak demand while others, such as the Northeast, may offer new markets because of high alternative fuel costs.

The National Energy Board is now reviewing applications for new and extended licences to export Canadian gas. One of these concerns the proposed export of liquified natural gas to Japan. There is also an outstanding proposal by a consortium led by Petro-Canada to construct the Arctic Pilot Project, a project to deliver natural gas from Melville Island in the Arctic by LNG tankers to export markets. Should these LNG projects be approved by the government, it would represent the first step in the diversification of Canadian gas markets away from the United States.

Canadian *coal* resources appear adequate to support even larger than anticipated foreign and domestic demand over at least the next two decades. Measured coal resources total over 50 billion tonnes: recoverable coal reserves total almost 6 billion tonnes. Coal production reached 40 million tonnes in 1981, an increase of 9 percent over 1980. This production was valued at $1.0 billion. Domestic consumption totalled 38 million tonnes in 1981.

The world coal market is depressed at present, largely as a result of the fall in the price of oil and the economic recession. However, the demand for thermal coal world-wide is projected to increase rapidly over the next two decades, especially if there are increased public pressures for nuclear moratoria in industrialized countries. The future demand for coking coal is related to steel production and will be affected by the rate of economic recovery. Japan is expected to be the largest market for Canadian exports of both metallurgical (i.e., coking) coal and thermal coal over the 1980s and 1990s. Other Asian countries, such as South Korea, Hong Kong and Taiwan, and Western Europe will also be important future markets.

In 1981, coal exports totalled 15.7 million tonnes of which 88 percent comprised coal shipped principally to Japan, Korea and Brazil. The remainder, including coking and bituminous thermal coal, was exported to over a dozen other countries. Exports of thermal coal are projected to grow rapidly in the 1980s based upon an anticipated sharp growth in Canadian productive capacity and an improvement in the Canadian rail and port system to handle increased volumes. The sale of 10 million tonnes of coal to Japan will make possible the development of two new mines in northeastern British Columbia.

The construction of new infrastructure is critical to the success of new coal export projects. In addition to the new rail and port facilities under construction to serve northeastern British Columbia, the existing port facilities in Vancouver are being expanded beyond their current capacity of approximately 18 million tonnes per year. The new Phase II coal terminal now under construction at Roberts Bank will add approximately 10 million tonnes of capacity by mid-1983. More than a threefold increase in coal exports from western Canada will be possible by the end of this decade.

The increased export of coal is to some extent limited by the potential environmental problems associated with its production, transportation and consumption. In this regard, Canada may benefit from the application of new technology, such as coal liquefaction or gasification, which result in the production of fuels of more general use than coal itself. The technological feasibility of coal liquefaction is well established, but the only process in commercial application (the South African Coal and Gas Co. — SASOL process) is relatively inefficient and costly.

In Western Canada, the possibility of converting coal to liquid fuels in central British Columbia has been under study by the provincial government and the Mitssho-Iwai Idemitsu Kosan Corporation of Japan. A prefeasibility study is evaluating a $5 billion, 50,000 barrel per day plant near Hat Creek, west of Kamloops. In southeastern BC, a similar study is underway involving BRIC, Petro-Canada, and Westcoast Transmission. In Eastern Canada, the federal government and a group of six companies are engaged in a feasibility study evaluating technologies for the possible liquefaction of Nova Scotia coal at two potential sites, Sydney and Point Tupper.

Canada's *uranium* supply capabilities are large, even on a world scale. The Uranium Resource Appraisal Group (URAG) of EMR recently reported Canada had 460 thousand tonnes of uranium resources in the measured, indicated and inferred categories. Allowing for production, this represents an increase of 203 thousand tonnes since 1974. In 1981, production by primary uranium producers in Canada was an estimated 7,800 tonnes, a 9 percent increase over 1980.

Projections of domestic uranium requirements are based on estimates of nuclear generating capacity either already operating or committed for operation by 1991. For this capacity, estimated at 15,111 MWe, the "protected supply" amounts to some 62,000 tonnes of uranium. Annual requirements, including first cores for future reactors, are expected to grow from some 1,100 tonnes per year in 1981 to between 2,200 and 2,400 tonnes per year in 1991.

Export demand, based upon existing commitments, will be much larger. During the period September 5, 1974 to December 31, 1981, contracts totalling some 79.7 thousand tonnes of uranium were reviewed by the federal government and found to be consistent with Canadian uranium export policy. This total reflects scheduled deliveries under 62 contracts, 31 of which remain active. As of December, 1981 forward export commitments under all active contracts, including those in place prior to September 5, 1974 were estimated at some 60,500 tonnes. Major markets include the United States, Japan, the United Kingdom and West Germany.

Since late 1979, there has been a sharp fall in uranium prices on world markets as a result of surplus uranium supply capability and postponement of substantial nuclear power plant construction. The short-term market outlook remains poor. A study released by the Uranium Institute in 1981 revealed an apparent surplus of uranium supply capabilities at least through the mid-1980s. This will have a depressing effect on prices and on investment in exploration and development. Beyond 1990, however, uranium supply capabilities could fall short of requirements if new sources of supply are not developed. Over the long term, nuclear power is still expected to contribute a significant portion of the world's energy supply. Given these prospects, and the probability of significant new uranium discoveries in Canada, the Canadian uranium industry has the potential to enhance its position in world markets. US restrictions on the use of foreign uranium, introduced in 1964 are now scheduled to be phased out by the end of 1983. There remain, however, provisions for triggering investigations under US trade law should imports of foreign uranium exceed an established ceiling.

Total installed *electrical generating capacity* in Canada was 81.6 gigawatts (GW) at the end of 1980. It is projected that electricity demand in Canada will

TABLE 19

ESTIMATED ANNUAL URANIUM PRODUCTION CAPABILITY FROM CANADIAN DEPOSITS KNOWN IN 1980

Year	Tonnes U contained in concentrates	
	(A)*	(B)**
1980	7,145 (actual)	7,145
1981	8,400	8,400
1982	9,500	9,500
1983	10,800	10,800
1984	14,800	14,800
1985	14,900	14,700
1986	15,900	14,000
1987	16,800	12,900
1988	16,500	12,300
1989	16,500	11,500
1990	17,000	10,500
1991	18,400	10,200

* Projection based on operating, committed and uncommitted production centres; output from resources currently mineable at a uranium price of $200/kg U or less.

** Projection based on operating and committed production centres only; certain planned but as yet uncommitted expansion at operating production centres are excluded. Output from resources currently mineable at a uranium price of $135/kg U or less.

increase to 100.6 GW by 1985 and 119.5 GW by 1990. Increasing conversion from oil to electricity for residential space heating is currently increasing domestic demand at rates well above the growth in GNP. Electricity demand growth exceeded annual average GNP growth by about one percentage point from 1974 to 1978. While demand for total energy is growing more slowly the price of electricity has been declining in real and relative terms.

Electricity trade between Canada and the United States has increased dramatically over the past decade due to the efforts of many US utilities to reduce their reliance on oil-fired generation and increases in transmission linkages to take advantage of opportunities. The majority of current Canadian export contracts are for interruptible power. In 1980, sales of interruptible power totalled 20,922 GWh, or 74 percent of total sales. The remaining 26 percent, or 7,236 GWh, was firm power (where the supplier is obligated to supply capacity or energy for a fixed period, as scheduled in an energy agreement). In 1980, Canada also imported 2,940 GWh of electricity from the United States.

In recent years considerable attention has focussed on the possibility of power sales from capacity built ahead of domestic needs. Virtually all generating capacity in Canada has been constructed primarily to serve domestic requirements. However, when projects are committed, the output of a specific plant may be partly surplus to immediate requirements. For some kinds of projects the construction could take place in stages to avoid excessive cash requirements, but if a short-term market can be found it may be more economical to complete the entire project within a minimum construction period. This provides an attractive opportunity for both supplier and purchaser to enjoy the benefits of the savings achieved.

The prospects for increased electricity exports will depend upon supply/demand trends in both Canada and the United States, as well as political and regulatory factors. The major potential markets for Canadian-generated electricity are in New York, New England, the Mid-West and the Pacific Coast. The provinces most capable of exporting power to these markets are New Brunswick, Quebec, Ontario, Manitoba and British Columbia.

There may be a limit to the level of external dependence which would be tolerable politically in the United States, as there may be problems of public acceptability in Canada associated with the construction of nuclear power plants ostensibly to serve the US market. If these political issues could be resolved, issues of contract duration, contractual security, pricing and transmission still would be critical to project development.

Development of an export trade in electricity has as its foundation a strong industry with large utilities that are technically and financially sound. Several of the Canadian utilities have relationships with their US counterparts in profitable exchanges extending over a period of many years and, in general, they are supported by their provincial governments. Competition among provincial utilities in Canada for access to export markets is a relatively new phenomenon, and one which may influence patterns of electricity trade in future.

Constraints and Opportunities in the Energy Sector

The "constraints" upon trade in energy derive both from supply and demand conditions and from public policy objectives. Since 1974 it has been an explicit objective of Canadian policy to seek to reduce, and eventually eliminate, Canada's dependence on foreign crude *oil imports*. In October 1980, the government put in place the National Energy Program, to lay the basis for the attainment of oil self-sufficiency by 1990. The NEP is a comprehensive set of programmes to increase domestic oil supply and reduce demand through conservation and substitution. Recent indications are that significant progress towards this goal is being made.

The export of most energy products is regulated by federal and/or provincial bodies. In approving any export of petroleum, natural gas or electricity, the National Energy Board must satisfy itself that the quantity to be exported "does not exceed the surplus remaining after due allowance has been made for the reasonably foreseeable requirements for use in Canada, having regard, in the case of an application to export gas, to the trends in the discovery of gas in Canada." The Board has developed specific tests which permit it to assess, on a case-by-case basis, whether an "exportable surplus" exists.

In order to determine whether an exportable surplus of *crude oil* exists, the Board has since 1975 used a procedure often referred to as the "T/10" formula. The principle underlying this formula is that if forecasts of supply and demand for indigenous feedstocks indicate that reasonably foreseeable Canadian requirements are not protected for at least 10 years, exports will be phased out.

In the case of natural gas, the National Energy Board in May 1982 revised its procedures for the determination of surplus. Henceforth, the Board will use a "Reserves Formula" and a "Deliverability Appraisal." Under the Reserves Formula, the Board will require firms applying to export to demonstrate that there are established reserves of natural gas adequate to provide coverage of 25 times *current* Canadian demand plus the maximum quantities of gas which it considers exportable under existing licence conditions. The Reserves Formula will determine the maximum amount of surplus available for export.

The export of electrical energy is also regulated by the National Energy Board. The NEB is required to certify that the power to be exported does not exceed the surplus remaining after due allowance has been made for the reasonably foreseeable requirements for use in Canada. (This has been interpreted to mean surplus to Canadian requirements which can be supplied economically from the generating facilities producing the power for export.) Licences may not be issued for a term in excess of 25 years, and in fact most licences are limited to terms of 5 to 10 years.

In regulating the export of oil, natural gas and electricity, the National Energy Board enjoys a considerable amount of discretionary authority. It is free, for example, to change the formula upon which the level of "exportable surplus", if any, is calculated; it has, in fact, recently made a significant change in the formula applied to natural gas. Especially in the case of electrical energy, but also for natural gas and oil, the Board's consideration of export applications is directly related to a new production and/or transportation project whose viability depends in whole or in part on access to export markets. The criteria which the Board applies in determining the acceptability of such projects is, therefore, often an important element of export review.

A surplus test is also applied to uranium based upon a resource test to determine the adequacy of domestic supply, and a requirement calculation derived from the anticipated fuel needs of nuclear reactors in Canada. This is undertaken by the Uranium Export Review Panel. In recent years, the magnitude of resources found surplus to Canadian requirements has been large enough compared to producers' supply that it has not represented an export constraint. Producers are more constrained by the general limitation on the duration of export contracts to 15 years, the final five of which are subject to partial recall. Uranium exports are controlled by the Atomic Energy Control Board (AECB), under the Atomic Energy Control Act.

At present there is no federal regulation of coal trade, nor, since the dissolution of the Dominion Coal Board in 1970, does a federal mechanism exist to effect such regulation other than in emergency situations. Recent legislation amending the Petroleum Administration Act and the National Energy Board Act (Bills C-103 and C-108) specifically excluded coal from the definition of "hydrocarbons" for purposes of the Acts. However, the Minister may designate "as an oil product" any product arising from the processing of coal under certain conditions. With respect to Bill C-106, the Energy Monitoring Act, the Minister of Energy, Mines and Resources may designate coal "along with uranium and thorium" as a substance to come under the purview of the Act. It also should be noted that the transport of coal is regulated by the Canadian Transport Commission.

The *opportunities* for Canadian energy trade vary considerably by commodity. The export of energy will be considerably influenced by the pace of general economic activity and the price of oil. In the past, Canada generally has not been in an advantageous position. Since the early 1970s, we have not had sufficient oil production capacity excess to our own needs to be able to explore new export markets. In the cases of coal and uranium, Canada must compete with other world producers on price and other terms.

In the period before 1990, the opportunities for increased sales of Canadian gas and electricity will depend primarily upon developments in the US market. In the case of natural gas, it seems probable that demand in traditional market areas will be constrained by general economic conditions and the relative surplus of US domestic gas supplies until 1984 or 1985. The recent decline in drilling activity in the United States, and the continued rapid depletion of older reserves, suggests that a significant supply shortfall and market restructuring could occur in the late 1980s.

The opportunities for increased electricity sales will depend upon the pace at which US utilities move off oil for base-load generation, the rate at which new nuclear generating capacity is added, and the rate of growth in electricity demand, particularly in the northernmost tier of states near to Canada.

The short-term market outlook for new coal exports (i.e., beyond sales contracts already concluded) is poor because of extremely aggressive marketing of coal by our competitors (i.e., the United States, Australia, South Africa and Poland) and consequent depressed prices. Over the longer term, however, the prospects for increased coal and uranium exports appear promising.

Canada's *policy* concerning the *export of energy* reflects the following principles:

- The reasonably foreseeable requirements of the Canadian economy must be protected before energy exports are authorized;
- The price of energy exports should more than cover the costs of production in Canada and reflect the opportunity cost to Canada of not using it domestically; and
- To the extent possible, energy exports should be used to achieve other benefits for Canada, including industrial development resulting from the construction of production or transportation facilities.

The National Energy Program emphasized that a major goal of government policy is oil self-sufficiency for Canada. It put in place a variety of programmes to ensure that Canadians would have secure domestic oil supplies, would use existing energy supplies more efficiently and would increasingly substitute for oil plentiful domestic supplies of other fuels. The NEP also sought to increase the opportunity for Canadians to benefit from energy exports.

The NEP: Update 1982 contained further clarification of the government's approach to exports of both conventional and liquefied natural gas. It reaffirmed the importance of providing adequate protection for Canada's domestic market, espe-

cially in view of the determined effort to convince Canadians to switch from oil to natural gas. It stated that the government agreed with the National Energy Board's proposed new approach to the determination of natural gas surplus. With respect to the marketing of gas in the United States, the government indicated that it favoured "regulatory and commercial measures directed towards achieving a higher degree of utilization of exports already committed to traditional US markets and supports current efforts to market Canadian gas in regions of the United States that are regarded as offering reliable new markets". The government also stated that it would continue to show flexibility in implementing its export pricing principles.

There clearly remain many unresolved issues regarding energy, and in particular natural gas, export policy. The longstanding principles upon which Canadian policy is based, and the government's most recently articulated views, reflect the myriad of considerations which must govern Canada's approach to exports. Fundamentally, that policy rests upon a view of the magnitude of Canada's non-renewable energy resources in geological terms, and of the probable economic cost and technological feasibility of extracting them now and in the future. Canada's resources clearly are large in terms of its own current requirements, but they are not so large relative to the demands of other countries that Canada's future security of supply would be adequately protected by a laissez-faire attitude to energy exports. Coal is an obvious exception to these considerations, given the magnitude of the resource base and Canada's relatively small domestic demand. This consideration also does not apply to exports of renewable energy, and government policy has traditionally reflected the view that, with certain precautions regarding pricing and the length of commitments, exports of renewable energy should be encouraged.

The need to assure security of supply over a reasonable period remains the key imperative in energy export policy. The uncertainty of future projections, the experience of the past decade in the international oil market, and the problems created in the past from too optimistic views of Canada's future supply capabilities are considerations which argue strongly in favour of a cautious approach to export policy, and particularly to the authorization of long-term export licences. In economic terms, there clearly may be costs to deferred production assuming (and this is a key assumption) that the price of oil will not continue to rise in real terms. This is a cost which successive Canadian governments have indicated they are prepared, within limits, to pay, to protect the rights of future generations.

Short-term considerations, of course, are also important. Exports provide cash flow to the producing industry, and thus stimulate increased exploration and development. In periods of economic recession, this may make a valuable contribution to general economic activity. It also may result in the proving of additional energy reserves, atlhough experience with oil in Canada and other countries suggests that the additional reserves discovered rarely are sufficient to replace those exported.

It is generally agreed that, with respect to the energy which is found to be "surplus", Canada should seek to optimize its benefits. There are, of course, a variety of ways in which this can be achieved. Prices should be set so as to maximize revenues in the short-term and recognize the long-term intrinsic value of the resource, although occasionally these goals may conflict. Prices also should be set so as to

recover an equitable share of economic rent from foreign consumers, especially where the energy supplies being exported were developed with the assistance of generous government incentives. Another consideration, which is relevant in the case of large scale or remote production projects, entailing long lead times and the possibility of significant cost overruns, is that prices should be set so as to protect Canadian suppliers and the Canadian government from undue risks.

Often Canada's ability to derive benefits from energy export projects may depend upon the posture assumed vis-à-vis foreign governments and consumers. For some energy commodities, and certainly for oil and natural gas, the assurance of a secure supply is extremely valuable in economic terms.

Petrochemicals

The petrochemical industry plays a strategic role in the balanced growth and development of major economies around the world, upgrading hydrocarbon resources into products which are utilized directly or indirectly by nearly all other industries. For example, the textile industry must have ethylene glycol to produce polyester fibres, and the automotive industry is a large user of moulded and extruded plastic parts which are in turn produced from synthetic resins. Without a strong, competitive petrochemical industry, downstream end-user industries would not develop fully. Conversely, the health of downstream industries, particularly plastics, is extremely important to the petrochemical industry itself.

The USA, Western Europe and Japan dominated world petrochemical production, consumption and trade in the 1960s and early 1970s. However, rapidly escalating feedstock costs and uncertain supplies have become serious constraints for the European and Japanese petrochemical industries, while new producers in Canada, Eastern Europe, Mexico and Saudi Arabia with access to stable and competitive domestic feedstock supplies have begun to take an increasing share of world markets. The US industry is maintaining a dominant position, but it too may ultimately lose some of its market share to producers in energy-rich areas, particularly after US natural gas decontrol in the late 1980s. World petrochemical consumption will grow more rapidly than GNP but at a rate significantly lower than the historical average. The expected slowdown in growth of consumption is a direct result of slower economic growth in the developed countries, higher feedstock prices, and slower penetration by synthetics of the markets for natural materials. Indeed, the economic recession forced a reduction of a significant amount of production capacity in Europe, the USA and Japan.

The Canadian petrochemical industry which emerged in the 1950s and 1960s was small and fragmented, catering almost exclusively to the domestic market. As economies of plant scale became increasingly important, the small size of the Canadian plants made them less and less economic in comparison to their international competition. The size of world scale ethylene plants, for instance, increased from 150-200 thousand tons/year in the 1950s to about 500 thousand tons/year by the late 1970s. Fortunately, a number of developments in the 1970s helped to slow down, and ultimately reverse, the deterioration of the Canadian industry's interna-

TABLE 20

PRODUCTION AND TRADE STATISTICS FOR PETROCHEMICALS AND SELECTED DOWNSTREAM INDUSTRIES

($ Millions 1980)

	Shipments	Imports	Exports
Petrochemicals, incl. intermediates	4,220	1,171	1,234
Paint and Varnish	647	86	9
Miscellaneous Chemicals	1,677	851	185
Industrial Rubber Products	750	570	45
Plastic Products	3,800	1,254	380
Man-Made Fibres, Yarns & Cloth	1,270	650	225
Floor Tile & Coated Fabrics	226	144	50
	12,590	4,726	2,128

tional competitiveness. The trend to larger and larger production units was halted in the face of technological constraints and, more importantly, the enormous financial risk of plant failure and shut-down. At the same time, rapid growth of the Canadian market created a situation where Canadian demand was in itself sufficient to support one or more world scale plants in a few key product areas. These factors combined with a favourable movement in the exchange rate of the Canadian dollar, the emergence of Canada as one of the few developed countries with assured supplies of hydrocarbon feedstocks at favourable prices, and a competitive taxation regime, to make Canada fully competitive in the late 1970s as a site for new petrochemical investment. The multinationals that dominate this industry took these developments as a signal to make major new investments in both Ontario and Alberta, leaving Canada as it entered the 1980s with three major internationally competitive petrochemical complexes located in Alberta, Ontario (Sarnia) and Quebec (Montreal). In Atlantic Canada, prospective significant development of petrochemical capacity based on availability of oil and natural gas liquids from reserves off the east coast remains uncertain and some years away.

The Central Canadian industry, based on feedstocks derived from crude oil, is oriented primarily to the domestic market, which is itself located largely in Ontario and Quebec. Exports are important, but mainly as a means of absorbing incremental production from new world-scale plants necessary until the Canadian market grows to accommodate the new entrants. Imports are also quite large, as there are many products for which the Canadian market is too small to support economic production. Provided the non-ethylene petrochemical end-use markets continue to grow in Ontario and Quebec, the Central Canadian petrochemical industry will have a basis for expansion over the longer term in the domestic market. However, this part of the Canadian industry will continue to be sensitive to the pricing and availability of oil-derived feedstocks, and thus to developments in the National Energy Policy.

For its part, the Western Canadian industry, based on feedstocks derived from natural gas, is oriented strongly to export markets, principally in the USA, but also in other countries of the Pacific Rim. The current phase of industry expansion is focussed in Alberta and to a lesser extent in British Columbia under the influence of

domestic natural gas pricing policy. Alberta Gas Ethylene's second and third ethylene plants are scheduled to come onstream in 1984 and 1986, respectively. In addition, derivative plants are being built to use ethylene and several methanol facilities will come into operation in 1982. The longer term future of the Western petrochemical industry is dependent on the degree to which Canada remains competitive as a site for new plants. In this regard, the pricing elements of the National Energy Policy and the more recent Memoranda of Agreement with the producing provinces favour the continued international viability of gas-based petrochemical production, while the possible use of export controls on basic petrochemical products to prevent the circumvention of energy policy objectives through the export of energy-derived petrochemicals, may have the effect of discouraging some investments.

Clearly, OPEC pricing policies will have a major influence on the competitive position of the Canadian industry. For example, the current decline in international energy prices coupled with the economic recession has brought pressure on Canadian producers in both Western and Central locations whose feedstock costs have become higher than those of their international competitors. This situation is expected to correct itself to an extent with renewed economic growth. Furthermore, as deregulation of natural gas prices in the USA is expected to result in higher gas costs in that country by 1987, the competitive position of the Canadian industry should be improved.

The petrochemical industry, in summary, is entering the 1980s in a good position to take advantage of emerging export and domestic market opportunities. The international environment, however, will be fiercely competitive, and Canada will have to compete with both existing and new petrochemical suppliers as a site for incremental investment. The governmental policy environment will be an important determinant of the industry's success, with energy policy, tax policy, trade policy, and exchange rate policy in particular having the capacity significantly to facilitate or constrain its future development. The industry, whose future viability could be in doubt if feedstock costs get too far out of line, will tend to be significantly influenced by developments in energy policy.

As the Canadian petrochemical industry takes on an increasing export orientation, improved access to the USA and other foreign markets will continue to be an important Canadian trade policy objective for this sector. Although only minimal improvements in international market access proved to be obtainable in the recent multilateral trade negotiations, the situation is somewhat different for derivatives and plastics which face more liberal market access conditions in the USA, Japan and EC. The promotion of Canadian petrochemical exports to Japan and other Pacific Rim countries is also being encouraged by increased technological and industrial cooperation links between Canadian and Japanese companies.

Textiles, Clothing and Footwear

In June 1981, the federal government announced its policy for Canada's textile and clothing industries in the 1980s. The policy comprised two elements: a five-year, $250 million programme to deal with adjustment problems, and actions to limit tex-

tile and clothing imports over the five-year period to facilitate smooth and balanced adjustment. In October, 1981 the Canadian Industrial Renewal Board was established to assist in the modernization of existing viable firms and to create new employment opportunities for displaced workers. The mandate of the Industrial Renewal Board is to help restructure, consolidate and modernize the textile and clothing industries, to renew the economic base of communities heavily dependent on those industries and to help workers affected by these changes. The Board will also encourage and assist new firms in other sectors wishing to locate in designated communities. This policy builds upon the dual adjustment/protection direction set by the 1970 Textile Policy which provided financial support to assist industries "progressively to phase-out of the least competitive lines and to move into those with the highest competitive potential for the future."

In 1981, the textile and clothing industries accounted for employment of 81 and 108 thousand respectively. This represents 10 percent of overall Canadian manufacturing employment, and 7 percent and 20 percent of manufacturing employment in Ontario and Quebec where these industries are heavily concentrated. In Quebec there are 22 communities where textiles and clothing represent between 20 percent and 76 percent of manufacturing employment.

For many developing countries, textile and clothing production represents an important step on the industrial development ladder. The latter half of the sixties saw the emergence of a large number of LDCs as important suppliers of yarns and fabrics. This was followed in the seventies by substantial growth in apparel exports from these countries. As a result, the textile and clothing industries in all OECD countries were faced with increasing import competition during the last decade and declining employment levels. This was accompanied by significant productivity improvements in primary textiles which, as estimated by the OECD, accounted for 80 percent of "labour shedding" in Japan, 74 percent in the USA and 59 percent in Europe between 1973 and 1978.

In grappling with the problems facing the textile and clothing industries, developed countries have reacted in a number of ways. They have severely restrained imports of these products. It is estimated that some 90 percent of US and EC textile and clothing imports from developing countries are covered by restraint agreements. Sweden, after having reduced or eliminated special measures of protection on textiles and clothing in the mid-sixties with resulting sharp increases in imports and a significant contraction in output, re-instated these measures on apparel less than a decade later. About 90 percent of Canada's clothing imports from developing countries and about 7 percent of all textile imports were subject to quantitative restrictions in 1981. Canada's use of quantitative restrictions has gradually been drifting away from primary textiles to clothing as more countries developed production capacity for low-cost apparel, and as the import patterns, and resultant concerns of domestic manufacturers, shifted to clothing from primary textiles. As a result, a very broad range of apparel products was subject to restraint at the close of the decade in response to the rapidly increasing competition from, and market penetration achieved by, low-cost sources in 1975-76. During the period 1970-77, the textile industry moved out of the areas facing the strongest competition from low-cost imports — in such sectors employment declined by almost 11,500 — but employ-

ment increased in other sub-sectors (carpets, autofabrics and miscellaneous textiles) by almost 7,500. These growth sectors responded to market opportunities and to the 1970 Textile policy.

In the 1970s, the Canadian non-rubber footwear industry experienced a similar situation to that facing the clothing industry, i.e., disruptive levels of import penetration from a number of low-cost sources. Following a 1977 finding of serious injury caused by increasing imports, the government introduced a global quota on leather and synthetic footwear on December 1, 1977; this quota expired on November 30, 1981. In February 1981, the Tribunal finished an investigation into the state of the industry and its ability to compete internationally. It concluded that the industry had made efforts to restructure and could meet competition from developed and state-trading economies but was threatened by imports from low-cost developing countries. On December 1, 1981 the government introduced a new global quota restraining imports of synthetic and canvas footwear, the bulk of which originates from low-cost developing countries. It also extended to the footwear and tanning industries the benefits of assistance measures provided to the textile and clothing industries through the Canadian Industrial Renewal Board; additional funding of $17 million was also approved. The decision not to restrain leather footwear imports was viewed with considerable concern by the industry. In the first part of 1982, production levels started to decrease, imports of leather footwear to increase, and employment to decrease again substantially, leading the government to introduce a global quota on leather footwear imports for a period of 29 months effective July 12, 1982.

While there has been a heavy emphasis on import problems and the need for adjustment in the textile, clothing and footwear sectors, there are sub-sectors or individual firms which have successfully pursued new opportunities, both at home and abroad. For example, at least one man-made fibre producer has a world mandate to export and is currently exporting 60 percent of its production. Companies in other sectors such as coated fabrics and industrial textiles have developed strong markets in the USA for specific products and are now exporting up to 50 percent of their total production. The fur garments sub-sector has continued its export orientation to the point where half its output is exported to Western Europe, the USA and Japan. The federal government programme aimed at improving fashion design capability has been used successfully by the private sector to promote Canadian fashions abroad, particularly in the US market. With modern apparel production facilities and aggressive management, several Winnipeg-based operations have also been successfully pursuing export opportunities in US and EC markets for winter outerwear and ladies sportswear. Despite some US customs classification practices including the "ornamentation clause" in the US tariff, such opportunities should continue to exist during the 1980s.

Electrical Machinery and Equipment

The electrical industry manufactures products which generate, transmit, store and use electricity. The industry commonly is broken into six subsectors: industrial electrical equipment (i.e., power generation and transmission, plus heavy electrical industrial applications); wire and cable; major household appliances (refrigerators,

stoves, etc.); small appliances; batteries; and miscellaneous products. It is, however, convenient to think of the electrical industry in terms of the production of the equipment required to generate and distribute electricity and the manufacturing of products that use electricity.

As recently as 1965, the export of electrical products from western countries amounted to little more than 8.5 percent of shipments and no major producer relied on exports for more than 18 to 20 percent of sales. Today, in Canada over 28 percent of shipments are for export and some producers manufacture as much as 50 percent of their production for the export market.

With $5.5 billion in total shipments and 70,000 employees in 1981, the Canadian electrical industry ranks in size behind automotive and machinery, and on a par with clothing and textiles. Some 90 percent of the industry's activity and employment is in Ontario and Quebec. The growth of a substantial domestic industry with competitive advantage in many product lines has in the past been supported by a strong emphasis on the role of electricity in energy production in Canada, in addition to protective tariffs, and other government incentives. These factors created a sufficiently attractive investment climate to entice many multinational enterprises to establish subsidiary companies in Canada. Although manufacturing plants have been generally small scale, fragmented (partly as a result of the procurement practices of individual provincial utilities) and oriented to the domestic market, Canadian firms have developed several areas of internationally recognized competence, such as production of hydraulic generators, turbines, extra high voltage transformers, long distance extra high voltage transmission lines, large motor and control systems, and variable speed coordinated drive systems.

The 1980s are expected to experience a slowdown in the rate of growth of domestic electricity demand, severely limiting domestic market growth for the electricity generating and distribution industry. Similar conditions may exist for electrical consumer products. This situation, in contrast to the tendency in the 1970s for domestic market growth to outpace production, underlies the need to overcome the structural weaknesses of the electrical sector, which has adversely affected its ability to compete in Canada and abroad. Indeed, most foreign subsidiaries were set up to produce for domestic — even regional — markets, while Canadian-owned firms, unwilling or unable to compete with MNEs, have tended to proliferate by concentrating on the production of specialized items and filling smaller gaps in the domestic and occasionally the export market. Export success has been increasingly limited to firms doing custom work in the heavy electrical equipment sub-sector and to manufacturers with specialized plants capable of more competitive production runs. If Canada is to fully benefit, in the longer term, from electricity-based industrial development, and if Canadian industry is to grow, further product rationalization and export development efforts across all sub-sectors of the Canadian industry will be needed. In the major appliance sub-sector, for example, industry rationalization in the last few years has provided the base for a more competitive industry and the prospect of better export performance in the future.

In spite of a growing trade deficit, the Canadian industry continues to increase its export sales. In 1981 approximately $800 million worth of electrical goods were

exported, in contrast to 10 years earlier when only $1.5 million was exported. Although the USA is Canada's largest market for all electrical products, in recent years Canadian manufacturers have supplied equipment for projects throughout the world: including 805 MW hydro generators for the Guri dam in Venezuela, vertical rise oil-filled cable for Panama, 825 MW generators for the Grand Coulee dam in the USA (the largest generators ever produced in the Western world), and switchgears for Venezuela. It is indeed in industrial electrical equipment that Canada's export performance has been most significant. This performance stands to benefit from further Canada-US corporate rationalization of product lines, although growth in the US market has slowed in recent years. To a considerable extent future market growth may come from developing countries and China, as per capita energy consumption in these areas could grow at many times the rate in North American electrical generation, requiring the establishment of distribution infrastructure networks.

International competition is fierce and market access conditions are subject to restrictive trading practices on the part of both foreign governments and MNEs, particularly in respect of power generation and distribution equipment. It is well documented that competitor governments generally provide extensive market support for their national electrical "champions", while virtually ensuring the full domestic market to national suppliers through protective procurement policies. In fact, in many countries, such as Japan, Germany, France and the UK, bidding documents are unavailable to other than domestic manufacturers. In the USA, the impact of "Buy American" programmes and other incentives effectively eliminate foreign competition from roughly half of the total US electrical utility market. These procurement policies often enable producers marginally to price goods and services when bidding internationally. Governments accept the resultant higher domestic prices and provide other direct support to their exporters including concessional export financing. Similarly, developing countries also have a tendency to move rapidly to introduce protective structures as they establish indigenous electrical manufacturing capability. Market access conditions in respect of industrial electrical equipment have been virtually isolated from the move towards international trade liberalization. For example, trade in heavy electrical equipment is not subject to the GATT Agreement on Government Procurement. Preferential procurement practices and foreign export supports are generally seen as quite significant factors affecting competition, in fact much more so than tariffs per se.

In the domestic market, provincial utilities provide the largest single category of user-purchaser of electrical equipment. Utilities in the manufacturing provinces tend towards preferential procurement practices in support of local industry, while those in the non-manufacturing provinces tend to purchase on the basis of price competition alone, without regard to nationality. In either situation, Canadian electrical manufacturers often view themselves as the victims of unfair competition exacerbated by lack of free trade within Canada.

Strong government-supported links between utilities — which are often central government monopolies — and domestic equipment manufacturers confer significant international strength to foreign producers of industrial equipment. This is particularly relevant in the context of integrated project bidding, involving overall management responsibility, which has become an increasing feature of trade in this sector.

Such interdisciplinary links are not prevalent within Canada, limiting its current ability to compete internationally. In the prevailing international competitive environment, a successful export push in the heavy electrical equipment sub-sector would require the creation of specific Canadian bidding capabilities to exploit the opportunities of turnkey projects in developing country hydro-electric generation and distribution projects, by, for example, linking the considerable design, planning and project management capabilities of Canadian utilities with the engineering, consulting, and supply potential of domestic equipment manufacturers. Similarly, as construction schedules, standards and specifications by national governments are geared as much as possible to suit the needs and peculiarities of their domestic electrical industries, Canadian industry could benefit from the establishment of arrangements with other producer countries on the methods of testing and certifying products to conform with standards applicable in those countries. Such arrangements are encouraged by the GATT Agreement on Technical Barriers to Trade. Indeed, some progress has been made with Japan, where an arrangement was concluded recently that will allow nine electrical products to be tested in Canada for conformity to Japanese standards, thus significantly facilitating the export of these items to Japan.

With respect to competition in the domestic market, the existence of global overcapacity and a slow growing domestic market in the 1980s may well exacerbate the difficulties of Canadian suppliers created by predatory pricing practices of foreign companies.

Machinery and Equipment

Machinery and equipment required for the development of resources, processing, manufacturing and service industries, play an important role in the growth of economies around the world and of international trade. Although there are segments of the machinery sector in most industrialized countries geared primarily to serve local requirements, machinery and equipment markets are predominantly international. Indeed, trade in machinery and equipment among developed countries has been both a major driving force leading to, and a large beneficiary of, the substantial international liberalization of market access conditions in recent decades.

Most industrialized countries have strong machinery producing capabilities and compete extensively with each other for the broad range of machinery needs characteristic of developed economies and for machinery needed by the infrastructure and resource development projects underway in developing countries. All major machinery producing countries export a substantial portion of their production (25 percent to 30 percent for the USA and Japan, and between 55 percent and 65 percent for West Germany, UK, France and Sweden) and import a considerable share of their domestic requirements (13 percent for the USA, 24 percent for Japan, 30 percent for West Germany, and from 50 to 60 percent for UK, France and Sweden). Canada has increasingly participated in the internationalization of this broad and diverse industry with half of its production going to exports and 65 percent of its domestic requirements filled by imports. These figures were 20 and 54 percent respectively in 1965. International competition is dominated by large corporations and is influenced by many factors other than price (e.g., quality and reputation,

engineering services, distribution facilities and financing, including concessional and tied export financing in respect of large capital equipment).

There are approximately 2,000 firms manufacturing machinery in Canada, ranging from some of the country's largest industrial corporations, to small machine shops serving local markets. Production comprises a wide range of equipment required in the resource, processing, manufacturing and service industries, including both custom-engineered equipment and standard off-the-shelf machinery. In the last 15 years domestic production of machinery and equipment in Canada ($8.6 billion in 1980) has been increasing at about the same rate as the overall domestic market i.e., a real average annual growth rate of about 5 percent with exports ($3.8 billion in 1980) being the fastest growing component i.e., 8 percent annually. As economies of scale are usually a major competitive consideration for the production of standard or off-the-shelf items of machinery, many machinery producers have gradually reduced the range of machinery lines manufactured in Canada and concentrated on certain types and sizes of machinery as well as on custom-engineered equipment. This has, of course, significantly narrowed the range of models and sizes of equipment produced in Canada and increased the domestic requirements being filled by imports. Although the nominal self-sufficiency of the industry (as measured by the ratio of production to the domestic market) has improved from 57 to 63 percent, the industry's share of the domestic market has been reduced from almost half to about one-third.

The development of the Canadian machinery and equipment industry has been significantly influenced by national industrial and trade policies. Historically, a relatively high tariff and preferential access to Commonwealth markets encouraged the establishment of foreign-owned subsidiaries to supply these markets. At the same time, however, reduced rates of import duty were provided on machinery and equipment of a class or kind not made in Canada in order to reduce costs to machinery users in different parts of the country and increase their efficiency and competitiveness. There has also been a long history of tariff-free treatment over a wide range of resource-based machinery for mineral, oil and gas, and agricultural and fish processing equipment to enhance the development of resource-based industries. Rates on dutiable machinery have been progressively lowered (down to 9.2 percent by 1987) in successive international trade negotiations. Under the Machinery Programme introduced in 1968, provision was made for the remission of duty on the importation of machinery not available in Canada while ensuring that Canadian machinery firms were afforded full support from the tariff.

The Machinery Programme has provided a major tool to foster development of a strong, internationally competitive industry and this has been reflected in the industry's demonstrated success in export markets in product areas where it has specialized. This process of product specialization and rationalization has also been brought about by the need to adjust to increased competition in the domestic market. The narrowing of the production base resulting from this rationalization and specialization process has raised some concerns domestically. Thus the focus is now on the need to ensure that Canadian manufacturers of resource-based equipment are provided with full and equitable opportunity to compete for the market opportunities expected from major resource projects and stepped-up industrial automation to

strengthen the industry's share of the domestic market, while at the same time continuing to pursue new and expanding markets.

Canada manufactures a broad range of resource-based machinery such as forestry, mining, power generation, construction equipment and agricultural equipment. These sectors represent about 40 percent of total domestic production of machinery and equipment and over 60 percent of exports. For Canadian firms, domestic and international activities must be pursued simultaneously, in order to achieve stability of demand sufficient to justify the substantial capital expenditures needed to maintain technologically- and cost-competitive production facilities. In this regard, major domestic resource projects could provide unique opportunities for Canadian machinery firms to secure additional financial strength and build on their proven track record in order to expand their presence in export markets.

In international markets, major capital projects are extensive — of the order of $100 billion in 1980 alone. In recent years, Canadian machinery firms have participated in a number of large resource development projects overseas such as the Kwidzyn pulp and paper project in Poland; the Gilan forest products complex in Iran; a cement plant in Indonesia; and a steel mill project in Trinidad. They have also obtained substantial contracts for pipeline compressors, valves and portable drill rigs for the USSR. Although the majority of Canadian firms participating in capital projects abroad have done so as sub-contractors, one or two of the capital projects abroad each year have been obtained by Canadian firms as prime contractors. Only a few consulting engineering firms have had the required financial capacity to act as prime contractors while many of the larger foreign-controlled manufacturers have not been in a position to assume the necessary leadership and associated risks and responsibilities. In these circumstances, it is reasonable to expect that the capacity of domestic capital equipment producers and associated consulting firms in obtaining their share of major capital projects abroad would be enhanced by a fair and equitable opportunity to compete for major projects at home. In particular, this should contribute to improving the capability of some Canadian firms to assume prime contracting roles in overseas projects.

Significant new opportunities for the export of industrial and service machinery are also expected over the next few years. In this regard, exports in such areas as packaging equipment, material-handling equipment and environmental equipment, should be strong, particularly in the United States market where the very broad range of new equipment applications provides an opportunity for Canadian suppliers to specialize in particular segments of the market. In addition, Canadian manufacturers of industrial equipment should be in a position to benefit from new market demand which will result from an accelerating world-wide trend to increased automation of industrial processes, which is being facilitated through the application of micro-electronic technology.

Overall, the United States market should continue to be of prime importance to Canadian machinery and equipment firms. This market presently absorbs over 70 percent of machinery exports and, following the last round of tariff negotiations, US duties will be progressively reduced to modest levels, in the range of 2.5 to 5.5 percent. In addition, a range of major machinery exports, including agricultural

machinery, pulp and paper equipment and some heavy metal working equipment, has been provided duty-free access to the United States. Similarly, the introduction by the USA of an injury test into its countervailing duty legislation reduces the risk that Canadian machinery and equipment producers benefitting from domestic industrial and regional development support programmes will be penalized upon exporting to the US market.

Continued export growth at the levels experienced in recent years will become an increasingly challenging task for Canadian industry to sustain. This will require firms to obtain technologically advanced facilities and introduce new productivity-improvement measures through various technologies such as micro-electronics and computer aided design and manufacturing. The achievement of a strong and healthy machinery industry in the 1980s will, to a significant extent, be enhanced by the industry's ability to use the opportunities available in both domestic and export markets, particularly in respect of major resource projects. New investments aimed at structural improvements in the operation of foreign subsidiaries will need to go beyond the cost-oriented rationalization process that has characterized much of the adjustment undertaken by these firms in recent years. To continue to achieve major gains in both export and domestic markets, subsidiaries will need to obtain from their parents a mission to develop independent technological capability for new innovations and a mandate to establish the marketing infrastructure needed to sell these new products in world markets. Moreover, these investments will have to be obtained for Canada under circumstances where the advantages of locating in Canada will be no better than the advantages for foreign corporations of serving Canadian markets from their domestic facilities. As for the large number of small and medium-sized machinery manufacturers which lack the international stature of their foreign competitors, a successful trade performance in the 1980s will require further productivity improvements, the acquisition of more automated facilities and equipment, the diversification into more advanced product areas, and the structuring of marketing efforts to compete more effectively against the extensive distribution networks and the established reputation of the large foreign multinationals.

The achievement of the industry's objectives will be significantly influenced by developments in the international trading environment. For instance, there are continuing concerns that the United States DISC programme adversely affects new investment opportunities in Canada by providing relatively more favourable conditions for locating new export-oriented investment in the United States. Restrictive procurement practices by both the United States and European governments, are also constraints to the export aspirations of a number of Canadian machinery subsectors, including environmental equipment and major items of power generation equipment. Similarly, the increasing use of concessional and tied financing arrangements provided by foreign governments to their machinery firms is of growing concern to Canadian capital equipment manufacturers, in respect of both the domestic and export markets.

Automotive Products

The Canadian automotive industry accounts for roughly 10 percent of total manufacturing shipments and 6 percent of total direct manufacturing employment. The industry is an important customer of the products of other industrial sectors

such as synthetic rubber (35 percent), iron foundry (28 percent), rubber products (19 percent), machine shop products (18 percent), wire products (14 percent), carpeting and fabrics (8.5 percent), aluminum products (9 percent), and plastics (5 percent). It is also the largest single component of Canadian trade, particularly with the USA.

The "Big Four" automobile manufacturers produce approximately 90 percent of the vehicles (mainly automobiles and light trucks) manufactured in Canada. These firms also account for the production of roughly one-half of original equipment motor vehicle parts and components while about 17 percent is produced by the ten largest independent parts companies. The remaining one-third is produced by roughly 460 firms with a high degree of Canadian ownership and control. Over 80 percent of parts-industry production is for the original equipment market. In terms of location, vehicle assembly activity takes place in Ontario (83 percent), Quebec (12 percent), and the remaining 5 percent in other provinces; original equipment parts plants are located in Ontario (80 percent), in Quebec (10 percent) and the rest largely in Western Canada; exclusive aftermarket producers are in Ontario (68 percent) while Quebec and Western Canada each account for 16 percent.

The Canada-US Automotive Products Trade Agreement (APTA) is the single major factor which has conditioned the development of the Canadian automotive industry since 1965. The APTA basically involves the granting of duty-free access between Canada and the USA in respect of motor vehicles and original-equipment parts. The USA obtained a GATT waiver allowing the benefit of the duty-free access to be limited to Canada but duty-free access to Canada for products imported by qualified vehicle producers is not limited to goods originating in the USA. The agreement contains "safeguard" provisions requiring that APTA producers in Canada maintain levels of vehicle production in Canada related to the value of their vehicle sales in the Canadian market. It also includes provisions requiring a minimum dollar amount of "in-vehicle" Canadian value added (CVA). However, the significance of this requirement has been eroded, particularly as a result of inflation. The APTA was also accompanied by letters of undertaking to the Canadian Government from the "Big Four" producers containing commitments regarding levels of growth in CVA related to expansion in the value of their Canadian market sales. This CVA commitment can be met through both assembly activity in Canada and domestic use or export of Canadian-made automotive parts.

The developments which flowed from the APTA resulted in a North American rationalization of assembly operations. However, in respect of major original-equipment parts, they have continued to be produced largely in-house in the USA. The Canadian motor vehicle industry has developed little management autonomy and little R&D is undertaken in Canada. Relative to US production patterns, the Canadian industry's operations are more geared to assembly and independent parts production and less to captive parts production. The independent parts producers have nevertheless closely geared their production to the needs of the major North American vehicle manufacturers who, until recently, have largely sourced their parts needs from firms in North America. They are reliant on sourcing contracts on a "make to drawing" basis and on access to the centralized purchasing structure of the car manufacturers. To a large extent, the subsidiary parts producers are second sources for iden-

tical products currently being produced within the corporate structure. Those independent and subsidiary parts producers that design and produce components have until recently benefited from, and perhaps become overly dependent on, the relative stability of automotive technology and product designs, particularly in North America. The domestic original-equipment parts industry does very little business with the overseas producers and therefore little of its engineering activity is geared to the requirements of those firms.

The extent of Canadian participation in domestic motor vehicle sales varies considerably from one foreign supplier to another. Japanese producers have made substantial inroads in the domestic market but have purchased negligible amounts of Canadian parts and components, reflecting their traditional sourcing patterns despite the availability of duty remission on imported vehicles in proportion to exports of Canadian parts to Japanese assemblers. The CVA level in relation to sales of North American vehicles has declined considerably since the early 1970s, reflecting reduced potential economic growth and North American demand, increasing pressure on the subsidiaries to withhold further investment decisions for Canada and the marked increase in import penetration of automotive parts. From the early years of the APTA to the early 1970s, buoyant demand conditions and the time lag required for major rationalization had resulted in the major US manufacturers substantially exceeding their APTA ratio requirements. Under the soft demand conditions prevailing in 1980 and 1981, the APTA manufacturers were operating at the margin of the production-ratio requirements, but they exceeded these requirements in 1982.

In the 1970s there was a rapid and pronounced shift in demand by North American consumers toward smaller cars together with a significant cyclical downturn in demand for passenger cars. These developments had a significant impact on passenger vehicle production in Canada — which fell from 1.0 million units in model year 1979 to 0.82 million in model year 1981 — and on motor vehicle assembly employment — which fell from 53,000 to 46,000 workers while employment in the parts industry fell from 74,000 to 70,000 workers. They have also affected Canada's trade position in automotive products which shows an overall trade deficit vis-à-vis the USA of $1.7 billion in 1981, caused by the significant deficit in parts which had reached $5 billion in that year. Canada's deficit with respect to overseas countries, especially Japan, has risen sharply in recent years, largely the result of a large increase in the passenger car deficit. Nevertheless, Canada has had some success in penetrating export markets, particularly in developing countries, such as Venezuela. Indeed, automotive products are being accorded increasing priority in Canadian export development efforts. Overall exports of automotive products reached some $16.5 billion in 1982, compared to $600 million in 1964, the year before APTA came into effect.

In a world context, the fate of the Canadian industry is closely tied to that of the US industry. The dramatic penetration of the North American market by Japanese auto companies has created severe competitive pressures on the industry, based on a variety of factors including product mix, cost advantages and consumer perceptions of quality differentials. The Japanese auto firms have had a marked advantage over their North American counterparts in terms of the fuel efficiency of their products but the North American industry is actively restructuring its own product mix and is now substantially closing the fuel efficiency gap vis-à-vis present Japanese

models. However, Japanese companies are forging further ahead in the area of fuel efficiency and this could pose renewed problems for the domestic industry if consumers demand even more fuel-efficient vehicles than are now being planned by the domestic industry.

In terms of costs of production, it has been estimated that the Japanese currently enjoy an average net cost advantage of roughly 15-20 percent in the production of small-sized cars. This cost advantage is attributable to a number of factors, including lower wage costs, superior productivity performance, superior inventory and quality control systems, lower absenteeism, and lower-cost materials (especially steel). The Japanese auto companies are also employing robots in vehicle manufacturing more extensively than their North American counterparts.

There is likely to be a significant move by the world automobile manufacturers toward the further development and production of a world car: a vehicle assembled in many countries from components manufactured in a smaller number of countries. The internationalization of the industry along these lines will be dictated by the shift in world demand toward new markets, the relative labour costs in various countries as well as by the local content regulations imposed by governments. It is expected that developing countries such as Brazil, Mexico, Argentina and Korea will be increasingly attractive locations in which to site production facilities in the 1980s (primarily world-scale components). Assembly operations will likely continue to be performed "locally" i.e., in areas offering large or rapidly growing markets. Further industry consolidation is anticipated over the next two decades, with a reduced number of strong, broad-based manufacturers likely to be sharing the world market by the turn of the century.

Automobile producers in the USA and Europe have approached the development of the world car through the standardization of major components produced on a world scale. The attempt to catch up quickly with changing technologies and to take advantage of competitive pricing has also resulted in North American vehicle assemblers increasingly sourcing components offshore for the new generation vehicles. For example, GM, Ford, Chrysler, AMC and VW of America have made commitments to source diesel engines and other key components, such as transmissions, from offshore countries. These large companies are also increasing their sourcing of complete vehicles from Japanese manufacturers (e.g., GM from Isuzu, Chrysler from Mitsubishi and Ford from Toyo Kogyo in Japan). To date, the Japanese auto makers have pursued an opposite course with their basic strategy being "world car" production in Japan with world-wide marketability. Nevertheless, the Japanese companies are diversifying their production sites to some extent (e.g., in the USA, the UK, Australia and the newly industrialized countries) and, partly in response to pressure from some countries, have agreed to some sourcing and assembly abroad.

Technological development and efficient production of componentry will continue to be the core of future automotive activities worldwide. The pervasive issue in automotive parts manufacture in Canada is the urgent need to improve productivity, upgrade innovative capability in the near term and to share in the new technological developments. In this regard, the North American automakers will likely, to a large extent, retain in-house the development and production of quality-sensitive compo-

nents such as engines, transmissions and diesel technology for passenger cars, while also keeping a certain degree of vertical integration for security of supply purposes. The multinational parts producers will probably continue to focus on power-train components for heavier vehicles. At the same time, the automakers are looking for independent R&D capabilities to develop advanced-components technology in such areas as aluminum castings, fuel-injection systems, electronic components, motors and systems, plastics and plastic components, suspension components, advanced transmissions and drive train components.

With respect to demand prospects over the medium and longer term, it is expected that the trend toward smaller vehicles will continue through to 1990. It is foreseen that the rate of growth of demand in North America and Western Europe will also decline from past experience. The relatively buoyant new markets will be found in Latin America, the Asian developing countries (excluding India) and in Eastern Europe. In terms of the Canadian market, pressures to contain imports of Japanese cars, which now fill 25 percent of domestic consumption, may be expected to continue. Demand for North-American-built cars may be expected to recover somewhat but not to reach the peak of the 1979 model year.

In the face of the recent and prospective developments in the world automotive industry, it is clear that domestic firms will have to develop a much stronger innovative capability if they are to adapt effectively to the structural changes now underway in the industry — both in respect of in-house parts production and the independent parts production sector — and if they are to continue to participate fully in the highly competitive international markets. Indeed, the more competitive and innovative Canadian suppliers become, the greater the prospect for encouraging assemblers abroad and of influencing their decision-making to agree to increased Canadian parts sourcing. In the absence of a significant industry restructuring and strengthening of technological capabilities, the longer term outlook is for declining output and employment in the latter half of the 1980s and into the 1990s.

The Canadian industry clearly faces more than sufficient competitive pressure to provide the incentive to restructure and become more competitive. Although voluntary trade restraints do not offer a long-term solution to the problems facing the industry, the temporary arrangement with Japan gives the industry a breathing space to effect the necessary restructuring which should be stimulated by the expected growth in demand for North American vehicles as economic recovery continues.

The possibility of renegotiating the terms and conditions of the APTA to provide for further original-equipment parts activity in Canada has been considered from time to time. However, the prospects of obtaining further leverage from APTA negotiations to encourage parts production in Canada and of securing US cooperation to this effect are somewhat doubtful, as the main competitive challenges have gradually moved overseas and as Canadian tariffs vis-à-vis those suppliers have been progressively reduced. Similarly, the USA has consistently maintained the safeguards contained in the APTA and the separate letters of undertakings from the "Big Four" were meant to be temporary. The USA regards these instruments as detracting from the achievement of what they consider to be the purpose of the

APTA, i.e., the liberalization of trade in automotive products between Canada and the USA and "the development of conditions within which market forces could operate effectively to obtain the most economic pattern of investment, production and trade".

The possibility of a more protectionist policy framework for the longer-term development of the automotive parts industry is favoured by those who suggest that Canadian-regulated content be introduced. Content regulations for the automotive industry, in conjunction with prohibitive tariffs or quotas, are in place in several developing countries and in Australia. Initiatives to achieve mandatory increases in Canadian content through regulations raise several complex and wide-ranging issues, including in respect of the operation of the APTA. With respect to offshore manufacturers exporting vehicles to Canada, the imposition of content regulations would require sanctions, presumably involving the introduction of prohibitive tariffs, quotas or embargoes. Aside from the international considerations, including dangers of trade retaliation, there is also the question of the impact of more protectionist programmes of this type on consumer interests and on the long-term ability of the industry to innovate and be efficient. In this regard, it would appear that the competitiveness of the Canadian industry could suffer severely if its focus of activity were to become the Canadian market alone.

As the industry becomes more and more internationalized and manufacturers in many countries are gearing to protect their home markets and striving to maximize their strategic positions within a limited growth business, pressures to find international solutions and to negotiate new rules of the game may well intensify. Similarly, the problems of overseas competition on the North American market may make it increasingly imperative to develop a broadly based and coordinated Canada-US approach. For example, the question of whether Canada should continue to extend the same tariff treatment to overseas and US suppliers under the APTA may need to be reconsidered.

Urban Transportation Equipment

The Canadian urban transportation industry has become world-renowned for its innovation and high standards, and should be well positioned to benefit from anticipated expansion in world markets. In terms of conventional equipment, the industry has established its capability to supply equipment incorporating the most advanced sub-systems proven in revenue service in cities such as Montreal and Toronto. The UTDC light-rail car system, the SPAR linear induction motor, the Hawker-Siddeley double-decker commuter car and the systems expertise of the Toronto Transit Commission (TTC) and the Montreal Urban Community Transportation Commission (MUCTC) are examples of the high degree of innovation and technology in this sector. Canadian firms have also established a world lead in a number of selected technical areas and the recently completed Intermediate Capacity Transit System (ICTS) of the UTDC is providing a continuing and effective stimulus for Canadian research and development.

Urban transportation equipment includes products as diverse as mini-buses, buses, trolley-buses, streetcars and intermediate capacity systems, support systems

for vehicle monitoring and control, computerized traffic signals, passenger and management information and communication equipment. These products, nevertheless, tend to be regrouped into vehicle systems and electric and electronic systems as two distinct industrial sub-sectors. In the process of urban transportation systems becoming more complex, the relative importance of vehicle manufacture in terms of total industry activity has declined while electrical and electronic equipment associated with urban transportation systems is increasing.

Domestic production capacity of vehicle systems is concentrated in Ontario, Quebec and Manitoba with the approximate distribution of employment being 44 percent in Ontario, 36 percent in Quebec and 20 percent in the Prairies. Consultants are concentrated mainly in Montreal and Toronto. As to the electrical and electronic systems, which are produced by companies for which urban transportation is only one element, there tends to be more regional dispersion of production capacity, particularly because material and transportation costs are not significant for these high-value, low-weight components.

Many of the major Canadian urban transportation manufacturers are foreign owned and the industry's capability was initially based on foreign technology. Although foreign-owned manufacturers of components may, on occasion, be inhibited by licences from exporting individual components, there are usually no artificial restraints on their freedom to supply these components to Canadian end-product manufacturers as long as they form part of a completely exported vehicle. A number of major Canadian-owned firms are emerging as leaders in the industry (e.g., Bombardier, Flyer).

The world market for urban transportation equipment to the year 2000 may be as high as $400 to $500 billion. The growth markets for the future will likely be the densely populated urban centres of developing countries in, for example, South America. The US market, however, will continue to provide major opportunities as large cities have a strong demand for urban transportation systems, even though this demand will be constrained by the level and conditions of the US government operating subsidies and funding to state and municipal governments.

Current Canadian exports approximate $300 million, amounting to approximately 75 percent of total annual production in the Canadian industry. Exports, with potential to increase substantially, are critical to the continuing growth of the industry. In view of the sporadic nature of sales in North America, causing scheduling, production, cash flow, and capital utilization problems for Canadian manufacturers, exports are also crucial for ensuring a reasonably stable and predictable level of production and employment. Although Canadian exports of urban transportation equipment have been mainly to the USA, the recent $180 million sale by Bombardier to Mexico is an example of the growing market in developing countries. Except for minor sales of specialized components, Europe and Japan have been essentialy closed markets to Canadian manufacturers. These countries also have overcapacity in their own highly competitive industries.

Canada could stand to win a significant portion of the $400-500 billion world markets to the year 2000 if a number of constraints are overcome and appropriate

policy instruments are put in place to support the export performance of Canadian producers. These relate to access to the US market, domestic market fragmentation, systems capability and export financing.

Access to the important US market is impeded by substantial tariff and non-tariff barriers. Urban transportation equipment was virtually left untouched by the Tokyo Round of trade negotiations with neither the USA nor Canada reducing their tariffs on rolling stock and the USA refusing to remove the domestic content requirements of its Surface Transportation Assistance Act (STAA). The STAA, which was enacted in 1978, provides federal leverage through substantial federal funding assistance (approximately $51 billion to September, 1982) on purchasing of highway and urban mass transit projects at the state and local levels. These projects are funded 80 percent federally and 20 percent at state and local levels. The "Buy American" provisions of the STAA generally provide for a 10 percent margin of preference for US products. Qualification as a US product requires both final assembly in the USA and a minimum of 51 percent US content. Accordingly, the "Buy American" restrictions apply even in cases where the US content is over 51 percent on vehicles manufactured in Canada, as is normally the case on urban buses.

The requirement for US assembly was instrumental in the establishment of plants in the USA by Bombardier, and Ontario Bus Industries. The level of federal assistance in operating subsidies and in funding for new urban transit systems was cut back under the Reagan Administration. Nevertheless, the trend of Canadian production capacity transferring across the US border is likely to continue, to the detriment of production and employment in this country with possible eventual implications for R&D activity, as long as Canadian urban transit manufacturers are forced to meet the requirements of "Buy American" provisions, Minority Business Enterprise requirements and the like.

The Canadian market for urban transportation equipment is fragmented by various "Buy Provincial" sourcing practices. The national industry now has under development every type of system for which a Canadian requirement is foreseen, but its success is dependent upon its ability to penetrate the domestic market and thus demonstrate its systems capability in revenue service. In addition, the need for appropriate product design by our industry has resulted in the development of systems, components, and the design capability to offer proven systems performance in a variety of operating environments. At the same time, standardization of system specification requirements across Canada could help manufacturers reduce costs and lead to a more stable domestic market base. In the same vein, domestic marketing efforts, such as the federal assistance for the sale to Vancouver of an ICTS system for the purpose of demonstrating Canadian industrial capability, are the sort of practices that should assist positively in reducing fragmentation of the domestic market while enhancing international sales prospects.

Canada has the technological potential to supply complete turnkey systems with a high degree of Canadian content based on the manufacturing expertise of a number of the larger Canadian corporations, coupled with the R&D capability of the UTDC. Individually, these organizations are already recognized internationally as proficient manufacturers and transit operators. Nevertheless, closer cooperation

between these manufacturers and operators would clearly help Canadian producers to compete effectively in world markets. A more integrated approach between consultants, government and the industry in international marketing efforts, may also be a determining factor in the stiff international competition since these activities often result in specifications matching the systems or equipment available from the same country as the firm performing the initial consulting work. Once a system is installed in a foreign country, succeeding orders tend to involve the same type of equipment. Canadian consultants could therefore seek to ensure that the availability of Canadian systems is examined during the development of specifications.

While the US export capability in urban transportation is minimal, Canada faces stiff competition from Europeans and Japanese who are willing to offer attractive financing terms to penetrate the growing developing country markets. Canadian industry is also coming under increasing pressure for higher local content, joint ventures, licencing arrangements and technology transfer (e.g., the $180 million Bombardier sale to Mexico included some $80 million in Mexican content, chiefly propulsion equipment produced in Mexico by Hitachi). The willingness and ability of Japanese and European firms to respond to these pressures have been an important factor in their competitive position in developing country markets.

Timely and competitive export financing (in terms of rates, terms, conditions and payback schedules) will clearly be an increasingly important factor influencing the success of Canadian urban transportation equipment in maintaining a strong export performance during the 1980s.

Aircraft

Canada has the fifth largest national aerospace industry in the Western World, behind the United States, the UK, France and Germany. It has achieved this position essentially without a protected domestic market and on the basis of specialization to meet the needs of a variety of foreign market niches. The driving force behind the evolution of Canadian aerospace policy has been the decision to abandon attempts to serve from domestic sources all the diverse aerospace product needs of the relatively large, but fragmented, Canadian market. The Canadian industry is largely free of tariff protection and Canadian users of aircraft products, both civilian and military, now enjoy virtually unrestricted access to the international industry.

The Canadian aerospace industry has just completed a period of strong growth, doubling its sales to about $2 billion from 1977 to 1980. Almost all of this growth was in the export of civilian products. While this same period was one of expansion for the international aerospace industry, especially in civil products, the Canadian industry out-performed the world trend. In 1980, exports accounted for 85 percent of Canadian production, representing a 5 percent share of world aerospace trade. The US market accounts for 60 percent of exports and has been serving as the launch market for most Canadian products. Over the years, the product mix of the Canadian industry has gradually shifted towards civilian markets (78 percent in 1980). About a quarter of Canadian production consists of fully finished products sold to end-users (e.g., aircraft produced by de Havilland and Canadair), although many of the intermediate products are fully engineered and proprietary.

Beginning in 1981, the aerospace market experienced a substantial downturn, largely caused by the depressed state of the US air transportation system. Under the combined impact of deregulation, recession and the lingering effects of the air traffic control situation, passenger volume dropped and virtually every airline lost money. As aircraft orders tend to respond to current (as opposed to prospective) airline profitability, a recovery in the Canadian aerospace industry will probably have to await further improvements in economic conditions. Available evidence suggests that more buoyant conditions will characterize the longer term. The major civilian manufacturers all contend that there will be a 5 to 6 percent annual growth rate in airline traffic with a significant reduction in the US share of the world market. Early generation jet aircraft are now aging and their economic obsolescence has been accelerated by fuel price increases. Market segments such as general aviation and commuter airlines are also expected to experience real growth over the longer term.

The outlook for Canadian military aerospace producers is harder to predict. The current American rearmament has created favourable conditions, although Canadian capabilities may not be well matched to emerging US needs for electronics and missile gear. The Aircraft Industries Association of Canada has recently urged the federal government to re-emphasize the securing of military markets for aerospace products.

The Canadian aerospace industry is concentrated in Montreal and Southern Ontario and, to a lesser extent, in Winnipeg. The following table shows the regional distribution of sales and employment in 1980.

TABLE 21

CANADIAN AEROSPACE INDUSTRY

	Sales		Employment	
	$ Million	%	'000	%
Atlantic	9	0.4	0.3	0.7
Quebec	983	48.0	19.7	46.0
Ontario	919	45.0	19.6	46.0
West	130	6.0	3.4	8.0

Firms have been encouraged to specialize in exportable products through policy and programme instruments directed to both supply and demand. Supply capabilities have been encouraged through federal support programmes for technological and capital investment, such as the Defence Industry Productivity Programme and the use of government guaranteed loans. This has helped to create a relatively favourable industrial development environment in Canada in the face of extensive US and European funded contracts for development of military products which provide indirect, though profound, benefits on the civilian side. Industrial and technological capabilities have also been enhanced through the negotiation of offset arrangements in large civil and military aircraft orders and of a number of technology licencing arrangements.

On the demand side, access to international markets has been facilitated through various trade agreements on both defence and civil products which have

made it possible for Canadian firms to obtain sub-contracts, primarily in the USA, on a competitive commercial basis. Under the Canada-US Defence Sharing Arrangements, Canadian manufacturers of defence products (normally not taking the form of complete systems) are given access to US markets on the same basis as domestic manufacturers with the objective of establishing a "rough balance" in defence trade over time. This has generally been achieved, although Canadian suppliers are still subject to the risks arising from the elaborate defence procurement decision-making machinery in the USA. Changes in American military spending patterns in the direction of missiles and electronic gear suggest that Canada's best opportunities in the future may lie in avionic and defence electronics. Less formal arrangements exist to provide a framework for defence trade with other western countries with many of whom Canada has a substantial defence-trade surplus.

In 1980, tariffs and quotas on international trade in civil aircraft, engines, parts, avionics, ground flight simulators and repairs and overhauls were removed by the USA, EC, Japan, Sweden and Canada as a result of multilateral trade negotiations. Further negotiations to broaden and improve the GATT Aircraft Agreement are envisaged for 1983. This international agreement recognizes that, in the acquisition of large aircraft, a government may insist that its firms be provided, on a competitive basis, fair and full access to business sub-contracts of large aircraft producers.

The aerospace sector would appear to be reasonably well positioned for the 1980s in terms of its present stocks of capital equipment, technology and skilled manpower. Given the critical importance of exports for the Canadian industry, the liberal trading environment prevailing in civil aircraft trade must be preserved and strengthened wherever possible. This should include expansion of the coverage of the GATT Agreement on Trade in Civil Aircraft. The pace of technological development and governmental assistance will be a key determinant of the industry's ability to maintain and expand its markets. The expansion of export markets in the future may require Canada to seek out new industrial cooperation linkages with the major aircraft manufacturers in Europe and possibly Japan in view of its rapidly growing aircraft industry.

The availability and the terms and conditions of export financing are also becoming major ingredients of international competition in some subsectors of the industry. In the pursuit of their objectives of penetrating new markets, some exporting countries are offering export financing on concessional conditions in both Canadian and third-country markets. These practices have adversely affected some recent Canadian sales prospects for light aircraft and flight simulators. It will therefore be important for the sound and stable further development of the Canadian aerospace industry, that concessional export financing as a competitive trade instrument be contained internationally.

Ocean and Shipbuilding Industries

Ocean-based industrial activities have been a significant element of economic growth in the Atlantic Provinces, Quebec, and, to a lesser extent, in British Columbia and Ontario (if "ocean" be interpreted to include the Great Lakes). Ship-

building and ship repairing have been the main type of activity over the years. Production has been chiefly for domestic use but, from time to time, there have been periods of orientation toward export markets. However, the exploitation of ocean resources, particularly the exploration for and production of oil and gas resources off Canada's coasts is now generating a whole new set of manufacturing, equipment and service industries, supplying drilling rigs, supply vessels, sub-sea production and surveying systems and manned and remotely-controlled submersibles.

The difficult environmental conditions in which offshore activities must take place present opportunities to develop and to apply new technologies and areas of Canadian expertise that can be marketed around the world. Indeed, countries with a strong presence in ocean technology have had a strong presence in international markets. There has been considerable interest in recent years in ensuring that Canadian shipbuilding and related ocean industries are provided full and fair opportunity to participate on a competitive basis in the supply of goods and services used for offshore exploration and development activities. There has also been increasing concern that the capacity of Canadian suppliers of goods and services to take advantage of the market opportunities off Canada's coasts may be adversely affected by the fact that the regular import regime has not been applied to commercial activities outside the regular 12-mile offshore limit.

Up until now, the customs tariff and related valuation, anti-dumping and countervailing duty regulations did not extend to offshore activities where there is intense international competition to share in the market opportunities. This situation made it difficult to ensure that Canadian producers, particularly of capital equipment, were accorded effective protection against injurious subsidized or dumped imports. It also adversely affected the capacity of Canadian industry to build on domestic market opportunities for competing in world markets and thus reaping the benefits of production scale. As a result, the Government announced its intention to extend Canada's customs and excise laws to goods used in resource exploration and development of Canada's continental shelf beyond the 12-mile territorial limit to 200 miles or the edge of the continental shelf, whichever is greater.

As to the more traditional shipbuilding activities, the prospects for domestic yards to regain higher levels of export penetration (27 percent in 1980 compared to 60 percent in 1975) are slim. Shipbuilding activities around the world have been heavily influenced by government intervention of different forms such as direct production subsidies, legislation prohibiting the use of foreign-built vessels for national coastal shipping (e.g., the US Jones Act), state ownership and export subsidies including the use of concessional credit financing. This has resulted in considerable global excess capacity at a time of a substantial softening in world demand for traditional types of vessels and the emergence of new developing country suppliers such as Korea.

To improve the outlook for Canada's shipbuilding industry during the 1980s, the government also recently introduced new shipbuilding assistance measures and a new coasting trade policy. These policy initiatives include the retention of performance improvement grants currently available under the Shipbuilding Industry Assistance Program (SIAP), a more uniform application of existing rates of duty on ships

under the Customs Tariff and an extension of the production assistance available under the SIAP for ships completed and delivered by July 1, 1985. In addition, the adoption of new coasting trade policies will encourage fuller participation in the coasting trade and related commercial marine activities by Canadian ships.

In short, the international market outlook for the traditional shipbuilding activities in the 1980s points to continuing uncertain and difficult conditions, and to continuing concerns over the market distortions resulting from extensive government interventions of different sorts. However, there are significant new opportunities in a range of new high-technology ocean industries in the domestic market and, to some extent, in the highly competitive international market.

Electronics

The electronics revolution is underway. The products of the electronics industry are pervading every aspect of human endeavour. All industrial sectors must embrace the technology in their products, on the shop floor and in the office or risk losing their market position to competitors more willing to exploit the quality and productivity gains implicit in the use of new electronic technologies. Technological breakthroughs in semi-conductors, glass fibre optics and digital technology are giving rise to a whole new range of products and systems that will create challenges and opportunities for both users and producers. All Canadian industries are potential users of electronics technology; they must come to grips with it in the products they make, in the way they make their products, in the office, in their sales efforts, and in communications. Firms of all sizes, in all sectors and in all regions of the country can benefit significantly by dramatic advances in productivity and competitiveness through application of electronics.

The electronics industry is a highly internationalized, $200 billion a year business. If recent growth performance continues through the 1980s, it will quadruple in size by 1990. No serious limitations to this continued growth are foreseen. Exports and imports have been growing more rapidly than domestic production. Except for Japan, France and the United States, levels of import penetration in the range of 40 percent to 50 percent are now not uncommon. Even in the case of the United States and Japan, which have more than 50 percent of world demand, the absolute levels of imports are very high. Similarly, there is a high proportion of national production going to exports.

The Canadian electronics industry is tiny in the global context, but some significant technological capability already exists in Canada and opportunities are just waiting to be grasped. The direct benefits to Canada of these opportunities, by investing in the technology and its marketing, are employment growth in high-skill occupations, increased economic activity and improvement in trade performance in fabricated end-products. Nonetheless, simply because of the breadth of opportunity in electronics, domestic electronics manufacturers will probably not be in a position to supply the full range of products. Canada will have to specialize in those areas where we have strength, where prospects are reasonably good, and where the benefits of user/maker synergy are most promising. Telecommunications, office automation,

TABLE 22

ELECTRONICS — INTERNATIONAL PRODUCTION AND TRADE

	Imports as % of ADM			Exports as % of shipments		
Country	1965	1975	1980	1965	1975	1980
Canada	36.0	53.6	71.1	20.2	34.8	54.0
USA	3.0	11.0	13.9	6.6	16.9	19.5
West Germany	24.3	48.6	46.4	37.5	57.8	49.8
Britain	21.1	45.1	46.5	29.8	46.3	44.5
France	26.0	32.5	40.8	24.3	28.6	33.2
Japan	8.1	7.5	11.1(1979)	23.7	27.84	43.9(1979)

integrated circuits, industrial-process equipment and software and services are among those areas.

Telecommunications equipment manufacturing is the Canadian electronics industry's strongest performer. Some of the strengths stem from the relationship between producers and service suppliers — telephone companies, CNCP Telecommunications, Telesat Canada — which understand and can assist users with the application of the technology. The existing national communications network is extensive, modern and compatible with the new technologies and Canada is a world leader in the development of communications equipment and systems. Both demand and output of telecommunications equipment have grown rapidly in Canada.

TABLE 23

GROWTH IN PRODUCTION AND TRADE OF COMMUNICATIONS EQUIPMENT AND COMPONENTS

($ 000's)

	1975	1980
Exports	389	1,041
Imports	551	1,594
Shipments	1,368	2,319
Domestic Market	1,530	2,872
Exports as % Shipments	28%	45%
Imports as % Domestic Market	36%	55%

The telecommunications industry in Canada, as elsewhere, is undergoing some fundamental changes which are primarily technology-led, based upon developments in microelectronics and concurrent advances in satellite communications, fibre optics, digital transmission and switching. These innovations are bringing about a merging of computer and communications technologies and creating possibilities for sophisticated new consumer and business-oriented communications services (e.g., videotext systems, communicating word processors, video teleconferencing). In addition, they are eroding the traditional monopoly boundaries of the telephone companies and weakening the barriers to new entrants to the telecommunications manufacturing industry, resulting in strong pressures for increased competition in the supply of telecommunications equipment.

Paralleling this rapid growth of new technologies and products has been a deregulation of the Canadian telecommunications market through recent decisions of the CRTC. The terminal attachment (or interconnect) market, once the exclusive preserve of a few companies, is now subject to open competition. In Canada, this means that network-addressing equipment (telephone sets and PBX switches), adhering to the published Canadian standards, can be purchased from independent suppliers by individuals, and connected to the public telephone network. Satellite earth stations, once licenced only to telecom carriers, are now available to a wider selection of business and institutional users. While opening up new opportunities for domestic telecommunications manufacturers, deregulation will also result in increased pressure from imports into the Canadian market.

Deregulation in the USA has also altered the fundamental competitive position of US firms. It began in the interconnect market in the mid-1970s, and further deregulation is pending both in Congress and in the courts. As a result, the vertical integration of ATT, Western and Bell Labs will not only remain, but will be unshackled by past regulations which have constrained their freedom to compete in both US and foreign markets. In a parallel decision, IBM is now also free to enter telecom markets. As a result of deregulation, US firms will provide formidable competition in international markets in the 1980s. The USA is also exerting pressure to open up the relatively protected telecommunications markets of Europe, Japan and other countries. In December, 1981, the USA reached agreement with Japan to provide better access, on a most-favoured-nation basis, to Nippon Telephone and Telegraph Corporation procurement, and to the Japanese interconnect market. The USA is currently trying to interest some of its major partners in a similarly cast multilateral agreement in the interconnect market. The US Congress is also exerting pressure to obtain, through proposed "reciprocity" clauses, telecom market access for US exporters, with respect, for example, to satellite leasing policy and trans-border data flow via satellite. Current international work to agree on telecom network standards will also lead to a more competitive international environment in the 1980s. When such agreement has been widely achieved, it will be easier for MNEs to offer complete systems or complete ranges of compatible products with wide market acceptance. In anticipation of this trend, the next few years are critical in terms of establishing a Canadian market position in key export-growth areas such as the Pacific Rim. A probable side-effect of this trend is that it may become increasingly difficult for smaller companies to capitalize and prosper on the basis of "market niches", which may be increasingly filled by MNEs.

In this situation, it will be more important than ever to maintain and continuously upgrade Canadian capacities in key technologies. These include fibre optics, versatile third-generation PBX equipment employing the latest techniques such as fast switching, digital central office switching, VLSI microelectronics componentry, satellites and earth stations, and laser transmission. Government support for industrial R&D, through programmes such as the recently announced Support for Technology Enhanced Productivity and for export development, will be crucial to the attainment of Canadian industry's full potential and of a healthy trade performance. Similarly, industrial and trade development implications will need to be given weight in the decision-making framework of domestic regulatory instruments such as the CRTC and the Restrictive Trade Practices Commission. Also the expertise resident in government laboraties represents a valuable resource that can be marshalled in support of national technological development and trade objectives. For example, the pioneering work of the Department of Communications in the development of satellite communications and videotex systems (Telidon) has both stimulated the development of a domestic industry and helped gain international recognition for their products.

Over the last decade, the *Canadian computer and office machines industry* has become much more rationalized and specialized. Both imports and exports have grown much more rapidly than the domestic market or shipments, reflecting the increased internationalization of the industry and a shift towards increased speciali-

zation and parent/subsidiary rationalization. Today, over ninety-five percent of the domestic market is supplied by imports and over ninety percent of Canada's shipments of computers and office machines is exported, making this industry the most internationalized after the automobile industry. Concurrently, however, the industry has been experiencing a rapidly increasing trade deficit. The $1.8 billion trade deficit in 1981 was one of the highest deficits in the manufacturing sector.

The world-wide long-term trend in the production of computer systems has been toward a reduced value-added in the hardware portion and increased value-added in the software portion of EDP equipment. Up to five years ago, computer systems were made up of 80 percent hardware costs versus 20 percent software costs. Most experts agree that by the end of this decade, those ratios will be completely reversed. Each shift in component technology (initially from transistors to integrated circuits and latterly to large scale integration) has reduced the cost of producing the hardware for computers. Computer logic costs are decreasing at an average of 25 percent per year — and computer memory costs are declining at 40 percent per year.

Many of the major multinationals are experiencing stagnation in the growth of hardware-manufacturing capacity and employment, in spite of rapidly increasing output and sales which are increasing at an average 19 percent per year, world-wide. Cost reductions, product miniaturization trends, and large scale plant automation (CAD/CAM) are creating surplus plant capacity in some firms. This international situation suggests that there may be real limits to the prospects for increased investment or employment in Canada in the production of computers and office machines. In the software industry, however, where the trend is to purchase packages rather than custom-made software, there is the prospect of developing a solid indigenous industry. Indeed, it is estimated that 140 firms in Canada, predominantly Canadian-controlled, already derive their principal value-added revenues from software and special-purpose data-processing systems. It is widely accepted that the key to success in the "office of the future" market will be the ability of suppliers to offer full systems including hardware, software and communications services. An important thrust of domestic industrial development policies and programmes in the 1980s will be to achieve such a systems capability in Canada. For example, while Telidon was originally envisaged as an interactive home information service, it is becoming increasingly clear that the initial and perhaps primary market will be as the basis of interactive business information systems.

The cost of computers in Canada is somewhat higher than in the USA. This added input cost has important implications for most users of computers in Canada, especially the thousands of Canadian businesses who look to computers and novel office automation as a key component in increased productivity and lower office costs. Given the specialization and export orientation of the Canadian computer and office-machine sector, it has been argued that Canadian tariffs may now be acting as a brake on increased industrial productivity. Foreign tariffs, at the same time, tend to act as a constraint on investment in Canada.

For Canadian users of electronic equipment, many of whom are significantly export-oriented, an important factor in maintaining or improving their competitive position is access to innovative *micro-electronics*. In the past there has been a tend-

ency to downplay the opportunities for Canada in the production of micro-electronics because of the cost of entry, the size of existing foreign suppliers, and the failure in the mid-1970s of the one major attempt by Canada to get into the business. However, as part of micro-electronics technology is evolving towards the production of "semi-custom" chips of a standard design which can be modified or specialized to meet particular needs, even smaller countries like Canada can find a role to play in the basic technology of the electronics revolution. A presence in the integrated-circuit business provides the opportunity to design equipment in parallel with integrated-circuit developments and in turn influence circuit developments in line with end-user needs. The support and assistance of the chip manufacturer are becoming an essential part of the product-design activity.

The *defence electronics and avionics industry* in Canada accounts for approximately $600 million in annual sales, of which 80 percent is exported. The industry is highly innovative, with typically 6 to 8 percent of the sales dollar ploughed back into R&D. Trade prospects are closely linked to defence considerations and to arrangements such as the Defence Production Sharing Arrangements with the USA. These arrangements have helped Canada historically to maintain approximate overall balance in defence trade with the USA, although in recent years large Canadian defence acquisitions have contributed to an imbalance. There has also been some "creeping" erosion from US Congressional moves to limit access to US Department of Defence markets (No-Foreign, Bayh Amendment, US-only hybrid manufacture, etc.). Canada has a trade surplus with other partners, although there is a risk these surpluses will disappear over the decade as other countries demand "offsets" for their defence purchases. The enhancement of domestic R&D performance will also be a major factor.

Services

International trade in services has received growing attention in recent years and may crystallize into an important trade relations issue and export development challenge for Canada during the 1980s. Over the past two years, federal, provincial and private sector groups have been examining Canada's interests in regard to future international consideration of the complex conceptual, sectoral and policy issues involved.

Trading nations have long recognized the importance of "invisibles", including service exports, to their current account performance. Similarly, imports of services can make critical contributions to national economic development. Appeals for liberalization of trade in services are made on the grounds that increased internationalization of service trade through the market mechanism could produce global welfare gains through specialization. However, there are wide differences among the functions performed by service sectors as they take place in highly differentiated national and international regulatory regimes.

The latest impetus for international trade in services discussions in the OECD and the GATT has come from the United States, which is pressing strongly for multilateral action to deal with a perceived growth in impediments to its increasingly

important exports of services. Most developed countries recognize the important contribution of services in the international economy and have been prepared to support examination of the feasibility of greater multilateral cooperation in the services area, where rules and dispute settlement machinery are significantly less developed than in the goods sector. Developing countries have been markedly less prepared to accept discussion of international service activities in organizations such as the GATT, suggesting instead that service issues are better handled by technical organizations. It remains to be seen whether, where and how international cooperation can be strengthened in dealing with problems of trade in services. The study programme approved at the November, 1982 GATT Ministerial meeting will likely give further impetus to such efforts.

A recent government study of trade in services concluded that Canada has a major export interest in certain service sectors, and also certain distinct vulnerabilities as a large net importer of services and host country for foreign direct investment. It suggested that a knowledgeable and active Canadian presence to promote Canadian trade relations interests multilaterally and bilaterally in the trade in services area was necessary. Much work remains to be done in gathering basic data, examining the domestic service economy, identifying and developing areas of service export strength in an increasingly competitive global service trade environment.

The Service Economy

Services can be described as intangible economic outputs produced for sale or distribution through the market mechanism or through established state institutions or programmes. Examples run from personal and distribution services, through engineering and other consulting and business services, to banking, insurance and other financial services, and to transport and communication services, education, health and cultural services, and government and public administration.

A persistent current in economic thought for many years distinguished between goods and services on the basis that goods-producing activities were "productive" whereas activities producing services were "unproductive". However, recognition has steadily grown of the vital role of services in national economies. Conceptual and technical problems have also tended to make services an overlooked sector, despite their importance. For example, there are wide differences among the functions performed by service sectors and among the national and international regulatory regimes in which such activities take place. In addition, relationships vary between goods and services in different sectors: some key services exist without a relationship to goods, (e.g., many banking services, life insurance, and professional services such as accounting, law and medicine, telecommunications, data processing, and travel). Other services substitute for goods (e.g., franchising, chartering, leasing, and repairs and maintenance) while others are complementary to trade in goods, (e.g., shipping, handling and storage, and banking and insurance activities related to goods). Finally, some services are embodied in goods, (e.g., computer tapes, motion picture films, books).

Further complications flow from the nature of services, whereby the transfer of a service tends to rely upon close contact between "producer" and "consumer"; such

activities can take place through internationally traded services from the home country, or for one reason or another through the establishment of an affiliate abroad in order to carry out business more economically. Trade in services issues can thus blend into questions of investment. The activities of multinational enterprises serve as an example of complex service trade transactions carried out through establishment abroad. In this case, intra-corporate purchases and sales of services can distort the picture of transactions that would be available were purchases and sales to be made at arms length. Further complicating the analysis of services in the national and international economy is the poor statistical coverage of service activities compared to that available for goods.

Services account for a growing proportion of the overall economic activities of developed countries, despite changes which have seen some service sectors grow dramatically and others decline over the past few decades. Canada is one of the most highly service-oriented economies with 65 percent of its GNP and approximately the same proportion of total employment generated by services. Over 80 percent of the new jobs created in Canada over the past decade originated in the service sector.

The overall share of services in world trade appears to have remained more or less constant over the past fifteen years at about one-third of merchandise trade, but with significant changes in the composition and direction of service trade. This proportion does not include services provided through established affiliates. It has been argued that total service trade would have grown at a rate closer to its growth in the global economy were it not for the existence of barriers to such trade. It is these impediments to service market access, which exist for a variety of historical and policy reasons, that are now the subject of increasing international analysis and discussion.

Canada's Trade in Services

Despite the domestic importance of the service sector, Canada's trade orientation is concentrated in goods. In 1981, Canada exported $84.2 billion worth of goods and around 12 billion dollars worth of "tradeable"[1] services. In the same year, imports amounted to $76.9 billion worth of goods and around 15 billion dollars of tradeable services. The deficit in Canada's tradeable services has increased in absolute terms from 1971 ($0.8 billion) to 1981 ($2.8 billion), but has held fairly steady as a share of GNP at around one percent.

Canadian *travel* receipts from foreigners reached $3.8 billion in 1981; travel payments abroad by Canadians amounted to $4.9 billion in the same year, so that Canada's travel account was in a deficit position amounting to $1.1 billion in 1981. Canada's travel account in the early 1970s was not nearly so significantly in deficit. In 1971, for example, the deficit in this account was only $0.2 billion. By the mid-1970s, however, the travel deficit had widened substantially until it reached a peak

[1] The current account includes merchandise and non-merchandise items. Interest, dividends and transfers constitute important non-merchandise receipts and payments, but should not be looked at as tradeable services. Important tradeable services include travel, transportation, business and tourism.

at $1.7 billion in 1978. Several factors were involved in this deterioration including the relatively high value for the Canadian dollar during this period. During the last several years, however, the travel deficit has improved substantially and has been hovering close to the $1 billion mark.

Canadian *freight and shipping* receipts reached $4.3 billion in 1981, while payments amounted to $3.8 billion. Thus Canada's freight and shipping account was in a surplus position in 1981 amounting to $0.5 billion. In the early 1970s this account was in a slight deficit position; by the mid-1970s it was $0.4 billion in deficit. Since 1978 it has been in a surplus position, however, and has been improving annually until 1981, the latest year for which complete statistics are available.

Other services, which include business and personal services and government transactions, account for the remainder of service transactions. In 1981 this category generated receipts of $3.9 billion and payments of $6.1 billion. This account was in deficit by $2.2 billion. Excluding government transactions, the 1981 deficit was only $1.6 billion. The "other services" account has been in deficit every year for the past 30 years and growing in absolute terms. Excluding government transactions, however, it has held fairly constant over the last ten years as a share of GNP at about 0.5 percent (both in current and constant dollar terms).

Detailed information regarding the "other services" account is sketchy. Special Statistics Canada surveys for the years 1973 and 1977 revealed that some of the more significant sources of receipts, in order of importance, were consulting and other professional services, management and administrative services, payments for research and product development, royalties, copyrights, trademarks and film rentals, and advertising and sales promotion. The main payment categories in order of significance were royalties, copyrights, trademarks and film rentals, management and administrative services, special tooling and automotive charges, and research and product development.

Import penetration of services is by far the highest in *business services*, at 15.9 percent in 1977; this was the case over the full 1961-77 period. At the other extreme, personal and other miscellaneous services is shown to be virtually unaffected by import penetration. *Communication* services is the only category to show increasing import penetration, moving from 0.5 percent in 1961 to 1.6 percent in 1977. On the other hand, both transportation and storage, and other finance, insurance and real estate indicated quite stable import shares of the domestic market over the 1961-77 period, with both at 2.7 percent in 1977.

Transportation and storage has the highest *export orientation*, although it has been declining over time, moving from 10.2 percent in 1961 to 8.3 percent in 1977. Even so, export orientation remains substantially higher than import penetration in this category. In contrast, the personal and other miscellaneous services category shows the lowest export orientation. The export orientation of *business services* has varied over time, ranging between 4.7 percent (in 1961 and 1973) and 7.2 percent (in 1965). Over the most recent period for which data are available, 1973-77, the export orientation of this sector increased from 4.7 percent to 6.2 percent. However, the export orientation of this sector remains well below its corresponding import penetra-

tion figures. *Communication services* is the only sector to show a significant upward trend in export orientation, moving from 0.9 percent in 1962 to 1.2 percent in 1977, thus paralleling in direction but not fully matching the upward trend in import penetration in this sector.

TABLE 24

CANADIAN BALANCE OF INTERNATIONAL PAYMENTS: CURRENT ACCOUNT

(millions of dollars)
1981

Item	Receipts	Payments	Balance
Merchandise	84,221	76,870	7,351
Non-Merchandise	15,247	29,505*	-14,258
"Tradeable Services"	11,926	14,760	-2,834
Interests, dividends etc.	3,321	13,635	-10,314
Transfers	3,075	1,514	1,561
TOTAL	102,843	107,889	-5,346

*includes withholding tax

Key Canadian Service Activities

Some service sub-sectors closely associated with trade in goods or investment flows have been already discussed in the sections above describing those sectors with which they are associated. A brief account follows of some key service trade activities.

The transfer of knowledge and skills has shown itself to be one of the principal characteristics of "tradeable" services. In *engineering-construction and related consulting services*, Canadian industry received $1.7 billion in fees in 1980 and employed approximately 42,000 people, mainly from the professions. The industry is highly cyclical and closely tied to overall economic performance. The export market is growing twice as fast as the domestic market and 20 percent of company receipts come from export fees, a substantial proportion through official aid programmes. The Canadian industry is dominated by a few firms, large and competitive by world standards. There is increased formation of joint ventures between domestic and foreign firms across the Canada-US border as a way of establishing a presence in the US market or of obtaining technologies unavailable in Canada. Unlike European or Japanese firms, Canadian firms do not have vertical ownership links with either construction or manufacturing firms, although there are strong traditional links with them. The engineering-construction and related consulting sector is estimated to have exported services valued at approximately $340 million in 1980, while Canadian imports totalled some $170 million, not counting imports of MNE affiliates whose imports would add considerably to the total.

Canadian consulting engineering *exports* are equally divided between the USA, Latin America, Middle East, Far East, and Africa and have become an increasingly important source of revenue for some firms. Experience suggests that the Canadian

consulting industry, based on capacities developed in contributing to Canada's resource-based industries, has the competitive ability to win further markets abroad and to compete at an increasing level of sophistication in Canada. The industry faces significant impediments to its exports abroad including subsidization of contracts by some developed countries and NICs in both their own markets and in other developing countries. Eighty percent of reported Canadian *imports* come from the USA, and have traditionally been in the industrial sector related primarily to oil and gas projects.

In the field of *telecommunications*, the vast bulk of services is provided by 15 telephone companies and Canadian National/Canadian Pacific telecommunications. TELEGLOBE and TELESAT act primarily as "carriers' carriers" rather than dealing directly with customers. Canada is regarded as a leader in the provision of telecommunications facilities and services, as carriers have overcome great geographic difficulties and become more responsive to increasingly sophisticated user demands. Telecommunications consulting services are important to Canada and considerable trade takes place in telecommunications transmission services between Canada and the rest of the world. Against a global background of rapidly evolving technology, changing regulatory frameworks on both sides of the Canada-U.S. border may create significant opportunities for trade in value-added communications services.

Computer services are an area where demand is growing fast, propelled by rapid changes in technology. It is estimated that imports and exports of commercially marketed computing services in 1980 were about $125 million and $60 million respectively. The gap between imports and exports of both services and software could widen significantly in coming years. Canada, nevertheless, has strong domestic industrial and export capability in some specialized areas. The field of computer services, because of rapidly changing markets and technology, is one requiring close attention in terms of export promotion, import trends and national and international regulatory arrangements.

Canadian *banks* compete successfully internationally with operations ranging from representative offices to full retail banking facilities in over 50 foreign countries. Their foreign activities include participation in domestic banking operations in various countries, plus "cross-border" activities generally subject to fewer restrictions than established branches. Though Canadian banks face a wide range of restrictions in operating abroad, major Canadian banks have been able to achieve up to 40 percent of their earnings from foreign operations, particularly in the USA and Western Europe.

The international environment in which Canadian financial institutions operate is undergoing fundamental changes because, *inter alia*, of the increasing internationalization of banking through recycling of petro-dollars, the growth of MNEs and of world trade and investment, the keener competition in international and domestic financial markets, changes in information technology and the level and volatility of interest rates. In particular, the boundaries that have traditionally existed between various financial institutions are under pressure. This is particularly true in the case of the United States. The international activities of Canadian banks and other finan-

cial institutions make an important contribution to Canada's exports of sophisticated high-value services and offer potential for further export growth.

Freight and shipping show a small surplus in international transactions, but this is largely attributable to the contribution of inland freight to Canada's international trade statistics. *Air* transportation trade is extensively regulated by international treaties, including the Chicago Convention, by IATA, and in particular by bilateral treaties. In respect of maritime transport, Canada, without a significant deep-sea fleet of its own, relies on the competitive forces of the market place to ensure that reliable, economic shipping services are available to meet Canadian needs. In general, Canada shares with other developed countries a desire to limit the fragmentation of world shipping and to avoid flag discrimination. In Canada's coastal trade, about 95 percent of tonnage is carried in Canadian flag vessels. The US Jones Act limiting US coastal trade to domestic carriers and equipment continues to affect Canadian interests such as potential repair and servicing of US vessels in Canada. There is extensive trans-boundary *trucking* trade between Canada and the United States, a subject of recent bilateral frictions which were resolved to the satisfaction of both the United States and Canada.

Two sectors of interest from the perspective of trade in services are exports and imports of *education* and *health* services. Trade in education services is made up of the education of foreign students in Canadian public or private schools and transfer mechanisms involving Canadian teachers travelling abroad. The degree of competition from developed countries for education markets in developing countries is increasing, but demand remains large. Some of this demand is satisfied by Canadian aid programmes. However, it has been suggested that significant opportunities exist to expand exports of Canadian education and health services to developing countries on a commercial basis.

Within the domestic services sector, Canada's *cultural* industries occupy a large place. Culture, in its various ramifications, is now Canada's fourth-largest employer and is estimated to be a $65 billion industry employing over a million Canadians. Much more analysis is required, however, in order to determine the precise economic importance and implications of the cultural sector. Only in the last decade, and increasingly in recent years, has such attention been given to the industrial and economic magnitude and potential of the arts and the cultural industries.

The cultural sector is diverse and clearly not all its components lend themselves readily to trade. The visual and performing arts, for example, have limited potential in export terms, whereas film and television production, sound recording, book and periodical publishing, have considerable potential. Some of this potential, of course, is in terms of the goods produced. Those components of the cultural sector with limited trade potential retain their importance, however, in terms of their broader foreign policy context. Cultural activities, exchanges and agreements can result in significant non-cultural trade, economic and political benefits.

On the import side, Canada experiences one of the highest levels of foreign cultural penetration in the world which in turn has implications which go far beyond the cultural. Foreign cultural domination of the domestic market-place makes it difficult

for Canadians to compete effectively within our national boundaries and burdens effective policy-making. Canada is the top market for US television, with Canadian networks paying the highest price for US programmes. US networks, on the other hand, import less than two percent of their programming, little of it Canadian. While a significant and somewhat obvious issue, television programming is only one example of foreign cultural domination of the domestic marketplace and the lack of reciprocal outflow of Canadian cultural products. The same can be said for the film, sound recording and publishing industries.

Canada enjoys the appropriate creative, administrative and technical expertise to establish a vital and viable alternative to the foreign cultural presence. Strengthening of its cultural infrastructure will inevitably provide Canada with the opportunity to pursue greater marketing opportunities abroad. The non-industrial elements of the cultural sector could be further pursued within the context of international cultural relations to attain cultural ends, and non-cultural trade, economic and political benefits will result; the industrial components of this sector also merit fuller exploration of their foreign trade potential, and they too should eventually be better placed to seize opportunities abroad.

Chapter V

THE INSTRUMENTS OF CANADA'S COMMERCIAL POLICY

> . . . international economic policy commitments, in the form of agreed rules, have far-reaching domestic effects, indeed effects so important that they are indispensable for democratic governance. They are the element which secures the ultimate co-ordination and mutual compatibility of the purely domestic economic policies. They form the basis from which the government can arbitrate and secure an equitable and efficient balance between the diverse domestic interests: producers vs. consumers, export industries vs. import-competing industries, between particular narrowly defined industries.
>
> **Arthur Dunkel**
> Director General of GATT

Commercial policy consists of the development of initiatives, responses and other activities intended to safeguard and improve access for Canadian exports to foreign markets, and to manage the interrelationships between domestic and international policy issues, as well as the maintenance of a domestic economic and regulatory environment designed to support Canada's international trade relations and enhance Canadian competitiveness. In a broader sense, it is concerned with the international economic and political environment and, in particular, those developments and trends which have a direct bearing on Canadian trade interests and Canadian economic performance. Throughout the post-war period the thrust of Canadian trade policy has been to promote and maintain an open global trading system with adequate mechanisms for dealing with disruptive trade practices and changes in trading patterns.

The management of trade policy issues requires a dialogue between government and those individuals and firms in the private sector and in other levels of government whose interests are directly affected by changes in the trading environment. Trade policy equally requires interaction with the international community, the negotiation and implementation of solutions to issues, and the management of problems of concern to Canada. The ability to develop and effectively pursue coherent Canadian trade policy objectives internationally depends importantly on the constitutional arrangements which provide the federal government with the jurisdictional authority to make and implement positions on behalf of the whole of Canada (Trade and Commerce Power). Equally important is the maintenance of an appropriate organizational structure at the government level together with appropriate mechanisms for consultations with interested parties to ensure that positions are developed and projected in the Canadian interest.

Canada's export and import activities take place within a complex system of laws, regulations, and programmes which have developed over a considerable period

of time to meet the requirements of Canadian manufacturers, farmers, exporters, importers, labour and consumers. The ultimate test of these policies is that they contribute to an economy in which Canadians can find rewarding jobs and satisfy their needs from a wide variety of competitively priced goods and services. The system has been periodically modified and improved to meet changing circumstances. The import side is currently being extensively revised to reflect the results of the Tokyo Round of multilateral trade negotiations and the changing needs of Canadian producers. The government adopted an expanded and comprehensive export strategy following the 1979 report of the Hatch Commission. A major element of Canada's trade policy in the 1970s was expressed in Canada's participation in the Tokyo Round. This chapter reviews the evolution of Canadian trade policy with particular emphasis on Canada's import policy regime. The framework for the development and protection of Canadian export markets is examined in the following chapter.

Instruments of Tariff Policy

The Customs Tariff is a separate statute that provides the government with the authority to impose a tax or customs duty on imports. Schedule A to the Act lists several thousand products divided into twelve groups and specifies the rate of duty applicable to these products according to their country of export. The schedule currently lists five different tariff levels:

General, the highest level, applicable to those very few countries which are not members of GATT and with which Canada has not concluded a bilateral trade agreement (e.g., Oman, Libya, Albania, North Korea). This level has remained unchanged since the 1930s;

MFN (most favoured nation), the level which represents successive reductions under GATT and is applicable to all GATT members and others with whom Canada has negotiated bilateral trade agreements incorporating an MFN clause; it thus governs the preponderance of imports;

BPT (British Preferential), the level which represents the remnants of the Imperial system of preferences established at Ottawa in 1932 and now applicable to certain Commonwealth countries. Only Australia and New Zealand currently enjoy these rates on a contractual basis under bilateral trade agreements. BPT rates no longer apply to the UK and Ireland, following their entry into the EC and their application to Canadian exports of the EC common external tariff, or to South Africa;

GPT (General Preferential), the level which applies to virtually all developing countries and is either the BPT, or the MFN rate less one third, whichever is lower. It does not apply to a range of sensitive products such as textiles, clothing, and footwear; and

UK and Ireland, a transitional rate which applies to these countries until the full implementation of the Tokyo Round tariff reductions is completed in 1987, at which time they will be accorded the MFN rate.

Duties may be expressed in *ad valorem* terms, or in specific terms, or a mixture of the two. Most are now *ad valorem*, underlining the importance of an adequate and appropriate valuation system for calculating the duty. Specific duties are now largely confined to agricultural and textile products. Duties on a range of temperate-zone fruits and vegetables vary according to the season, providing protection while the products are in season in Canada, but providing duty-free access at other times.

Actual duty levels vary greatly. A large number of products now enter duty free under all but the General tariff, including tropical products, a range of producer goods, and many goods not made in Canada. On the other hand, a range of sensitive consumer goods such as clothing and footwear are protected by tariffs as high as 25 percent. The average incidence of the tariff on all imports is now between 4 and 5 percent, and the average rate on dutiable goods is currently between 12 and 13 percent. While the tariff is no longer primarily a revenue-gathering measure, it still makes an important contribution to overall government income (some $3 billion annually).

The figures mentioned above provide a good indication of the level of tariff protection in Canada in nominal terms. They do not, however, provide an idea of what the effective level of tariff protection may be. The distinction between nominal and effective tariff protection can be explained as follows:

> A nominal tariff on the final output of the industry permits the producer to raise the price at which he sells his product domestically while still remaining competitive with imports. But if there are tariffs on his inputs of material and components as well, these tariffs in turn raise the cost of the inputs to him regardless of whether he imports them or buys them domestically. If he buys domestically, the supplier of them can charge up to the foreign price plus the tariff on imports. The net effect of the nominal tariff structure on the price the producer can charge for his output domestically relative to the prices he must pay for his intermediate inputs — hence the effect upon his value added — is called the "effective protection" that producer enjoys.[1]

While it is not the purpose of this chapter to attempt to measure the effective level of tariff protection in Canada (past attempts at quantifying effective levels of tariff protection have always been interpreted with considerable caution because of data problems and the weaknesses of the various methodologies used), it would be fair to say that in Canada, as in other countries, effective protection in various sectors is generally higher than the nominal protective levels. This is recognized in current discussions in the GATT on the trade problems relating to "tariff escalation" in some specific sectors. The result of these discussions will be useful in any future tariff negotiations.

Value for duty is currently calculated on the basis of the fair market value in the country of export, i.e., the price charged by the foreign vendor for consumption by domestic consumers at the same level of trade as the Canadian importer. In order

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[1] *Effective Tariff Protection in the Canadian Economy*, James R. Melvin and Bruce W. Wilkinson, Economic Council of Canada, Special Study No. 9, 1968, p.4.

to ensure that the importer declares the proper value for duty purposes, the Customs Act (Sections 35 to 44) lays out detailed rules for calculating the appropriate value for duty under a variety of circumstances. Where the fair market value cannot be determined under the normal provisions, the Act specifies alternative methods for determining the value.

In addition to those resulting from multilateral trade negotiations, there are tariff changes being made on an on-going basis, usually as a result of representations by the private sector. Such changes are made in the context of budgets or by Order-in-Council depending on the circumstances. Changes of the latter type include temporary tariff items providing for a reduced or nil rate of duty on raw materials, semi-finished goods and components imported for further manufacturing in Canada, and duty remissions pursuant to the Financial Administration Act. In the course of the last few years there has been a growing demand for such schemes, especially from Canadian subsidiaries of foreign multinationals who find Canadian and foreign tariffs to be an impediment to the granting of "product mandates" to their Canadian plants. Part of the remission provided by such schemes is typically used to pay the US tariff on exports of the "mandated" product to that country.

The term *"duty remissions"* refers to Orders-in-Council passed under the authority of Section 17 of the Financial Administration Act which authorize the Governor-in-Council, on the recommendation of the Treasury Board, to remit any tax, fee or penalty when such remission is deemed to be in the public interest. Remissions under this authority may be approved before or after the liability for payment of duty arises and may be made conditional.

Duty-Remission Orders take many forms, the principal being the following:

- "One-shot" remission orders remitting duties paid on a particular shipment where the importer has demonstrated to the satisfaction of the government that the application of duty in his particular circumstances entailed hardship to him or inequity compared to the treatment given to other taxpayers;

- Refunds of duties already paid, but based on criteria known to the importer in advance of importation. An example of such remissions are those given on a yearly basis to Canadian processors of fruits and vegetables based on the extent to which Canadian crops yielded less than had been contracted for by the processors. It is not possible to determine whether the programme criteria have been met or the amount of the remission until after the importations have been made;

- Remission orders of general application which have the same effect as any other regulation or legislation waiving the customs duty on certain classes of goods or certain classes of import transactions (e.g., goods imported for further processing and re-export). The benefits of such orders may be claimed by any importer at the time of importation; and

- Remission orders which apply to defined categories of goods imported by defined classes of importers who must meet, annually, certain "performance criteria" which usually are unrelated to the fact of importation. The benefits

of the Order may be claimed at the time of importation under penalty of full duty payment at a later date if a post-audit reveals that the importer did not meet the performance criteria. Examples of such schemes are the various remission programmes which have been established for companies engaged in automotive production and similar schemes established to assist Canadian manufacturers of other goods (e.g., front-end loaders) in rationalizing their production with affiliated companies in foreign countries. The importer is generally required to maintain production in Canada of a defined class of goods at a specified level in order to qualify for duty-free entry of finished goods to complement his Canadian production and component parts for use in that production.

Under schemes falling in the last category, the manufacturer is enabled to import end-products duty-free and resell them on the Canadian market as if they were dutiable because his competitors, who do not qualify for the duty remission scheme, must pay the duty. The funds made available to eligible manufacturers from such schemes may be used for a variety of purposes, including payment of foreign tariffs on exports of the end-product for which the manufacturer has a "product mandate", offsetting other cost penalties for manufacturing in Canada rather than in a foreign country, or some reduction in prices to consumers in order to improve market share. To the extent that the cost of the Canadian tariff on imported products and of foreign tariffs on exported products are the main cost disadvantages of placing a product mandate in Canada, an intergovernmental arrangement providing for tariff-free trade would be a more efficient means of encouraging product mandates, assuming that there is an economic or other incentive to place production in Canada. Aside from their cost to the government, duty remission schemes designed around an individual company's product mandate may raise serious problems of equity vis-à-vis competing Canadian manufacturers and component suppliers whose production is based on the premise that existing Canadian and foreign duties will apply. Duty-remission schemes also raise important trade relations considerations, insofar as our trading partners have been critical of such schemes.

Canada does not have *free-trade zones* but does have a number of tariff policy instruments which achieve essentially the same objectives. A free-trade zone is a defined geographical area which is treated for customs purposes as being outside of the country in which it is located. Imports of goods into the zone are free of duty and tax; exports of products from the zone to a foreign country must, of course, pay that country's duty and taxes (if any), while shipments out of the zone into the customs territory of the country in which the zone is located would be subject to that country's duties and taxes on the same basis as if imported from abroad. Free-trade zones provide two kinds of benefits to manufacturers located within the zone:

- elimination of duties and customs formalities on imported components which will be incorporated into products for export (this carries with it the avoidance of interest costs on working capital which would normally be tied up in duty pending payment of drawback when the manufactured product is exported); and
- deferment of customs duty on components and materials which will be used in the production of goods for sale in the country of importation and in some

cases a reduction in the rate of duty (when the finished product is dutiable at a lower rate than the component materials).

With the introduction of the Inward Processing Remission Order in March, 1979, Canadian regulations regarding the importation of goods and materials for use in production for export are considered to provide benefits roughly equivalent to those which would be available in a free-trade zone, bearing in mind that the operation of a free-trade zone itself involves certain administrative costs which, in theory at least, should be charged to the firms operating within the zone. The Inward Processing Remission Order allows companies to manufacture "in bond" for export production without the necessity of tying up funds in customs duty on imported components pending the export of the finished product. With regard to the deferment or reduction of duty payments on imported components for goods destined for the Canadian market, Canadian regulations in this area are much more liberal and flexible than those of the United States where free-trade zones are common. We have an extensive array of "temporary tariff items" which provide duty-free entry for components and materials used in Canadian manufacturing. There are also fewer cases in Canada than in the USA where tariff rates on raw materials or semi-finished goods are higher than the rates on the finished goods. A policy of permitting the establishment of free-trade zones would allow Canada to follow a more regionally-selective approach to trade policy if it were prepared to authorize zones only in certain (disadvantaged) areas of the country. However, we have other programmes for this purpose, and it is questionable whether tariff policy is an efficient means of achieving this objective.

An example of a sector-specific tariff policy aimed at encouraging rationalization of a Canadian industry is the Canada-US Automotive Products Trade Agreement (APTA) signed in 1965. That agreement essentially provides for conditional duty-free trade between Canada and the USA in original equipment automotive parts and accessories (except tires and tubes) and in all but specialized types of motor vehicles (e.g., fire trucks). Its main objective was to obtain for Canada a better share of North American automotive assembly and parts production and employment than it had prior to the implementation of the agreement, without imposing additional penalties on the Canadian consumer or labour. Prior to the agreement, the Canadian automotive industry was characterized by production of a large variety of vehicles for a relatively small market, resulting in short production runs and costs and prices substantially higher than in the USA. Imports were rising rapidly while exports remained small.

The tariff has also been an important instrument in the context of Canada's bilateral trade relations. For example, the tariff has been the main instrument in bilateral trade negotiations with non-GATT member countries, particularly in Eastern Europe. Since those countries do not usually have a tariff, or, if so, its real effect on trade flows is questionable, it is very difficult to assess the gain in terms of access to their markets for Canadian goods when trade agreements are negotiated. On the other hand, the gains for those countries' exports to Canada can be clearly identified to the extent that they are accorded MFN tariff treatment. The benefits of MFN tariff treatment have, therefore, been an important tool in attempting to get better terms of access for Canadian goods to these markets.

The Tariff in the 1980s

In order to have a clear picture of the tariff in the next decade and of its role, one has to look at the *gradual tariff reductions resulting from the Tokyo Round.* The average reduction in the Canadian tariff on dutiable industrial products will be close to 40 percent when the tariff concessions made by Canada are fully implemented in 1987; in fact, the weighted average rate will change from about 15 percent in 1979 to 9-10 percent by 1987. Because of the harmonizing feature of the tariff cutting formula applied by countries in the MTN (i.e., high tariffs were cut proportionately more than low tariffs), it would be fair to say that the effective level of tariff protection was also reduced, although, from an export point of view, not to the extent Canada might have wished. In connection with the latter point, it will be recalled that one of Canada's objectives in the Tokyo Round was to achieve, through the reduction of foreign tariffs and non-tariff barriers, improved opportunities for investment and production in Canada of more highly processed materials and foodstuffs as well as fully manufactured goods.

The MTN tariff reductions were made not only to "pay" for better access to other markets but were designed to promote the efficient development of Canadian industry through greater competition in the domestic market and by reducing the costs of imported materials and other production inputs. At the same time, Canada will maintain, where appropriate, a reasonable level of tariff protection to promote the continuation of viable production in Canada for existing and new product lines.

On the non-tariff measures side, the new *Code on Customs Valuation* will have a significant impact on Canada's tariff regime. Canada has agreed to implement the new Code by January 1, 1985, provided tariff rate adjustments can be made to offset any significant loss of tariff protection that may result from adoption of the new system. That agreement provides for the acceptance of the price at which goods move in international trade as the primary basis for levying customs duties. This represents a significant departure from the current system. The fair-market-value approach is prohibited under the new GATT agreement. In line with its Tokyo Round undertaking, the Canadian government, in August 1980, directed the Tariff Board to study and report on draft customs valuation legislation implementing the new agreement and on the impact it would have on the level of tariff protection. The Board's study should be completed in 1983; the period between the date of completion of that study and 1985 should provide the government with sufficient time to discuss any necessary tariff rate adjustments with its trading partners. It is likely, however, that even with such rate adjustments, the system as a whole will provide considerably less protection than the current system.

Another feature of the Canadian tariff regime that is likely to be significantly changed as a result of the Tokyo Round is the provision of the Customs Tariff under which the tariff status of imported goods depends on whether they are of a class or kind made in Canada, i.e., the so-called *made/not made in Canada regime.* Pursuant to an agreement with the USA during the Tokyo Round, the Tariff Board was asked in September 1979 to conduct a study of those tariff items under which the tariff classification of imported goods depends on whether or not the goods are made in Canada. The Board was asked to consider alternative tariff arrangements and, par-

ticularly, the feasibility of replacing the items containing "made/not made" provisions with new tariff items setting forth product descriptions. This review should be completed by January 1, 1985. The resulting tariff structure will provide less flexibility in adjusting tariff rates to accommodate changes in Canadian production patterns.

Also of importance are the concessions granted by Canada in the Tokyo Round under the *Machinery Programme*, under which machinery not available from Canadian production is accorded duty-free entry. Canada agreed to reduce the tariff on machinery available in Canada to 9.2 percent from 15 percent and to bind the average incidence of the duty on imports under the Machinery Programme at 5.25 percent. Canada also agreed to restrict the product coverage of the Programme. In that connection Canada offered a significant number of tariff bindings, at free, on machinery which had been entering free, unbound, for many years. Such machinery is not likely to be produced in Canada.

Also worth noting is the decision by the Canadian government in July, 1981 to work towards the adoption by Canada later in the decade of a common international system of classifying goods for customs tariff and trade statistics purposes, i.e., the *Harmonized System* (HS) being developed under the auspices of the Customs Cooperation Council. Adoption by Canada of the HS would allow modernization and restructuring of the Canadian tariff nomenclature and improve the accuracy of Canada's import statistics. Tariff classifications would be more easily understood, and business people would be in a better position to evaluate opportunities for both import-substitution and export sale.

To sum up, in the next decade Canada's tariff regime should be more transparent and more certain for traders. At the same time it will create a more competitive environment in the Canadian market. Canada's implementation of the Tokyo Round results on the tariff side and in the customs valuation area, the changes in the made/not made provisions of the Customs Tariff, and the possible adoption by Canada of a new classification system for tariff and statistical purposes are the key factors that will influence the new environment.

Non-tariff Measures Affecting Imports and Exports

There are a variety of situations in which Canada, like other countries, finds it necessary to provide special protection for domestic producers in addition to that provided by the regular tariff. At present such action is possible through the use of: a) anti-dumping duties to counter the injurious effects on Canadian producers arising from exports to Canada at prices below those in the country of export; b) countervailing duties to offset the injurious effects on Canadian producers of foreign government subsidies on exports to Canada; and c) emergency safeguard actions. The latter includes surtaxes or quotas imposed on imports which, although not necessarily dumped or subsidized, are causing or threatening serious injury to domestic producers.

Canada was among the first countries to deal systematically with the problem of dumping when it established an *anti-dumping regime* in 1904 as an alternative to a

more general increase in tariff rates. Dumping occurs where the foreign exporter sells to customers abroad at prices lower than the normal price he charges for the same product to domestic customers. Anti-dumping duties are special duties imposed on dumped imports, in addition to any normal customs duties, to offset the margin of dumping. The antecedents to current anti-dumping legislation and the control of subsidy practices dates to the beginning of the GATT in 1947 when member countries began gradually to bring their national laws and practices into line with agreed international rules as they are contained in Articles VI and XVI. These provisions are based on the premise that *dumping and subsidization* are not necessarily harmful to a particular importing country's economic and commercial interests. In many cases subsidies are used by governments to promote industrial re-structuring, offset regional disparities, and promote infant industries, all of which help contribute to overall national economic welfare. Where home market competition is weak, firms may find themselves dumping in a technical sense, although their export price may be equivalent to the prevailing international price. As a corollary, producers in an importing country may be operating as an oligopoly or be generally inefficient, and imported goods dumped only in a technical sense (i.e., not predatory) could provide needed competition.

It was not until the Kennedy Round of trade negotiations, however, that attempts were made to harmonize procedures in various countries and to have a material injury test applied in conformity with the original GATT provisions. For example, in Canada an injury test was required for countervailing duties cases but not until 1968 for dumping cases while the USA did not require injury tests for countervailing cases, but did require them for dumping cases. Certain other procedures in Canada and the USA differed from each other and those of other countries. These attempts led to the *GATT Anti-dumping Code* which was accepted by Canada and implemented into Canadian legislation at the end of 1968 by means of the Anti-dumping Act. The United States finally accepted the material injury criteria for countervailing duty cases during the negotiation of the *Subsidies/Countervail Code* in the Tokyo Round (1979).

The *GATT Codes* lay down the general rules and procedures which must be followed by signatories in taking anti-dumping or countervailing duties action, but it is left to each country to establish its particular regulations and procedures in keeping with the Code requirements. Canada and the USA, for example, have chosen to have the injury determination made by a separate body, whereas the EC undertakes this through an administrative review. Canadian and US procedures also differ in certain respects, reflecting in large part the greater reliance in the US on the adversarial process and on legal contestation of intermediate administrative decisions.

The main features of Canada's *1968 Anti-dumping Law* are that it requires a case-by-case investigation of dumping, extends the legislation to cover threats of injury or retardation, establishes the Anti-dumping Tribunal as a quasi-judicial body separate from Revenue Canada to assess whether, in fact, the dumping is causing or threatening injury, and sets out procedures to be followed by Revenue Canada in its investigations.

Over the years the anti-dumping system has, by and large, served Canadian producers well. It effectively deters foreign producers from predatory dumping (i.e,

dumping aimed at destroying competitors in the importing country). Annually, the Department of National Revenue reviews some hundred complaints of dumping of which fifteen to twenty lead to formal proceedings. For many of the complaints which do not lead to a formal enquiry, National Revenue officials are often able to point the producer to other remedies available in Canadian law. For those cases which do proceed, some two-thirds usually result in a final determination of both dumping and injury. There has been a wide diversity of products investigated. The more frequent users of the legislation include the steel, heavy electrical, electronic and chemical industries. To a lesser degree, footwear and textiles have also been involved in investigations but the existence of quotas undoubtedly affected the extent to which these industries required other protective measures. The majority of complaints consist of small industries with one or two producers. Canadian businessmen on the whole find the system effective, except for the expense and length of proceedings. At the same time, the system must provide sufficient safeguards to importers and consumers, which adds to the time and expense required for a thorough and fair investigation and enquiry.

Canada adopted regulations in 1977 giving effect to existing authority to levy *countervailing duties* as set out in Section 7 of the Customs Tariff. This provision, introduced in 1955, permits the Governor-in-Council to impose a countervailing duty to offset a subsidy on goods imported into Canada. Section 7 of the Customs Tariff is subject to GATT Article VI and, accordingly, a countervailing duty can only be imposed where injury has been established. The 1977 regulations issued under Section 7 provide, among other things, that the Governor-in-Council may impose a provisional countervailing duty and instruct the Anti-Dumping Tribunal to report on whether or not the subsidized imports are causing or threatening material injury to Canadian producers. The regulations also provide for consultations between Canada and the subsidizing foreign government but reserve for the Governor-in-Council the final decision as to whether a countervailing duty should be imposed.

Canadian producers have not made much use of the countervail law. Since 1977 there have been sporadic complaints, some of which resulted in formal enquiries and consultations with foreign governments. All were resolved to the satisfaction of the Canadian producer, the importer, and the foreign government involved short of an enquiry by the Tribunal and the levying of countervailing duties.

Extensive changes to both the Anti-dumping Act and countervail legislation have been proposed in the *Discussion Paper "Proposals on Import Policy"*, which was tabled in Parliament in July 1980. The Discussion Paper also includes a number of proposals relating to emergency safeguard actions and procedures for responding to acts of foreign governments which adversely affect Canadian trade interests. These proposals were studied by a special Sub-Committee of the House of Commons Committee on Finance, Trade and Economic Affairs, and its report is currently under review.

The legislative proposals put forward in the Discussion Paper were designed to ensure that the government has the necessary authority from Parliament to take full advantage of Canada's rights under the GATT and its ancillary agreements. The government was of the view that Canadian legislation relating to anti-dumping and

countervailing duties should reflect the latest developments in the international trading environment and should incorporate procedures which are efficient and speedy, fair and open to public view, and consistent with our general economic development objectives and our overall trading interests.

"Safeguards" in the commercial policy context is a term used to describe *special measures of protection* which governments can take to safeguard domestic production and employment against imports which, although not necessarily dumped or subsidized, cause or threaten serious injury. Such measures could include temporary increases in tariffs, a surcharge on the tariff, a quantitative restriction, establishment of minimum import prices or any other appropriate action. The basic provisions in GATT governing safeguards are contained in *Article XIX*. The ability to have recourse to adequate safeguard provisions is one of the essential ingredients necessary to the continued maintenance of a liberal trade regime. Without the ability to extend appropriate short-term protection to industries injured by changing competitive conditions, governments would be reluctant to continue to extend improved access to their markets.

Canadian legislation currently provides three ways in which *safeguard action* can be taken. Section 8 of the Customs Tariff permits the Governor-in-Council to impose a surtax on imports for a maximum of 180 days, pursuant to a report by the Minister of Finance that in his judgement goods are being imported into Canada under such conditions as to cause or threaten serious injury to Canadian producers of like or directly competitive goods. The surtax may be extended with the consent of both Houses of Parliament. Section 5 of the Export and Import Permits Act permits the Governor-in-Council, on the recommendation of the appropriate Minister, to impose quotas on imports based on a finding by the Textile and Clothing Board or the Anti-dumping Tribunal that these imports are causing or threatening serious injury to Canadian producers. The 1982 Meat Import Law provides for limits on imports of fresh, chilled and frozen beef and veal whenever circumstances in both the domestic and world markets combined are likely to cause injury to domestic production.

The *Proposals on Import Policy* recommend a number of changes in Canadian safeguard provisions aimed at modernizing Canadian procedures. These include legislative authority to place products on the import control list for monitoring purposes based on a finding of injury or threat thereof by the Anti-dumping Tribunal or the Textile and Clothing Board; to maintain surtaxes for more than 180 days on a finding of injury by either the Tribunal or the TCB; and to allow for the introduction of tariff-rate quotas.

Canada has taken safeguard action over the years in a limited number of sectors. Temporary and emergency surtaxes have been imposed on bicycles, polyester filament yarn, men's and boys' shirts, and certain sensitive horticultural products. Quotas (both global and country-specific) have been applied on a range of textile, clothing and footwear products, as well as cattle, beef, and veal. A special valuation provision was applied to imports of turkeys in the mid-sixties. Discussions with Japan have led to that country exercising self-restraint in the export of automobiles, a measure analogous to safeguard action, as it did in the late 1950s and early 1960s

regarding exports of non-textile, low-cost consumer products such as stainless steel flatware.

One sector for which safeguard action has become standard (rather than of a temporary or emergency nature) is *textiles and clothing*. The problem is a general one shared by all industrialized countries which, in addition to high tariffs, maintain restrictions on imports from so-called low-cost suppliers under the *Arrangement Regarding International Trade in Textiles* (the MFA). Canada currently has bilateral restraint arrangements with some seventeen suppliers, the product coverage of which ranges from one or two items to virtually all textiles and clothing exported by these sources.

In *horticultural trade*, Canada has in the past experienced problems requiring short-term emergency safeguard action covering fresh cherries, strawberries, corn, potatoes, and peas. The problem arises out of the fact that the Canadian season for these products is slightly later than that in the USA, so that when the USA experiences a bumper crop, exporters will indulge in distress selling at mid- and late- season prices at the time the Canadian crop is just coming on the market. Because the product is usually highly perishable, a surtax of only a few weeks duration is often sufficient to remedy the problem. Since 1979, a streamlined system for implementing surtaxes in these cross-border trade circumstances has been in effect.

Resort to safeguard action by Canada's trading partners has also been relatively contained during the 35 years of the GATT's existence. GATT notifications list only some 110 actions on the part of its signatories during this period (Canada accounted for 22 of these, the USA for 24, and Australia for 35). This inventory, however, masks the large number of so-called voluntary export restraints arrived at by governments wishing to avoid more sweeping global measures, as well as unilateral measures which are not presented or justified as safeguard measures consistent with international agreements. It also does not include all the safeguard actions taken in the textile sector under the MFA, as well as a significant number of restrictive measures, especially on the part of the Europeans in the agricultural sector, which are rarely notified.

The GATT provides for offsetting compensatory or retaliatory measures by countries whose trade interests are seriously affected by safeguard measures taken by their trading partners. The USA has traditionally been most aggressive in pursuit of these rights and to some extent has succeeded in using US legislation to reduce the use of safeguard measures on the part of some of its trading partners. Since 1981 Canada has had similar legislation. The new import policy proposals contain further draft legislation designed to provide a secure base in law to respond to foreign government acts, policies, or practices harmful to Canadian trade interests.

While the GATT sets out the international rules governing resort to safeguard measures, and domestic legislation provides a basis in law for extending special measures of protection to domestic producers, governments must exercise a considerable degree of discretion and judgement before resorting to such measures. In arriving at a decision to apply quotas or surtaxes, the government must weigh carefully the effect of such a measure on industrial users, consumers, trade relations and

Canada's overall export interests. Resort to restrictive emergency measures has thus been limited to those few instances when an independent board of enquiry or similar process has clearly established that a Canadian industry is being seriously injured as a result of imports.

The basic statutory instrument for controlling imports and exports is the *Export and Import Permits Act*, which was enacted in 1947 as an outgrowth of controls imposed under the War Measures Act. Initially it was used primarily to control the flow of scarce and/or strategic goods to specific destinations in the context of post-war reconstruction programmes and was administered by the Minister of Trade and Commerce. The Act has since evolved through a number of amendments to the point where it is now the principal instrument for implementing at the border government policies that require the use of quantitative restrictions on either imports or exports.

The Act provides that the Governor-in-Council may establish an Import Control List (ICL), an Export Control List (ECL) and an Area Control List (ACL). It also sets out criteria to govern the placing of goods or countries on the respective lists. Control over the flow of goods or destinations contained on these lists is effected through the issuance of permits. The Act, as presently written, does not provide for the control of imports for reasons of national security or for balance-of-payments reasons.

Goods may be placed on the *Import Control List* (ICL) when it is deemed necessary to control their import for any of the following purposes:

- to ensure adequate supply and distribution of an article that is scarce on world markets or is subject to control in the country of export. To date, little use has been made of this provision although it could obviously come into play to ensure adequate distribution in the event of a trade embargo, e.g., the oil embargo imposed by OAPEC following the 1976 Yom Kippur War.

- to support any action taken under the Farm Products Marketing Agencies Act. Use has been made of this provision to impose global import quotas in support of the supply management programmes for eggs, chickens and turkeys.

- to implement any action taken under designated acts such as the Agricultural Stabilization Act, for the purpose of supporting the price of a commodity. This provision has been used to control or prohibit the import of fluid milk and dairy products including cheese.

- to implement an intergovernmental arrangement or commitment. Measures taken under this provision have included such diverse actions as the control of the import of certain plants and animals in keeping with Canada's obligations under the UN Convention for the Protection of Endangered Species, the control of imports of beef and veal, the ban on imports of goods of Rhodesian origin under the UN Rhodesia Regulations, and the control of imports of textile and clothing products.

- to implement a quantitative restriction pursuant to a finding of serious injury or threat of injury by either the Anti-dumping Tribunal (under Section 16.1 of the Anti-dumping Act) or the Textiles and Clothing Board. Action taken under this Section must be defined both in terms of extent and duration. These provisions have been used to impose global quotas on imports of textiles, clothing and footwear following the government's acceptance of findings of injury by the TCB or the Anti-dumping Tribunal.

The *control of exports* under the Act is effected in two ways, either by controlling the good itself by placing it on the Export Control List in which case the product is subject to licence regardless of destination (except, in most cases, the USA), or by restricting exports to particular destinations by placing a country on the Area Control List in which case all exports, regardless of their nature, are subject to licence to the proscribed destination.

There are no statutory criteria governing the use of the *Area Control List* (ACL) where a country's insertion into or removal from the ACL has been motivated largely by foreign policy objectives. Recent changes to the ACL have included the removal of Rhodesia and the PRC from the ACL to underscore improved bilateral relations. Iran, on the other hand, was placed on the ACL following the hostage-taking at the US Embassy in Tehran, but was later removed from the list.

Products may be placed on the *Export Control List* (ECL) for any of the following purposes:

- to ensure adequate supply and distribution of any good for defence or other needs. This has been used to control the export of goods such as ferrous scrap, pig iron, copper and blood plasma which were in short supply internationally.

- to ensure that any action taken to promote the further processing in Canada of a natural resource that is produced in Canada is not rendered ineffective by its unrestricted exportation.

- to implement an intergovernmental arrangement or commitment. This has been used to control the export of endangered species in keeping with Canada's obligations under the UN Convention and to control the flow of beef and speciality steel. In the case of beef the objective was to ensure that the Canadian quota for exports to the USA was not exceeded and to facilitate the movement of the commodity across the border. In the case of speciality steel it was used not only to ensure that the Canadian quota (fixed by the USA during a safeguard action on speciality steel) was not exceeded but also to ensure that no foreign steel was transshipped through Canada and counted against the Canadian quota allocation. Provisions of the Act were also used to allocate the export quota for speciality steel among various Canadian producers.

- to control the export of military or strategic goods for national security reasons. This has been used extensively since the enactment of the Act, but the nature of the goods contained on the list has changed substantially. Initially

the controls applied more to strictly military goods or to scarce commodities destined for Europe as part of the Marshall Plan aid. In recent years this use of the Act has been extended to include high technology goods that could have a military end-use. The foreign policy considerations governing export controls are discussed further below.

Licencing is the means by which the government administers and enforces at the border a wide array of policies from temporary safeguards, through export controls, to supply management of agricultural commodities. The Export and Import Permits Act is the principal instrument, but there are also provisions for licencing under the Wheat Board Act, the Narcotics Control Act, the Atomic Energy Act, and other similar acts. Canadian licencing practices are subject to international rules which aim essentially at transparency and predictability. These rules are to be found in the GATT *Agreement on Import Licencing* which elaborates existing GATT provisions by embodying a set of principles and guidelines intended to reduce and eliminate, where possible, the unnecessary trade restrictive effects which can arise from the administration of import licencing.

In addition to the various import policy instruments described above which affect the flow of goods at the border, Canadian commercial policy also encompasses various instruments which, while primarily aimed at industrial policy objectives, can also have an important effect on trade flows. Two important areas of public policy in this regard are the maintenance of product standards and purchases by governments. Both areas are now covered by detailed international rules.

All countries utilize *product standards* for legitimate purposes such as the protection of consumer interests. Barriers to trade, however, can be created by disparities among countries in product standards and related certification systems. Difficulties may also arise with respect to methods for determining conformity with such standards. With greater public and governmental concern in regard to the environment and consumer protection, governments at all levels, both in Canada and abroad, have become increasingly involved in regulating the products that may be offered on the market, whether on the store shelf or to industrial and agricultural producers.

As with the GATT itself, the *Agreement on Technical Barriers to Trade* aims at ensuring transparency and national treatment. Canada and other signatories have agreed that in the formulation, application and enforcement of product standards the basic operating principle of national treatment between domestic and foreign goods, and non-discrimination among foreign goods, shall apply. The agreement applies to standards for which the federal government is responsible. In respect of provincial, municipal and non-governmental standards, Canadian obligations are to seek compliance on a "best endeavours" basis. At the same time, parties adversely affected by these standards may seek normal recourse to the dispute settlement mechanisms with a view to restoring mutual economic advantage and the balance of rights and obligations.

Since the Tokyo Round, a significant proportion of purchases by the federal government is now subject to international competition. This was done on a recipro-

cal basis with other parties to the GATT *Government Procurement Agreement*. Purchases by governments, due to their size, can be used to stimulate industrial development and effectively advantage domestic producers. When such purchases begin to distort normal competitive forces, they can frustrate the efficient allocation of resources and become a significant hidden subsidy. The GATT Agreement is a first effort to bring a portion of the purchasing of governments into the international trading framework. It recognizes that governments discriminate in varying degrees in favour of local suppliers and that such practices can be important barriers to trade. The Agreement creates a set of rules designed to ensure that suppliers from each signatory have an opportunity to bid on certain foreign government contracts in excess of the national equivalent of 150,000 SDR (about $220,000). Should it prove successful, its coverage might be expanded in further negotiations. It is limited to purchases by federal or central governments and leaves intact provincial or state procurement practices which advantage local manufacturers. The coverage of this initial agreement is not as extensive as the government was prepared to envisage. Nevertheless, it opens important new export opportunities in large procurement markets for Canadian suppliers over a broad range of products purchased by governments. The possibility of extending the Government Procurement Agreement to services not associated with purchases of goods will be subject to future discussion in the committee which oversees its operation.

There are a number of other federal and provincial measures which affect the flow of goods into or out of the country. Over the years there has been a systematic attempt to bring these also within a firm framework of international rules. During the Tokyo Round, for example, a first attempt was made to deal with the trade effects of the practices of provincial liquor boards. The provincial governments, in a statement of intent, agreed to move towards a system of non-discrimination in their purchasing practices. This concession was an important ingredient in gaining improved access for Canadian distillers to the US and EC markets. Federal practices such as restrictions on the tax treatment of advertising costs have also been subject to international discussion because of their perceived effect on trade. Similarly, other countries follow policies and practices which can have an adverse impact on Canadian export interests. On the whole, however, international rules provide an increasingly firm basis for managing and containing such practices, both at home and abroad.

As we have seen, Canada has over the years developed and maintained a complex and sophisticated import regime to provide the necessary protection to help Canadian producers to compete, grow and increase their efficiency and productivity. Our trading partners maintain similar systems of contingency protection for their own producers. A good deal of effort in managing Canada's international trade relations is directed towards ensuring that these regimes do not unjustifiably frustrate Canadian export opportunities. In an interdependent trading world there is always some tension between a government's wish to protect domestic producers and the need to protect market access for exporters. Protection for the one is often viewed as protectionism by the other and governments must maintain a delicate balance between the two forces. In recent years there has been a marked increase in pressure for solutions to problems which are clearly on the protectionist side of the spectrum.

Canada's record in providing protection and containing protectionism is probably no better or worse than that of our major trading partners. Canada's tariff levels afford a level of protection considered to be among the highest in the OECD. At the same time, Canada provides duty-free entry for a higher proportion of its manufactured product requirements, so that the overall incidence of the tariff, in the 4 to 5 percent range, is equivalent to that prevailing in the USA and the EC. In the textile sector, while Canada's regime was more liberal than the USA and EC in the 1960s and early 1970s, we now provide a comparable level of protection. In footwear, Canada, by means of global quotas, maintains one of the highest levels of protection among industrialized countries. Similarly, where the need has arisen in other sectors, Canada has been prepared to extend special measures of protection as has happened recently in the case of automobiles. A variety of Canadian regulations and practices can have the effect of limiting imports of foreign services or foreign participation in Canadian service sectors through establishment and investment.

We are in the process of modernizing the import regime to strengthen our capacity to deal with dumping, subsidization, and injurious imports so that it will be as effective as the regimes existing elsewhere. Of course, this system reflects and will continue to reflect particular industrial and trade requirements. In this regard Canadian commercial policy has traditionally sought to promote efficient economic development and to maintain a reasonable balance between the interests of producers and consumers as well as the export and import interests of different regions.

It has been argued that the recent world-wide increase in protectionism was a result of recessionary conditions and that as these conditions turn around, protectionist pressures will abate. Undoubtedly, the immediate catalyst for today's protectionism was the recession which fuelled unemployment and generally reduced economic activity and for which imports are often the most expedient scapegoat. It can be further argued that high interest rates tend to restrict investment and generate volatile exchange rates which in turn lead to unfair credit and currency competition. Unfortunately, so-called short-term protectionist solutions have long-term effects and tend to undermine further a return to prosperity. In this sense protectionism is self-defeating and has been rejected by successive governments as a viable basis for the conduct of Canada's commercial policy.

The Use of Commercial Policy Instruments for Non-Trade Reasons

While the purpose of commercial policy is to promote the efficient development of the Canadian economy, commercial policy instruments are occasionally used for other reasons. Measures such as trade embargoes, controls on strategic exports, and prohibitions on imports of obscene literature are pursued because they may respond to compelling political, security, and social considerations of the day. Resort to commercial policy instruments for such reasons, however, needs to be carefully considered to ensure that the intended effect will be met and the benefits outweigh the disadvantages of distorting or limiting trade. Furthermore, such measures may need to be periodically reviewed to determine whether they continue to meet their original purpose. The need for controls of this kind are recognized in the exceptions articles

of the GATT (XX and XXI) as long as such measures do not constitute a disguised restriction on international trade.

Prohibitions for social and other reasons include such items as the following:

- the prohibition on the import of obscene or seditious literature, posters, films etc. for self-evident social and security reasons.

- controls on the export and import of endangered wild flora or fauna pursuant to the United Nations' Convention on International Trade in Endangered Species. This convention aims to stop the indiscriminate killing of endangered species such as, for example, elephants for their ivory tusks. Such items may only be imported or exported under strictly controlled circumstances.

- the prohibition on the import of products of prison labour. This prohibition serves two purposes. In the first place, because prison wages bear no relationship to economic factors, products made in prisons would have an unfair competitive advantage. Secondly, for humanitarian reasons Canada does not wish to encourage the exploitation of prison labour by totalitarian regimes. At the same time, it must be recognized that enforcement of this prohibition is rather difficult.

- the prohibition on the import of offensive weapons, except under strictly controlled circumstances.

Sanctions or embargoes for foreign policy reasons encompass a wide range of possible measures and have been employed by both Canada and other countries for various reasons with varying degrees of success. They can range from a complete ban on imports or exports, to a partial ban on exports of certain classes of military goods to countries at war, or to an area where war appears imminent. Sanctions can be applied pursuant to a UN Security Council Resolution (as was the case for Rhodesia following its unilateral declaration of independence), or in any other situation which in the government's view calls for such action, for example against the USSR over Afghanistan.

Sanctions, whether complete or partial, are perceived to be the most potent measure in a nation's foreign policy arsenal, short of war, to indicate disapproval of another nation's policies or practices. The term is not relevant to trade alone. It denotes a penalty generally. In practice, however, it has proven to be a form of economic warfare. Like war, such sanctions are not without cost and any decision to apply sanctions must carefully weigh the costs, the benefits, and the prospects for achieving the intended effect. A decision to proceed is largely a political decision that responds to broadly-based domestic views.

Trade is a continuing process in the sense that there are always orders in the course of being filled and contracts in the course of performance. Being a continuous process, it is difficult to interfere with trade because of the dislocation and interference it is apt to cause for both the supplier and the customer. In a democratic society, private traders must be able to assume that they can freely import or export

as long as they meet requirements for so doing established in law. Any change in those laws must be sensitive to existing contracts and other binding commitments. Democratic governments are reluctant to force their citizens to break contracts in other than rare and exceptional circumstances, and then only on the basis of law.

Effective partial sanctions are conceivable to deal with limited situations, when directed against countries that are vulnerable to them, and when imposed by an overwhelming consensus of countries in a position to make them stick. As such they can constitute a potent political message to the affected country and even, in some circumstances, cause enough pain to lead to a reversal in policy. The desired impact of the sanctions is often not so much the denial of certain exports or markets, which can be overcome by finding new suppliers or markets, as the disruption caused to established trading relations and the negative effect on investor confidence and money markets. The effectiveness of the sanctions is often dependent on the goods proscribed. The sanctions maintained by Canada and many other countries against South Africa for its apartheid policies afford a good example. The government no longer provides its services for exporters to this market; military equipment is completely proscribed. While South Africa continues to trade in some fashion with most countries applying these sanctions, they constitute a strong political statement of the general abhorrence of apartheid, although they have had only limited impact in softening this policy.

General sanctions are a more difficult matter. Only in rare circumstances is the case for such sanctions convincing and then only if done in concert with others and for a limited period of time. If done alone, their effect is largely symbolic and the cost to Canadian exporters is more evident in that their competitors are in a clear position to benefit. If imposed over an extended period of time, it becomes increasingly difficult to sustain them. There may also come a time when they need to be removed, often in circumstances that bear no relation to the reasons why they were first imposed. As such, their removal may thus convey unintended signals.

When imposing sanctions, whether limited or general, it is important to consider their purpose. If it is to convince the regime against which the sanctions are to be imposed to change its policies or practices, such results have historically been rarely achieved. Broadly conceived sanctions of this kind usually hurt innocent parties more severely than the intended regime — i.e., either the citizens of the country against which the sanctions are to be imposed or Canadian exporters and manufacturers. If it is intended as a signal of disapproval, then sanctions limited in duration and coverage are usually sufficient to convey the necessary message. As such, it can be a useful tool which middle-sized powers such as Canada can deploy when circumstances call for such a political signal. Limited sanctions can be tailored to minimize the costs to the country imposing sanctions and thus broaden support for them. Sanctions which deeply divide a nation are more likely to convey the wrong message.

The legal basis for trade sanctions in Canada rests in the UN Act (for sanctions mandated by the UN Security Council pursuant to Articles 39 and 41 of the UN Charter), the War Measures Act, and the Export and Import Permits Act. Sanctions against Iran resulted from a special Act of Parliament and were effected through the Export and Import Permits Act. Sanctions against the Soviet Union arising out of its

invasion of Afghanistan were limited to wheat sales and were effected through the Canadian Wheat Board. The embargo of Argentina was based on the intergovernmental commitment section of the Export and Import Permits Act. The War Measures Act has not been invoked for this purpose since the Korean War.

Canada operates basically three types of continuing strategic or foreign policy export controls: those arising out of our commitments to the USA under the Canada-US Defence Production Sharing arrangements; those motivated by concern for national security and effected in concert with our COCOM partners; and those maintained in support of foreign policy objectives. All three are administered under the Export and Import Permits Act as described above.

The Defence Production Sharing arrangements (DPSA), dating back to as early as the Hyde Park Agreement of 1941, are designed to foster the highest level of integration of the Canadian and US defence industries and thus enhance our collective defence effort. They are based on the free transfer of military goods between Canada and the USA and thus require that the two states operate parallel export control systems in order to prevent circumvention.

Within COCOM, the informal committee that coordinates the export controls of NATO countries and Japan on goods directed towards the USSR and the PRC and their allies, an embargo is maintained on goods and technologies of a specifically strategic nature. These controls are not absolute, and the listing of a product on the Export Control List only implies that the good is sensitive and that its export is subject to prior licencing. Depending on the end-use and the end-user, approval may be given for the transaction. This approval may be at national discretion for less sensitive goods or subject to the concurrence of the COCOM partners for proposed sales that significantly exceed the threshold of the embargo. Deciding on appropriate strategic thresholds and exceptions demands that adequate account be taken both of the technical-strategic impact of the items in question, and also of the economic and political factors affecting East-West trade. Thus such export questions are often 'technical' only in appearance — in operation, they effectively define one important dimension of the economic and political relationship with Eastern Europe.

The difficulties which arise from the use of export controls to safeguard national security can be classified under two headings: (a) the complexity of the international lists and the international clearance process and (b) the delays in obtaining the clearances. In cases where a Canadian exporter wishes to enter into a transaction with a Warsaw Pact purchaser, he faces complex procedures and usually expensive delays, as do his competitors in the USA, Western Europe, and Japan. The exporter must prepare, in the first instance, a submission to the Canadian Export Control authorities who review the case and decide whether a permit may be issued at national discretion or whether the transaction requires international clearance. In this latter instance, the Canadian Export Control authorities normally assist the exporter in preparing the case. Depending on the complexity of the transaction, this process can last from six months to a year.

Strategic controls, while they are complex and the decision process lengthy, are usually based on a case law system where export control authorities, if similar transactions have been approved in the past, and barring significant change in the politi-

cal climate, can provide reasonable assurances to the applicant about future similar transactions. The only uncertainty in the strategic area is how far beyond the threshold of the particular control one can carry a transaction. The system has proven reasonably successful in allowing the Western Alliance to maintain a control over the sale of strategic goods which is uniform in its application and does not unduly frustrate domestic commercial interests.

Canadian export controls also enable this country to enforce mandatory UN sanctions in arms sales to South Africa. They are also employed to withhold defence sales to countries involved in actual or imminent conflicts, and to countries whose repressive policies are considered wholly repugnant to Canadian values, especially where the articles concerned are liable to be used against the civilian population.

In practice it has proven difficult to exercise some of these controls in a fashion that provides defence industries with reliable indicators of what sort of exports will be permitted. Deciding when a conflict is "imminent" and when it has abated is often highly judgemental, and in some cases Canada has endorsed the cause for which one side is fighting. Withholding export permits on human rights grounds introduces a further source of uncertainty, strongly related to domestic preoccupations in Canada. Ultimately it represents a decision at the political level that Canada will not tolerate the degree of association with repressive regimes that might be created by the supply of Canadian arms and munitions, even though these items may be readily available from other sources. In application, defence export permits have generally been withheld on this basis for readily-identifiable items with potential use against civilians, but often not for components and spare parts that carry little Canadian identity. In domestic political terms it meets public expectations which have been strongly influenced by Canadian positions in favour of disarmament and human rights.

It is worth asking whether controls on military exports for foreign policy reasons meet their objectives and whether they meet them sufficiently to offset the uncertainties created for Canadian exporters. In the case of foreign policy controls, the uncertainty is greatly increased by the uncertainty of the objective, i.e., the subjective evaluation of a particular regime and the duration of that opinion. The speed with which these types of evaluations may change, and from the exporter's point of view, their apparent capriciousness, very often lead Canadian firms to avoid completely trying to do business in particular areas of the world. While the Canadian economy, through this policy, suffers the opportunity cost, Canada, from a foreign policy point of view, may not reap offsetting gains, particularly where the target state is unaware of the action being taken.

There is always the risk that export controls operated by Canadian authorities are more disruptive than they need be to achieve the government's objectives. A higher degree of transparency and accelerated decision-making would assist the exporting community to make more informed judgements as to where to place their scarce marketing resources. This could bring about a higher degree of involvement by the high-technology community in exports without eroding the government's security or foreign policy objectives. Further, such increased transparency and publicity could enhance voluntary compliance.

Canadian policy on defence exports is more stringent than other industrialized countries. Canada has, nevertheless, achieved the position of being the seventh largest defence exporter outside the Eastern bloc (with sales of $600 million in 1979-80) because of its ability to contribute to systems made and marketed through the USA and by specializing in the production of non-weapon categories of defence support equipment. In one sense this relative success can be seen as a measure of Canada's accomplishment in reconciling political and economic factors within this foreign policy/trade nexus: Canadian political principles on arms sales can be reaffirmed in good conscience, while the country still carries on a significant export trade in this sector. In another sense, however, there are some domestic critics of Canadian policy who perceive that the very factors supporting the growth of Canadian defence exports help to ensure we do not really control their destination, while industrial spokesmen remain unclear of the extent to which the government is committed to making Canada competitive in the high-technology goods which dominate our defence export sector.

Domestic Institutional Framework

The responsibility for the development and implementation of trade policy in Canada and for the management of trade relations has historically rested primarily with the departments of External Affairs, Finance and Industry, Trade and Commerce. These lead departments have shared these responsibilities on matters of particular interest with other departments including Agriculture, Fisheries, Energy, Mines and Resources, Revenue Canada and Consumer and Corporate Affairs. As a result of the government re-organization announced by the Prime Minister in January 1982, the international trade relations and export development functions of Industry, Trade and Commerce were integrated within a new Department of External Affairs, with a view to providing greater emphasis on the expansion of Canada's international trade and commerce within the conduct of Canada's foreign policy.

With its overall responsibilities for the management of the Canadian economy and with the fiscal origin of the Canadian tariff, the responsibility for the Customs Tariff and the main import regulatory instruments, except the Export and Import Permits Act, have rested in the Department of Finance, with Revenue Canada having the administrative and enforcement functions. Thus, the Tariff Board and the Anti-Dumping Tribunal report to the Minister of Finance. The Textile and Clothing Board, however, reports to the Minister of Industry, Trade and Commerce. In addition, there are a number of government agencies such as the Canadian Wheat Board and the National Energy Board which have regulatory authority extending to border measures on products within their respective mandates.

The Tribunal has two distinct functions: a) under Section 16 of the Anti-dumping Act it serves as a "court of record" to determine the existence or otherwise of "material injury" to a domestic producer arising from dumped or subsidized imports; and b) under Section 16.1 of the Act and at the request of the government, it inquires into and advises the government on injury to the production of goods in Canada arising from imports in circumstances that do not necessarily involve dumping or subsidization.

The Tariff Board is also an independent tribunal and "court of record". It adjudicates appeals to it from rulings with respect to customs and excise matters made by Revenue Canada. The Board can also serve as a board of inquiry into matters relating to the Canadian tariff, at the request of the Minister of Finance.

The Textile and Clothing Board acts in a manner similar to the Tribunal but limited to matters arising from trade in textiles and clothing. It can conduct inquiries on its own initiative, or on request from the Minister of Industry, Trade and Commerce or a Canadian producer, to determine whether the importation of any textile or clothing goods is causing or threatening serious injury to their production in Canada. In conducting its inquiry and in making any recommendations, the Board must take into account a variety of factors including the effect of any measures on consumers, the international rules, and the probability of the measures returning the sector to economic viability.

The Parliamentary Sub-Committee, which has recently held public consultations on import policy proposals, has suggested that the role of these import agencies be examined in relation to one another.

An increasingly important dimension of the management of Canada's trade policies stems from recognition of the critical interdependence of trade and commercial, industrial and other economic development policies. Trade and commercial policies, export trade development and other areas of international activity must be consonant with domestic industrial and regional development policies. By the same token, industrial and regional development policies must take account of the size and nature of the foreign markets for goods and services, the international environment, including Canada's international obligations, and the sensitivities of its trading partners. Similarly, from the viewpoint of the business community, it is the combined impact of both domestic and international policies, including the relationships of federal and provincial policies, that affect its ability to exploit Canada's competitive advantages.

A major challenge of public policy management is to ensure the proper coordination of the various policies, domestic and international, that affect the competitiveness of Canadian industries. The recent government re-organization is designed to strengthen the capacity of the federal government to respond positively and effectively to this challenge. Bill C-123 regarding Organization of the Government of Canada tabled in the House of Commons in June of 1982 defines the new responsibilities of the Minister for International Trade as: assisting Canadian exporters in their international marketing initiatives and promoting Canadian export sales; improving the access of Canadian produce, products and services into external markets through trade negotiations; fostering trade relations with other countries; contributing to the improvement of world trading conditions. The functions of the Minister of Regional Industrial Expansion are defined as covering, *inter alia*, manufacturing, processing and service industries in Canada and trade and commerce within Canada.

In the formulation and implementation of Canada's trade policies and the conduct of trade relations, consultations with various private interests have normally

been held on specific issues as circumstances warrant. This applies to the development of recommendations to Ministers on various import policy matters as well as on specific issues concerning access to foreign markets. At times, these consultations have been conducted in a more structured and formal manner, particularly when major international trade negotiations were held, so as to ensure that the various regional, sectoral, producer and consumer interests can be fully heard. For example, during the Tokyo Round, the Canadian Trade and Tariffs Committee, which was established to hold consultations with various interests concerned, received approximately 500 individual submissions. This consultative process was furthered by confidential discussions with different interests by the Canadian Coordinator for Trade Negotiations.

Historically, there has been no formalized and continuing institutional structure for Federal-Provincial consultations or exchanges of views on international trade and commercial policy matters. To a considerable extent, this has probably reflected the exclusive federal jurisdiction over traditional regulatory import policy instruments such as the Customs Tariff and the Anti-Dumping Act, as well as the overall federal responsibilities for the conduct of Canada's foreign policies. This has not meant the absence of consultations, but that they were of an *ad hoc* nature. However, one of the direct effects of the gradual shift, both internationally and domestically, away from the almost exclusive focus on traditional border instruments to concerns with the impact of domestic economic policies and programmes on international trade, has been the need to increase and intensify consultations with the provinces. At the same time, the provinces have become increasingly interested and concerned about the impact of international trade developments on their policies and economic development. Major examples of this relationship between federal and provincial policies as they bear on international trade and trade agreements are in the areas of government procurement, government subsidy and support programmes and regulations on product standards.

During the Tokyo Round, a special effort was made to keep the provinces informed of the progress in the negotiations by means of a committee of senior federal and provincial officials. The Provinces responded positively to this innovation and proved willing to make their contributions when they perceived their interests to be served, as for example by the Statement of Intent on Provincial Liquor Marketing Practices. This intensive process of federal-provincial consultations has helped to increase the understanding in the various regions of Canada's trade policy objectives and the context in which they are being pursued internationally, as well as to improve the awareness and sensitivity of the federal government itself to provincial priorities and concerns. It has also helped to develop a more informed appreciation of what the federal government can do in international trade negotiations to accommodate and pursue specific regional or provincial export interests and to respond to the particular concerns of the less-competitive sectors within the framework of national policies. Furthermore, these consultations also contributed to showing Canadian business and our trading partners that there can be effective federal-provincial cooperation in striving to enhance market access conditions for Canadian exporters.

As a result of these positive experiences gained during the Tokyo Round, a structured framework for federal-provincial consultations on international trade

matters was continued in the form of a Federal-Provincial Committee on Trade Relations at the senior officials' level. In addition, the first federal-provincial meeting of trade Ministers was held in June, 1982. One of the most important challenges of this ongoing consultative process in the 1980s will be to ensure that Canada's trade leverage internationally is not undermined or dissipated by conflicting domestic interests, policies or programmes or by predatory trading practices of foreign governments that may otherwise be tempted to play off one set of internal interests against another. Similarly, because Canada's international competitiveness depends significantly on its ability to maximize the economies of scale offered by its own integrated domestic market, and its negotiating trade leverage is considerably influenced by the attraction of its entire domestic market to foreign suppliers of goods and services, this consultative framework should contribute to a better understanding of the importance of an effectively functioning common domestic market.

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Chapter VI

FOREIGN MARKET ACCESS AND EXPORT DEVELOPMENT

Canada needs a vigorous renewal of will on the part of corporate management and labour to maintain international competitiveness and to get out and win export markets. That renewal of will needs a supportive federal government with co-ordinated and focussed export support services.

Strengthening Canada Abroad
Report of the Export
Promotion Review Committee

The consistent policy orientation of successive Canadian governments has been to preserve and improve access for Canadian exports to foreign markets, particularly the US market, and to seek to diversify export opportunities for Canadian producers. In this regard, the tariff and other terms of access to the Canadian market have been used as negotiating instruments in opening up markets for Canadian goods and services, whether in GATT negotiations or bilaterally. The government has devoted considerable resources over the years to exploiting and enhancing available export opportunities for Canadian resource-based, food, manufacturing, and service sectors. Indeed, as far back as the 1890s the forerunner to the Trade Commissioner Service was established to help Canadian companies find export markets. A century later, the federal government, through a greatly expanded Trade Commissioner Service and a number of sophisticated export-oriented support programmes, continues to encourage and assist Canadian firms to find foreign buyers for their goods and services.

Access Conditions Facing Canadian Exports

Successive rounds of tariff negotiations have reduced tariffs to such levels that for many sectors they are no longer major impediments to access to our industrialized trading partners' markets. Some sensitive areas, e.g., textiles, footwear and clothing, still enjoy relatively high tariff protection, but for many industrial goods the average tariffs of our major partners (the USA, the European Community, and Japan) are now or soon will be at levels where they can no longer be considered as a serious obstacle to the efficient development of the Canadian economy. This is not to say that tariffs are no longer important for a range of products in different markets for the profitability of Canadian exports; but tariffs no longer act as the major determinant to the location of investment and as the major impediment to the achievement of economies of scale in most cases.

The tariffs remaining represent two kinds of problems; tariff escalation and relatively high tariffs on some goods of interest to Canadian manufacturers. Tariffs which increase with the level of processing frustrate the industrial goals of many resource exporters, including Canada, which seek to increase the domestic value-added content of their resource-based exports. The relatively high tariffs remaining for particular products continue to represent barriers to certain markets, e.g., petrochemicals and rolling stock in the USA.

It is probably not an exaggeration to say that non-tariff measures now have a more significant impact on the expansion of trade in many markets than do tariff rates. The severity of the problem encountered varies widely, ranging from the essentially surmountable (lengthy and often expensive administrative formalities) through the restrictive (quotas) to the prohibitive (bans and embargoes, for instance). Negotiations and discussions of these problems in the GATT have progressively brought these barriers within a firm framework of rules so that few non-tariff barriers now present insurmountable obstacles to Canadian exporters.

The average tariff on dutiable manufactured exports to the *United States* will by 1987 be around 5.7 percent. With free access for automotive and defence products and virtually free entry for some other product areas, e.g., some machinery, the tariff is not a significant barrier for most of our current exports; however, there remain areas in which trade could be significantly expanded by a lowering of particular tariffs. In areas considered sensitive by the USA, such as textiles and clothing, tariffs remain high with no immediate prospects for their reduction.

There are no general limitations on imports into the United States and few of the consular formalities, prior deposit and import-licencing requirements that complicate trade with some other countries. Customs documentation is fairly straightforward. Valuation for customs purposes is far more predictable than it was prior to the Tokyo Round, when several alternative systems existed. There are only a limited number of quantitative import restrictions, and the bulk of these tend to be concerned with the maintenance of price support and other agricultural programmes. A large proportion of the problems that do arise in our cross-border trade are technical in nature and are to be expected in view of the huge volume of cross-border transactions.

Major problems do remain, notably in the realm of "Buy National" practices and in the treatment of unfair or disruptive imports. "Buy America" preferences can represent a considerable barrier, not just in sales to government purchasing agencies but also in those to entities being funded through federal programmes. Under the Surface Transportation Assistance Act of 1982, for example, state and local governments must accord a preference to US products in cases where federal funds are being provided for highway, bridge and urban mass transit projects.

Difficulties with the US system of contingency protection, e.g., anti-dumping, countervailing, and emergency import safeguards, tend to be accentuated by the legal procedures involved. Investigations can be initiated by private interests as well as by the Administration itself. However, the need to demonstrate injury to domestic interests as now required in US law, rising legal costs, and more stringent prelim-

inary requirements have made "nuisance" complaints less likely than before. Still, the Administration is often under heavy Congressional pressure to open investigations, after which "due process" must be observed, with all the delays, uncertainty, costs, and harm to the exporter that these may entail. The susceptibility of Congress to protectionist pressures results in much protectionist draft legislation which, even if resisted by the Administration (as it generally is), can contribute to a climate of uncertainty.

The Common External Tariff (CET) of the *European Economic Community* is relatively homogeneous in the range of 4-7 percent, but the CET maintains a substantial degree of tariff escalation. Some 40 percent of Canadian exports enter free of duties or levies, but these are primarily industrial materials in their least processed form. Access to the Community's markets is critical in a number of sectors, including forest products, metals and minerals, and agriculture. EC tariffs on further processed goods in these sectors are higher and continue to be an obstacle to upgrading in Canada. A major source of concern to Canada has been the preferential access granted to certain countries or groupings (EFTA, and certain Mediterranean countries) in a number of sectors.

The European Economic Community has a number of domestic policies in certain industrial areas and in fisheries and agriculture which have important repercussions on market access for Canada in those sectors. The effect of the Common Agricultural Policy in increasing production has largely been to reduce outsiders to the position of residual suppliers of a number of products. While European fisheries production possibilities are more limited than for agriculture, there is concern that member states will protect their domestic industries by pressuring the EC Commission to enforce reference prices on fish imports more frequently. Under the recently concluded Long-Term Agreement, access for cod and redfish has been somewhat improved through the establishment of tariff-rate quotas at rates of duty below GATT-bound levels.

The Community has a number of cumbersome procedures in obtaining standards approval for a number of products in Member States (notably phytosanitary regulations and, for asbestos, health standards), and procurement practices. The extent of government involvement in industry makes the openness of government procurement crucial to market development in many sectors such as telecommunications, electrical generating and transportation equipment, which are not covered by the GATT Agreement on Government Procurement.

In *Japan* many effective barriers to imports are not within the purview of government regulation — the complex distribution system, for instance, or parochial business practices, monopsonistic groups, or cultural and language barriers. Overall access to the Japanese market remains more restricted than to Canada's other major markets. Tariff rates are generally in the 5-7 percent range but non-tariff measures are pervasive. Nevertheless, tariffs on a range of manufactured products of export interest to Canada continue at relatively high rates. Quantitative restrictions are subject to variations, inconsistencies and complexities in their general administration. Twenty-seven formal quotas exist, with about fifty more "staple" or "strategic" goods subject to import controls. The quota allocation process is complex and subject

to unannounced administrative criteria; total volumes, determined twice a year, are not usually made public, which impedes the development of regular client-supplier relationships. These restrictions prejudice Canadian export interests on a variety of agricultural and fisheries products, the bulk of the protection being directed at those traditional sectors of the Japanese economy.

Various technical barriers also impede access — for instance, phytosanitary regulations and testing, labelling and certification procedures. Some Japanese industrial standards are strictly national and impose lengthy, expensive, and occasionally individual (as opposed to type) product testing. There are specific problems regarding certain common North American food additives banned in Japan, and the continuing non-acceptance of Canadian test data for many health care and pharmaceutical products. Improvements have been achieved in the acceptance of Canadian test standards for electrical appliances and for lumber grading, and the development of softwood plywood standards to allow North American products access should unlock a promising market.

Other non-tariff barriers to access to the Japanese market include rigorous customs enforcement, with no effective appeal system; the existence of government purchasing agencies and monopolies for wheat and tobacco; restrictive government procurement practices (albeit considerably improved by the GATT Code and by subsequent decisions affecting telecommunications equipment); the cost and complexity of patent protection; government subsidies and research grants in key developing industries (for Japanese-controlled firms only); the market dominance of industrial giants like Mitsubishi; an industrial policy allowing the formation of price-affecting temporary "cartels" in depressed sectors; the Ministry of Finance's control over foreign direct investment; discrimination against foreign freight carriers in access to facilities; and prohibitions, restrictions or charges imposed on foreign companies.

In *developing countries*, the use of tariff as opposed to non-tariff measures to control access varies. In most Asian nations the tariff is not a significant impediment, although the Republic of Korea uses its tariff to protect its agricultural sector, and Indonesian rates remain high on a number of items. In Africa, tariffs remain generally high, either to protect domestic industry or to attract foreign direct investment. However, in markets where certain goods are in strong demand their tariffs have occasionally been waived, mostly for projects funded by multilateral agencies such as the IBRD. The tariff is not an impediment to trade with the Middle East, although of late there has been a tendency, led by Saudi Arabia, to use it to protect import substitution industries. Brazil protects its significant and growing industrial sector and attempts to alleviate its balance of payments position through the tariff, amongst other measures; rates range up to 205 per cent and are not likely to be reduced in the foreseeable future. The Andean Group — Colombia, Venezuela, Ecuador, Peru, and Bolivia — is struggling to harmonize trade policies through the establishment of a common external tariff and the abolition of barriers to intra-regional trade. The trend is toward more protection as specific industrial sectors develop, as is already happening in the automotive sector. The governments of Argentina, Chile and Uruguay have embraced market economy policies to encourage industrial efficiency and lower inflation through competition from imports. Access is

improving in all three, although economic difficulties in Argentina in particular could slow the process of tariff reduction. Tariff rates in most parts of the Caribbean and Central America are generally reasonable and do not constitute a major barrier; in the case of Mexico, tariffs remain a significant barrier.

National development plans and shortage of foreign exchange lead most developing countries to restrict access to their markets. To this end various techniques are deployed, sometimes in addition to a tariff: licencing of most or all imports; quotas or a complete ban on imports competing with local production; automatic protection for any import-substitution industry; regional preferences; bureaucratic slowness or lack of transparency in customs and documentation procedures; stringent health certificate requirements for agricultural products especially; and priority allocation of funds to essential imports — capital goods, raw materials for local industry, and food. Other problems include the competition of other industrialized countries through crédit mixte; a closed distribution system; widespread state-trading practices; and, sometimes, the absence of investment insurance or taxation agreements, potentially increasing the costs of the exporter.

The above elements are present in varying degrees in different countries. All these barriers are commonly encountered in Africa, for instance, whereas Asian nations tend to rely chiefly on import licencing and quantitative restrictions or embargoes. A particular feature in some Caribbean countries is the existence of foreign exchange restrictions and the imposition of often onerous taxes further to the tariff on some products. A liberalizing trend has been noted in South America, but Brazil maintains strict control on access to its market: in addition to a high tariff, there are severe foreign exchange controls, bans on the importation of several thousand "non-essential" items, regional access preferences, and demands for concessional project financing over and above normal supplier credits. The potential of the Mexican market is also sharply curtailed by a tight import-control system affecting a substantial portion of imports.

The *state-trading countries* of Eastern Europe rely extensively on a wide array of non-tariff measures. Comprehensive import licencing, rigorous and restrictive exchange controls, and occasionally costly countertrade demands condition sales to these countries, with the hand of administrative guidance overlying every purchase. The guidelines used in the enforcement of these regulations are never made public, but consideration is given to the availability of hard currency (or financing terms), political relations, the progress and needs of the sectoral economic plan and its priority within the national plan, the profitability and export potential of the project (or the end-user's reputation in those areas), and previous experience with the firms submitting bids. End-users are all too often inaccessible; both sides must deal with a central sectoral foreign-trade organization.

Canadian *exports of services*, through both trade and establishment, face a wide range of impediments in the developed and developing world. Some obstacles appear protectionist in content; others result from differing historical evolution, regulatory, industrial and fiscal systems. Some impediments reflect the preeminence of basic national economic and cultural objectives over commercial considerations. The export subsidy practices of a number of developed countries constitute an obstacle to Canadian service exports in certain sectors.

Role of Government in Export Trade Development

Given the importance of exports to Canada's economy, a need exists today, as it did in earlier times, to encourage companies to expand the number of countries to which they are exporting beyond those markets that are traditional and certain. Although the number of traditional export markets has greatly increased in the intervening years, new markets must be pursued in order to ensure an increasing flow of exports from this country.

Many small and medium-sized Canadian companies, because of the size of their sales force, insufficient capital for market development, lack of knowledge of foreign markets, or timidity, will not, if left to their own devices, venture beyond a few select foreign markets. The federal government has a vital role in overcoming these obstacles and promoting exports in order to strengthen the economy. Not only medium-sized and small firms, of course, need the support of the federal government; frequently, large Canadian firms seek the reassurance of the federal government's presence in a foreign country or its support in negotiations with the host government before pursuing a marketing opportunity. It is not only the Canadian exporter who is reassured by the federal government's involvement in export marketing; often the foreign buyer also welcomes the intermediary role of the trade commissioner as a sign of the reliability of the Canadian supplier.

The federal government, through its departments and agencies, has produced a large number of programmes that encourage export marketing. The list of government organs involved in this activity includes the Departments of External Affairs, Agriculture, Fisheries, Regional Industrial Expansion, Energy Mines and Resources, Supply and Services, and Communications, as well as the Canadian Commercial Corporation and, to a lesser degree, several similar agencies. The large number of export-oriented assistance programmes and the related, if not overlapping, mandates of some of these departments and agencies pose a constant challenge to the achievement of efficiency in the allocation of human and financial resources.

Even with the large number of programmes that the government has in place to foster exports, federal expenditures on these programmes and other forms of assistance have been modest when compared to adjustment assistance and regional development. In fiscal year 1981/82 approximately $70 million was spent on a range of export development activities (e.g., PEMD, TCS, Fairs and Missions) in addition to the resources devoted to the Export Development Corporation and other specialized government agencies. An international study prepared by Business International Corporation in 1979 gave Canada a fairly low rating in terms of export credit and insurance and tax incentives and total incentives when compared to nine other leading exporting countries, although Canada finished high up on the list for more traditional market assistance.

The federal government is not the only level of government actively involved in promoting exports. In recent years provincial governments have considerably intensified their export efforts to assist their firms to participate in international trade fairs and missions, to research new markets, to receive foreign buyers, and to improve their marketing skills. Some provinces also maintain offices in foreign countries to

promote industrial development in their provinces and promote exports to the host country. In most cases these promotional efforts have been coordinated with federal government activities to ensure the best possible results.

Traditional involvement in export promotion is not sufficient justification for a continued government, federal or provincial, role in this activity. With this in mind, the federal government in 1979 sponsored a review of its export promotion programmes under the chairmanship of Roger Hatch. This Export Promotion Review Committee concluded that:

> If Canada's balance of trade is to improve significantly, a fundamental change is needed in the economic climate for Canadians doing business abroad. Export financing and taxation of export earnings in Canada are not competitive with those of other major trading nations; export promotion programs are impeded by regulatory procedures; and too few exportable products are designed and developed in Canada. The situation is aggravated by lack of co-ordination and consequent failure to ensure the sharper focus and more decisive thrust needed in foreign trade. Relative to other leading nations, not only is business-government co-ordination deficient, but also co-ordination between the various federal agencies that represent Canada abroad — and between federal and provincial governments.

Among the actions recommended by the Committee and accepted by the federal government are the following:

- appointment of a Cabinet Minister with prime responsibility for international trade;
- decision in September, 1980, to accord high priority to export development and prepare an export development strategy;
- establishment of an Export Trade Development Board to ensure that the government's efforts in pursuit of export development are as coordinated and supportive of private sector initiatives as possible;
- study of Canada's tax structure and its effect on firms wishing to do business abroad;
- improvement in PEMD approval and payment procedures and increases in the level of funding;
- preparation of detailed export market development plans for priority country markets;
- opening of new trade posts;
- introduction in January 1981 of a three year $900 million "crédit mixte" facility to match international competition;
- expansion of EDC financing facilities;

- increased emphasis on bilateral assistance programmes compared to the level of development assistance channelled through international financing institutions;
- improvement of parallel financing offered by the EDC and CIDA;
- information dissemination on major capital projects improved; and
- more readily accessible export promotion assistance to small businesses entering export markets for the first time by decentralizing the delivery of these programmes.

Trade Development Services and Programmes

The federal government has developed a range of support services and incentive programmes to assist industry in identifying and developing export markets for their products. In addition to providing companies with the services of Trade Commissioners abroad and of various commodity and marketing specialists in various departments and agencies in Ottawa and at Regional Offices throughout the country, marketing assistance programmes, loans and insurance, and government-to-government contracting are delivered by various departments and government agencies.

Trade Commissioner Service — At 92 posts in 68 countries, some 400 trade commissioner from the Department of External Affairs, both Canadian Foreign Service Officers and locally engaged Commercial Officers, provide assistance to Canadian companies in their pursuit of export sales of goods and services. Aimed directly at assisting Canadian companies, the range of their activities includes identification of new market opportunities, introduction of the Canadian firms to potential buyers, assistance in finding a local agent, and monitoring of the company's progress in the foreign market. The preparation of economic and commercial reports is also part of the trade commissioners' functions. Given Canada's need for foreign investment and new technology, trade commissioners also pursue opportunities that will lead to such transfers to Canada.

International Marketing and Trade Relations Divisions — With a staff of approximately 200, these divisions in External Affairs provide the Canadian business community with market intelligence on foreign markets. They provide instructions to government posts abroad on trade issues and furnish them with general guidance. They are instrumental in the implementation of bilateral agreements related to, *inter alia*, international trade, industrial, and technological cooperation. These units seek to ensure a coordinated approach to export markets among the various government departments and agencies as well as the provinces.

Industry Sector Branches — Within the Department of Regional and Industrial Expansion (DRIE) there exist a number of Branches specializing in industry sectors which provide the main interface between domestic manufacturing industries and the federal government on a range of industrial and trade development concerns. As a result, there exists a close working relationship between these officials and trade commissioners at posts abroad with a view to matching Canadian capabilities with export opportunities.

Market Intelligence — The core element of the existing market intelligence system involves the trade sections at posts abroad serving as Canada's source of commercial data on foreign market opportunities. They are also increasingly involved in market studies. A major part of the marketing process concerns the provision by posts of accurate, and easily accessible, information on Canadian suppliers. Similarly, Canadian suppliers need regularly to receive data on export opportunities for their products in overseas markets. Within the Department of Regional and Industrial Expansion, a computerized Business Opportunities Sourcing System (BOSS) provides a list of Canadian suppliers and their vital statistics. The data is supplied by the DRIE Regional Offices across Canada in cooperation with the provinces and stored in a master data base at headquarters.

Consideration is being given to an improved Export Marketing Information System to expand on BOSS by providing directly accessible computer data which could also include more information on the export activities of the listed companies. This new system would give posts in major foreign markets computer access terminals and provide for screening of confidential information on companies on a "need-to-know" basis. Eventually, the Export Marketing Information System could parallel the US Department of Commerce Worldwide Information and Trade System which also contains data on offers to export or import specific products, up-to-date statistics on market conditions for those products, and schedules of up-coming promotional events.

The Promotional Project Program (PPP) is the funding vehicle to support government-organized events. It shares the costs to companies of coordinated national exhibits at trade fairs outside of Canada; arranges outgoing trade missions to identify market opportunities, improve trade arrangements or negotiate sales; and hosts incoming missions of foreign businessmen and officials in Canada. For trade exhibits, the government purchases display space, designs and constructs an integrated exhibit, and manages the operation of the show. Companies are reimbursed for the return of unsold products to Canada. On missions organized and led by the government, the company travel costs and other related costs for interpreters, meeting space, merchandising aids, and official hospitality are paid by the government. This programme funds the bulk of the projects identified in the country-action plans of the Department of External Affairs. During the 1982/83 fiscal year, $10.5 million was allocated to the Promotional Projects Program to cover approximately 85 trade exhibits involving 975 Canadian companies in 25 countries around the world, 60 trade missions taking Canadian businessmen to foreign markets, and visits of foreign officials to Canada.

The Program for Export Market Development (PEMD) is the funding vehicle through which the federal government contributes to company costs for their individual export initiatives. As the various efforts to encourage Canadian industry to expand their export marketing activities meet with success, the demand for PEMD assistance is expected to continue to grow. In 1982/83, approximately 3,300 applications were approved and $20 million contributed for bidding on specific export projects, visiting new market areas to identify opportunities, participating in trade fairs outside of Canada, bringing foreign buyers to visit Canadian facilities, forming export consortia, setting up new permanent marketing organizations in for-

eign countries and developing export promotions for agricultural, fisheries and food products. PEMD is now delivered mainly through the DRIE Regional Offices across Canada. Under this programme, contributions are repayable on specified terms if export sales are achieved as a result of PEMD assistance.

As the principal mechanism for government-to-government sales from Canada, the *Canadian Commercial Corporation* (CCC) plays an important role in the expansion of Canadian international trade by acting as an agent to assist Canadian firms in obtaining foreign government contracts where the customer prefers to deal with a Crown agency. The CCC annually assists some 500 Canadian suppliers and 50 or more foreign customers by lending government credibility to less well-known firms. The CCC originally specialized in military procurement, but more recently the corporation's non-military sales in many sectors have been increasing. This is particularly true, for example, with respect to Canadian aid projects financed by CIDA and sourced, on behalf of the CCC, by the Export Supply Directorate of the Department of Supply and Services. The CCC can also act as the prime contractor on major projects and as such increase Canadian participation in this kind of export sales. The CCC has also been instrumental in bringing selected World Bank and other multilaterally-financed opportunities to the attention of the private sector. In most cases, the CCC will have the ability to buy, sell, import or export in connection with any transaction being undertaken by it. However, the corporation will not engage in paying direct subsidies to either producers or processors on any Canadian agricultural or food product nor will it deal in products under the control of the Canadian Wheat Board or the Canadian Dairy Commission. It is intended that *Canagrex* will use existing programmes and activities of the federal government where appropriate, and operate within Canada's overall policy directives. Although its funding will come from annual Parliamentary appropriations, it is envisaged that it will be able to charge for its services.

Trade/Aid Relationship — The Canadian International Development Agency channels Canadian official development assistance to Third World countries. Its objective is "to support the efforts of developing countries in fostering their economic growth and the evolution of their social systems in a way that will produce a wide distribution of the benefits of development among the population of these countries, enhance the quality of life and improve the capacity of all sectors of their population to participate in national development efforts".

From 1976/77 to 1980/81, Canada disbursed approximately 32 percent of offical development assistance ($1.8 billion) through multilateral institutions such as the World Bank and the four Regional Development Banks, UN organizations, the Commonwealth, la Francophonie and international research institutions; 40 percent ($2.2 billion) bilaterally; 18 percent ($1.0 billion) for food aid; and 11 percent ($614.2 million) for special programmes such as Canadian and international non-governmental organizations involved in development assistance, financial support to Canadian firms and developing countries for activities related to the establishment or expansion of Canadian private sector operations, and the International Development Research Centre.

An important direct and indirect benefit of Canadian official development assistance is to support Canadian export trade interests in food, manufactured goods

and services. It has been estimated that some 65 percent of bilateral aid disbursements is spent on goods produced in Canada. There is, for example, a very high Canadian content in food aid. Under the Food Aid Convention of the 1980 International Wheat Agreement, for example, Canada undertook to provide 600,000 tonnes of cereals annually; the food aid basket in 1980/81 also contained other major commodities including rapeseed oil, skim milk powder and fish. CIDA's Industrial Cooperation Programme was created specifically to support initiatives of the Canadian business community within Canada's development cooperation programme. CIDA funding has also been used in parallel with EDC funds to provide Canadian exporters with competitive export financing known as crédit mixte. It is important to note that one criteria for eligibility for receipt of Canadian official development assistance is the commercial significance of the country to Canada. Finally, a portion of contracting out by multilateral aid institutions goes to Canadian firms (on a cumulative basis, it has been estimated that some $650 million in exports was derived from contracts obtained through multilateral financial institutions). It is generally recognized that Canada's multilateral assistance has resulted in a level of procurement of Canadian goods and services that is lower than that of a number of other industrialized countries. In response to the recommendations by the Hatch Commission, the government has committed itself to further growth and concentration in its bilateral development assistance programme and a reduction in official development assistance channelled through its multilateral assistance programme during the period 1981-86, as a means of improving the commercial benefits derived from aid.

The Canadian business community understandably wants improved integration of Canada's aid policy and export trade development. Businessmen have recommended that CIDA set aside funds from the bilateral budget to enable it to engage in parallel financing with EDC when it is necessary to meet competition. With a view to improving parallel financing ventures, CIDA has prepared standard guidelines to facilitate the use of this instrument. The government's determination to exploit more fully the benefits of forging new and growing commercial relationships through its official development assistance is also reflected in its organizational network and new initiatives. For example, CIDA holds regular consultations with the private sector; the views and agreement of different departments are sought in major CIDA developments such as decisions on eligibility and allocations; CIDA is a member of the Board of EDC as well as the Export Trade Development Board; and CIDA is a member of the EDC Committee of Alternate Directors and the Senior Committee on Export Development. Although all of the business community's expectations cannot be met without running the risk of negating the real developmental considerations which form the primary objective for Canadian official development assistance, there is nevertheless considerable scope for Canada to pursue commercial objectives in its aid programme. In the longer term, the developmental aid provided by CIDA will help to create more viable trading partners for Canadian exporters.

The Export Development Corporation (EDC) is a Crown Corporation that provides services to assist Canadian exporters offering competitive products in terms of price, quality, delivery and service, to compete internationally. The services of the corporation are provided through a series of programmes including loans, insurance and guarantees.

Canadian firms of any size can *insure* their export sales against non-payment by foreign buyers. EDC normally assumes 90 percent of the commercial and political risks involving insolvency or default by the buyer as well as blockage of funds, war or rebellion, cancellation of import licences, and the like, in a foreign country, and cancellation of export permits in Canada. Almost any kind of transaction involving the export of goods, services or technology may be insured. Insurance is available to cover sales of general commodities and services normally made on short credit terms of up to 180 days, and capital goods and services made on medium-term credit of up to five years. In order to facilitate the exporters' banking arrangements, EDC will agree to assign any proceeds payable under an exporters' policy to a bank or other financial organization.

Other types of insurance services available include Loan Pre-Disbursement Insurance, which provides cover for the production risk from the effective date of financing until disbursement under the loan agreement is made; Foreign Investment Insurance, which provides cover for periods of up to 15 years against three broad political risks: inconvertibility or the inability to repatriate earnings or capital, expropriation, and war or revolution; Performance Security Insurance, which provides cover for the exporter against a wrongful call by a foreign buyer of an Irrevocable Letter of Credit (ILC) provided by the exporter's bank on behalf of the exporter; Consortium Insurance, which protects members of an exporting consortium against the call of a performance instrument where the other member(s) of the consortium are unable to pay their shares; and Surety Bond Insurance which insures a domestic surety company providing a performance bond to a foreign buyer. The corporation also issues *guarantees* to banks making export loans or issuing performance and bid securities.

EDC facilitates *medium- and long-term export financing* to foreign buyers of Canadian capital goods and services. Funds are provided directly to Canadian suppliers on behalf of the foreign borrower or by purchasing credit notes payable to the Canadian suppliers, in effect providing the exporter with cash sales. The corporation will consider all transactions which, on their own merits and within the framework of internationally-accepted practices, normally justify financing for periods of two years or more and provide significant benefits to Canada.

In its financing programmes, EDC seeks the maximum involvement of banks and other financial institutions, consistent with the requirements of international competitiveness. This involvement may take the form of parallel loans, co-lending, or participation in EDC loans. Types of financing include:

- *Loans*: EDC provides loans to foreign borrowers, and although they can be arranged for any export transaction involving capital goods and/or services, they are more applicable for transactions of a size in which the terms of repayment are normally more than five years.

- *Allocations under lines of credit*: EDC has established Lines of Credit with public agencies and private banks in many countries. These "umbrella-type" financial agreements provide encouragement for buyers in these countries to look seriously at Canadian technology and industrial capabilities, and they

alert Canadian manufacturers and consultants to the potential market for equipment and services in the country involved.

- *Forfeiting* (Note purchases): Under certain conditions, EDC will purchase promissory notes issued to exporters by foreign buyers in payment for goods and services sold on medium-term credit (up to five years). Chief among these conditions is that the note be guaranteed by a bank or financial institution in the buyer's country which is approved by EDC.

- *Parallel financing*: On many occasions there exist opportunities in less developed countries for EDC to provide loans along with the Canadian International Development Agency (CIDA); CIDA's portion of the financial package is provided at very low interest rates or on a grant basis. Such loans must meet the criteria of both EDC and CIDA.

- *Crédit Mixte*: EDC administers on behalf of the government crédit mixte as a "matching" facility. Crédit mixte is export financing which mixes highly concessional financing with conventional export financing to produce very low blended interest rates. In the context of crédit mixte, "matching" will be defined as effectively countering crédit mixte terms offered by competitors.

Recently, because of changes in the financial environment, the government reviewed the funding of *Corporate Account* activities. As a result of drastic changes in the cost of funds relative to the yields being achieved and expected on related loans, EDC projected losses on its financial statements. The government examined alternative solutions to this problem and decided to continue to support business levels projected by EDC and make the traditional equity payments to EDC, and to assume "loss makeup" payments necessary to avoid equity erosion due to losses during the current recession.

Government Supported Export Credit Facilities and the OECD Export Credit Arrangement

Nearly all OECD Member countries provide some degree of support to ensure the availability of medium- and long-term export credit as a means of promoting the export of capital goods and services. The systems adopted by different countries vary widely, however, in their institutional structure, and in the extent of official intervention in the sourcing and pricing of funds.

One feature common to all the systems is the assumption of the bulk of the credit risk inherent in extending finance to foreign buyers whose creditworthiness prevents them from obtaining funding from private sources. Each country has a specialised credit insuring or guaranteeing institution for this purpose, either an official body or one that acts in the state's name. These institutions are members of the Berne Union (International Union of Credit and Investment Insurers), through which they exchange creditworthiness information and seek to harmonize general policy in the field of credit and investment insurance.

The scope and degree of credit cover available to exporters is broadly similar in each country, with the basic purpose of facilitating the mobilisation of funds for the extension of credit. Typically, the institution issues credit insurance to the exporter covering both political and commercial risk of non-payment by the buyer, and may also issue a guarantee to the private funding institution. Some countries, however, offer insurance facilities in such areas as surety requirements (e.g., performance bonds), foreign exchange risk, and cost escalation.

In a few OECD countries, official support for the bulk of export credits is restricted to the provision of insurance and guarantees as just described. Intense international competition for the sale of capital goods on credit has resulted, however, in the prevalence of export credit offers at interest rates that are at or near the minimum "Consensus" rates, and that are fixed for the duration of the credit, which may be as much as ten years or, in certain cases, more. Such terms cannot be provided by the private banking systems without some form of government subsidy. Most OECD governments, to keep their exporters competitive, have, therefore, developed mechanisms to ensure that funds will be available for export credit at competitive terms. In the majority of these countries, official financial support is provided to the banking sector, either directly to individual banks or through a specialised intermediary. In other countries, the bulk of the longer-term export credits are provided directly by government agencies.

In 1976, in an effort to avoid destructive competition that was leading to a race in export-credit terms and to prevent the distortions of trade resulting from excessive competition in official support for export credits, the seven Summit members reached an informal "Consensus" that set floors under permitted interest rates and ceilings on maturities, and stipulated minimum down-payments and maximum local-cost financing, for most officially supported export credits of two years or more. On April 1st, 1978, these rules were incorporated into an Arrangement on Guidelines for Officially Supported Export Credits, in which all OECD members except Iceland and Turkey are participants. (The Members of the European Economic Community participate in the Arrangement as a single entity.) Participants meet at OECD headquarters for an annual review of the functioning of the Arrangement and the appropriateness of its Guidelines.

Broadly defined, an export credit arises whenever a foreign buyer of exported goods or services is allowed to defer payment for a period of time. The focus of OECD activities is, however, confined to those export credits which are extended for medium term (2-5 years) and long term (over 5 years), and which involve some degree of official support. Credits of this type are usually granted to finance the sale of capital goods (machinery and equipment) and related services. They may take the form of "supplier credit", extended by the exporter, who then arranges his own refinancing; or "buyer credit", where the exporter's bank or other financial institution lends to the buyer (or his bank) the funds required for the purchase.

The Arrangement provides that any participant who intends to offer a credit that exceeds the maximum degree of permitted concessionality (e.g., by a lower interest rate, or a longer maturity) should notify his intention beforehand to other participants, and explain the reason for his intended action. Special notification rules

apply to the use of tied-aid credits. The permitted interest rates and maturities vary according to the classification of the intended recipient: the highest rates and shortest maturities apply to buyers whose countries are considered "relatively rich", while progressively more lenient terms are permitted to "intermediate" and "relatively poor" countries. In all categories, the minimum interest rates are lower than commercial rates prevailing in most capital markets.

While the Arrangement brought some order into export financing, it had major drawbacks. The minimum interest rates agreed in 1976 became a norm for many countries. In the face of rising market interest rates, subsidies grew rapidly and by 1980 reached $6 billion annually for participating governments, when it was agreed to renegotiate the Arrangement's guidelines. The main objective of the negotiations was to introduce more market-related minimum interest rate provisions and to adopt stricter rules on the use of crédit mixte, a predatory type of financing introduced by some trading partners.

In October 1981, OECD countries agreed on substantial increases of 2.25 percent to 2.5 percent in the minimum interest rates of the Export Credits Arrangement and stricter rules for "crédit mixte" for a period of six months, and called for the negotiation of further increases in minimum rates in the spring of 1982 because the higher Arrangement rate went only a small part of the way towards reducing the subsidy element in export financing. In July 1982, the rates were further revised marginally upward and the classification of borrowing countries was revised. The major effect of the latter was to increase interest rate surges to Eastern European and newly industrialized countries.

The direct costs and the market distortions which export-credit subsidies entail are of particular concern to the United States and Canada which run commercially-oriented export-financing programmes with built-in incentives to reduce subsidies. The trade effects are also of concern to countries such as Japan, Germany, Switzerland and the Netherlands, whose market interest rates are often below the Arrangement's minimum interest rates and who, unlike other participants, cannot make use of the Arrangement to subsidize their exports.

Canada has strongly supported and participated actively in efforts to reform the Arrangement so as to bring its terms closer to market realities. It considers that in spite of recent progress, much remains to be done, especially on interest rates. Canada is strongly committed to seeking international agreement to contain the use and reduce the cost of government-backed credits as an element of competition in international trade. The basic thrust of the Canadian position has been to work towards the reduction and elimination of subsidies and the trade-distorting effects of export credits. In future negotiations, Canada will continue to seek further adjustments in minimum interest rates to bring them more in line with existing market interest rates. Ideally, there would be a system to adjust rates automatically to reflect developments in the market. Failing this kind of automaticity, there should be, at a minimum, a framework for periodic review and adjustment of minimum interest rates.

International Industrial and Technological Arrangements

Canada's ability successfully to achieve its own economic development potential and fully to exploit opportunities on international markets has historically been significantly influenced by such market-driven factors as access to technology and investment, both incoming and outgoing. However, with an increasingly complex set of regulatory instruments and domestic industrial and economic development policies, both in Canada and abroad, the capacity of many Canadian industries to take advantage of the opportunities offered internationally is being significantly influenced by the extent of their involvement in direct investment undertakings, joint ventures and licencing arrangements.

These techniques to gain or ensure market access have been an important complement to conventional negotiations of reductions in trade barriers and deployment of export promotion activities. Access to the latest technologies and to scarce investment capital will be a major determinant of the industrial innovation capabilities and trade performance of individual countries in the 1980s. The last decade already witnessed a considerable expansion in the network of industrial, technological and economic cooperation agreements internationally. For its part, Canada negotiated such arrangements with almost thirty governments, providing government-to-government frameworks aimed at fostering development and trade-related commercial undertakings by the private sector. Some of these arrangements are highly structured (e.g., with Middle Eastern countries) while others are of a more informal nature.

With Western Europe and Japan, the emphasis has been on encouraging investment in areas beneficial to the national economy, promoting an awareness of Canadian products and expertise, and fostering a better understanding of the impact of national industrial policies on trade in both directions. This has been complemented by government-sponsored private-sector missions which, in addition to exploring direct export opportunities, expose Canadian businessmen to new technologies and products and encourage company-to-company contacts. For example, within the framework of the Economic Cooperation Agreement with the EC, Canadian industry has been able to enhance the acceptance of Canadian timber-frame construction techniques in the important European housing market. With Japan, considerable efforts have been made to encourage Japanese investment in mineral processing and petrochemical facilities in Canada, thereby diversifying the historical concentration in the extraction of raw resources.

With the state-run economies of Eastern Europe and many developing countries where commercial undertakings are frequently entered into, with or through the state and state-trading organizations, bilateral cooperation arrangements also provide the necessary political impetus to promote Canadian trade and investment and an awareness of Canadian capabilities in certain areas through joint working groups, exchanges of missions, etc. It is often difficult for Canadian firms to penetrate non-traditional markets due to a lack of understanding of the peculiar features of state-trading systems, difficulties in accepting counter-trade demands and high marketing costs associated with prolonged negotiations. In these types of framework agreements, of course, the role of the Canadian government is largely one of a facilitator. To a considerable degree, the effectiveness of these arrangements depends on the level of interest shown by the private sector.

Market Development Plans

Not all foreign countries present equal export opportunities for Canadian goods and services. This, combined with constraints on the government's human and financial resources, points to the need carefully to manage and direct Canadian export development efforts in support of private sector initiatives. The export development framework paper, *Export Strategy for the 1980s*, which currently guides the government's efforts in this respect, has two broad thrusts: greater selectivity and concentration of federal government export development resources towards high priority markets, both on a sectoral and country basis; and a greater coordination of export policies and programmes, not only among federal departments and agencies but also with provincial governments and the private sector.

In consultation with provincial governments and private sector groups, and in concert with ongoing efforts to focus bilateral foreign relations on those countries which can contribute to our economic development, the government has initiated a series of export marketing plans for individual countries where it appears that good prospects exist for making significant export gains over the next few years. Priority sectors reflect primarily three major considerations: the ability or potential to make substantial sales in foreign markets; the ability or potential to create employment and economic growth in Canada; and the expectation of relatively high returns to Canadian society from government funding to support export initiatives. Similarly, the selection of high-priority country markets reflects considerations related to high-export potential for the priority sectors, high overall export potential for other Canadian products, substantial market size, and considerable import-market growth. These priority sectors and country markets should allow industries in all parts of Canada to exploit more fully their economic potential.

The export marketing plans should assist both exporters and would-be exporters in responding to opportunities identified in the plans and in gaining a better appreciation of the characteristics of these markets and the challenges involved in undertaking successful export marketing efforts. For example, the plans developed for *Mexico*, *Australia* and *Korea*, have been distributed to officials in government and the private sector. Export marketing plans for Germany (FRG), France, Japan, Saudi Arabia, Hong Kong, Brazil, Venezuela, Norway and ASEAN countries are in preparation. The United States market is being treated as a number of regional markets because of the size and diversity of the market and its significance to Canada. There is no question that trade with the USA will remain extremely important for Canada's industrial growth. Efforts to increase exports of goods and services to the USA will clearly need to be sustained and even intensified. However, the USA is expected to be a relatively slow growth market in the 1980s while developing countries will become increasingly important and growing markets. The share of exports to developing countries is still relatively small, but prospects for growth are good.

In 1980, Canada's overall trade balance in manufactured products with the developing countries was $2.7 billion. This surplus does not mean that Canada has a firmly established foothold in these markets. It is attributable primarily to exports in commodity categories in which increasing export competition from some developing countries must be anticipated over the longer term. As an example, machinery and

transportion equipment have begun to replace clothing and textiles as the principal manufactured product exports of a number of developing and newly industrialized countries (NICs).

A greater focus in Canada on exports to developing countries, therefore, appears desirable. This has already been recognized by the private sector as reflected in the number of private organizations operating to improve Canada's trade with the developing countries (e.g., the Canadian Association-Latin America & the Caribbean, the Brazil-Canada Chamber of Commerce, the Canada-Korea Business Council, and the Canada-China Trade Council.) Due to the significant extent of government involvement in the economies of many developing countries, either through regulation, state ownership, or public procurement, there is a need for government-to-government contact in support of private sector interests in developing trading relationships. This is reflected in the number of Canadian government trade missions undertaken with the purpose of opening up export opportunities and assisting Canadian companies in overcoming constraints in their overseas marketing.

In this regard, probably the most significant barriers that Canadian exporters face in developing countries are distance and lack of familiarity with markets. Most Canadian companies consider the United States as their major export market. Sales there can be arranged with relatively small expenditures of time and effort and in effect can be dealt with in a manner similar to the domestic market. The relative proximity of the United States and the ease of exporting to it contrast sharply with the distance and knowledge barriers that must be overcome in most overseas markets.

The opportunities for Canadian participation in *capital projects* abroad are considerable. The world market is huge, estimated at over $100 billion in 1980. A large share of this business in infrastructure projects and industrial plant construction is in sectors in which the expertise and competitiveness of Canadian firms are recognized world-wide.

Over the past decade, Canadian firms have sold one or two major capital projects abroad each year (supplying services with equipment). This prime contracting role has been limited primarily to the larger consulting engineering firms with the majority of Canadian firms limiting their participation in capital projects abroad to acting as sub-contractors. In terms of the number of potential Canadian participants, about 12 to 15 consulting engineering firms, 40 to 50 equipment manufacturers, and 6 to 10 construction firms, appear to be of sufficient size to assume a prime contracting role either alone or as a consortium member. The major deterrents to Canadian firms acting as prime contractors, both abroad and domestically, have been their relatively small size and limited financial capacity to provide front-end funding and to assume the high risks of participation in capital projects.

In the *consulting engineering* field, the majority of firms limit their participation in capital projects abroad to selling only their own engineering services. A number of the larger firms are now actively building up a full "EPC" (engineering/procurement/ construction) capability; many have established corporate relationships with foreign firms, with the Canadian firms retaining majority control. The degree

of association between consultants and manufacturers and contractors has been less in North America than in Europe because of differences in the nature of the markets. In North America, consultants generally provide their services directly to clients. Clients arrange their own contractors and equipment suppliers. In Europe, clients have traditionally requested package bids from a single source for consulting services as well as contractors and equipment manufacturers. Partly as a result of these differences, Canadian consulting firms have evolved independently. This has contributed significantly to their international reputation for unbiased and objective consulting but has restricted their ability to undertake the financial risks assumed by large, associated groups such as those active in Europe.

Equipment manufacturers do not normally assume a prime contracting role alone but act as sub-suppliers to foreign and domestic prime contractors. Wholly-owned Canadian equipment manufacturers often resist joining consortia because of their relatively small size. Many of the larger manufacturers are foreign-owned subsidiaries whose parent organizations are not prepared to allow their affiliates to assume joint and several risks associated with consortia formation. The export activity of Canadian equipment manufacturers has, therefore, focussed much more on supplying equipment only (or islands of equipment such as chemical recovery systems, boiler islands, or turbine generators) than on acting as prime contractor, either alone or as a consortium member.

Canadian *construction firms*, with a few notable exceptions, have been less active than either equipment manufacturers or consulting engineering firms in export markets. In capital projects, their role abroad is, of course, limited to project management and construction supervision since labour is invariably supplied from local sources or countries such as Brazil and Korea, which have been increasingly active in providing both equipment and labour for capital projects abroad.

In the 1980s, the extent to which firms will pursue projects abroad will be influenced by the rate of development of many projects planned in Canada. Although the capacity of Canadian firms to assume the role of prime contractor on capital projects abroad would obviously be limited if many domestic mega-projects proceed, the realization of these projects should, in effect, contribute to the financial strength of these firms and help them establish a track record. In the decade ahead, an increasing number of them will be able to provide EPC or project management services and also act as prime contractor on foreign capital projects on the basis of experience acquired on those domestic projects that proceed as scheduled.

Provincial Involvement in Export Development

Provincial governments have also been actively involved in promoting exports. To a large extent these provincial activities have tended to supplement federal programmes by picking up where federal programmes end. However, provincial governments have been significantly intensifying their export efforts in recent years and have begun to move into less traditional areas such as export financing. Several provinces offer their companies a considerable range of programmes that assist them to participate in international trade fairs, to research new markets and to improve their

marketing skills. Provincial Ministers and officials have also led missions to foreign markets and have received many foreign buyers.

A number of provinces have trade offices abroad which actively engage in promoting exports and seeking potential investors for their respective provinces. In this regard, the federal government traditionally has not actively sought incoming investment as part of the regular commercial activities abroad except in a relatively few instances. By and large, the existence of both federal and provincial offices abroad has led to constructive working relationships although there may be, from time to time, a degree of confusion about Canada's representation roles from the perspective of foreign buyers.

In the area of export development, where both federal and provincial governments have marked interest in common export opportunities, there has tended to be a high degree of co-ordination. The capacity to co-ordinate appropriately is being strengthened by the establishment of the Federal Provincial Committee on Export Development which provides the opportunity to discuss questions of export promotion and the implementation of marketing plans in a way that complements the extensive liaison existing between officials responsible for various export marketing activities in day-to-day operations. This Committee also serves as a mechanism for briefing provinces on activities of the Export Trade Development Board. This ongoing co-ordination at the officials' level is enhanced by discussions at the Ministerial level including Federal-Provincial meetings of Trade Ministers.

In the highly competitive international marketplace for goods and services of the 1980s and with the considerable expansion of marketing programmes at the provincial level, there will clearly be a need for the two levels of government to co-ordinate fully the development and administration of these programmes in order to maximize benefits to Canadian exporters in all regions. Industrial and technological cooperation and the search for foreign investors are also areas that would benefit from concerted and co-ordinated efforts.

CHAPTER VII

THE INTERNATIONAL INSTITUTIONAL AND TRADING ENVIRONMENT

> We have done this as a matter of policy because we believe that economic reconstruction of the world must go hand in hand with political reconstruction. We are aware, too, that economic revival is a matter of great importance to us. We are dependent on markets abroad for the large quantities of staple products we produce and cannot consume, and we are dependant on supplies from abroad of commodities which are essential to our well-being. It seems to me axiomatic, therefore, that we should give our support to every international organization which contributes to the economic and political stability of the world.
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> **Louis St. Laurent, 1947**

Canada's domestic commercial policy instruments and practices have evolved within an international institutional framework in which Canada is a full and active partner. Canada has positively influenced the development of the GATT, IMF, OECD and other multilateral institutions. Similarly, decisions taken collectively in these institutions have influenced the development of Canadian commercial policy, practices and institutions.

Canada was actively involved in the creation of the IMF and the GATT and has always supported the activities of these organizations as the most effective and constructive way to advance Canadian trade and economic interests. In a world of strong multilateral arrangements, Canada has been able to influence the policies of the major economic powers and minimize the risks and costs of direct confrontation with them.

This chapter examines the principal international trade and economic organizations and their implications for Canadian commercial policy objectives, as well as the international economic environment of the 1980s.

Evolution of the Post-War Trade and Payments System

The post-war institutional framework was largely created out of experience with depression and war. In the depression of the 1930s unemployment fostered defensive and highly protectionist "beggar-thy-neighbour" policies consisting of high tariffs, quotas and devaluation of currencies, all designed to export unemployment. Since all the major countries adopted similar measures the effect was cumulative, perverse and self-defeating. There was a general contraction of production and trade which only made the overall economic situation worse.

In an effort to restore the world economy, the United Nations Monetary and Financial Conference at Bretton Woods in 1944 established the International Monetary Fund and the World Bank and influenced the subsequent establishment of the

GATT. All three institutions were dedicated to a liberal multilateral trade and payments system with agreed rules to manage particular problems such as disruptive imports, currency devaluations and temporary waiving of trade obligations for balance-of-payments reasons. The foundations were set in 1934 in the USA with the Reciprocal Trade Agreements Act, and in 1936 with the Tripartite Monetary Agreement between the USA, Britain and France, as well as the various bilateral trade agreements based on the MFN principle concluded in the late 1930s.

The entire system was initially underwritten by the United States. In 1945, the United States possessed the bulk of the western world's economic, political and military power. It accounted for over half of world production and held more than half the world's monetary reserves. Europe and Japan were undertaking their own economic reconstruction so that it took almost fifteen years, until 1958, to restore most West European currencies to full convertibility and fully implement the new system. Japan joined the GATT in 1955 under US sponsorship and strong Canadian support. At that time, there were, of course, important mutual economic interests but of overriding importance to the United States in the 1950s and 1960s were strategic military considerations in Europe and in the Far East.

In this period of strong push toward a more liberal international trade environment and more open and stable monetary relationships, international trade grew rapidly, and foreign investment across national boundaries expanded considerably, particularly from US multinational enterprises.

By the late 1960s and early 1970s, the traditional position of leadership by the USA had begun to decline, accompanied by a shift in responsibilities and in political and economic power to Europe and to Japan. Although the USA's ability to shape the multilateral trade and payments system to conform to its perception of its global trade and economic interests became less dominant, the sharing by the new major trading powers of the broad ideological commitment of the USA.to the advantages of an open and multilateral trading system made it possible to continue the efforts to negotiate reductions in trade barriers, and strengthen the rule of law in the trading system. The recently completed Tokyo Round is the latest example. This development was accompanied and, to a significant extent, prompted by the emergence of regional trading arrangements, particularly in Europe with the proliferation of free-trade arrangements between the EC and EFTA countries and preferential arrangements between the EC and Afro-Asian and Mediterranean countries. The latter, of course, are based on preferred access to the EC but do not require these countries to grant equivalent preference to the EC, and their developmental nature was key to their acceptance by others. These arrangements clearly challenged the overall concept of non-discrimination on which the GATT was built. For its part, Japan was forging ahead, taking full advantage of the trading system in terms of export penetration of foreign markets, while at the same time continuing successfully to shield its own market from the rigours of full international competition.

Canada and the GATT

As we have seen, the *General Agreement on Tariffs and Trade* (GATT) is the central element in the world trade system; most of the other elements in the system

complement or supplement it. The GATT is Canada's main trade agreement with the United States, the EC, Japan, and many other member countries. Most countries of the world belong to GATT, with some notable exceptions including the Soviet Union, China, Mexico, Venezuela and most other OPEC countries.

Reflecting the requirement of the Canadian economy for assured access to world markets, and at the same time, for insulation from bilateral pressures from larger powers, the consistent policy orientation of successive governments in the post-war period has been in support of the multilateral trading system. Active participation in international rule-making, particularly in the GATT, has been seen as one way of effectively augmenting Canada's trade leverage. The GATT does this in *three* important ways. *First*, the multilateral trade negotiating process provides Canada with the means to increase its individual leverage by allying itself with other states whose interests may be similar on particular issues in a negotiation. It also provides the flexibility to change those alliances when interests differ on different issues. *Secondly*, the most-favoured-nation principle has been effective in the past both in preventing Canada from being singled out for special treatment by larger powers (since members are obligated under most of the GATT rules to apply equal trade treatment to all contracting parties), and in providing benefits to Canada through the MFN application of tariff reductions negotiated by other contracting parties. *Thirdly*, the GATT, in providing an agreed set of international rules, promotes stability, order and predictability in the conduct of trade relations.

Despite these strengths, the GATT has its weaknesses. It is showing signs of age. It has been unable to contain and manage the unanticipated proliferation of preferential trade arrangements. It has not come to grips with the impact of the socialist state-trading economies and with the complete range of non-tariff measures which increasingly affect trade, production and investment. Nor has the GATT so far provided a fully satisfactory basis for trade relations between developed and developing countries, the number of which increased rapidly in the 1960s and 1970s. This may be particularly significant in the future. It will, therefore, be important to ensure that the GATT adjusts and adapts to these changed circumstances.

The GATT generally reflects the economic theory of comparative advantage and the view that the competitive forces at work in international trade and the effective operation of the price mechanism are beneficial and should be strengthened. It consists of a balanced set of rights and obligations that relate to virtually all government measures that impinge on the movement of goods and affect the trade of virtually all industrial, agricultural and fishery products. The GATT rules provide a basis for negotiations directed to the reduction of tariffs and other barriers to trade. These rules, combined with the results of successive negotiations, provide a legal framework within which member countries can conduct their trade relations with one another.

Reduced to its simplest terms, GATT is an agreement to reduce tariffs and bind them against increase. It is the product of the initial series of bilateral *tariff negotiations* which took place in Geneva in 1947 and which were modelled on the negotiations of the US bilateral trade agreements of the 1930s, especially with Canada, the UK, and Mexico. It was initially negotiated as an interim agreement to be superseded by the Charter of the International Trade Organization. The ITO, how-

ever, failed to come into being, and the GATT has continued to stand on its own. Since the first negotiations in 1947, six further "rounds" of multilateral tariff negotiations have been held within the GATT framework, including the recently concluded Tokyo Round. Earlier GATT tariff negotiations were conducted largely on an item-by-item basis between pairs of member countries, with the resulting reductions extended to others. The Kennedy and Tokyo rounds involved, in addition to such bilateral negotiations, agreement to reduce tariffs on a comprehensive basis in most sectors. In addition to these general rounds, there have been extensive negotiations arising from the accession of certain countries (e.g., Germany in 1951, Japan in 1955 and Switzerland in 1966), the formation of the European Economic Community in 1957, and the accession of the UK, Ireland and Denmark to the EC in 1973.

Tariff levels and product descriptions agreed in negotiations are annexed to GATT in schedules which are an integral part of the Agreement. Virtually all industrial tariffs are now bound among the major industrialized countries and have been gradually reduced through seven rounds of negotiations. Tariffs that have been bound under GATT can only be subsequently increased by a process of further negotiations with countries directly affected — normally involving concessions in other areas of interest — or in special circumstances that are defined and limited, such as emergency safeguards under Article XIX.

Many of the GATT rules are designed to ensure that the value of tariff concessions obtained through such bargaining and negotiation is not eroded by the application of other duties and charges, or by the imposition of non-tariff barriers to trade. After seven rounds of negotiations which have reduced tariffs to their lowest historical levels, the tariff has become relatively less important in trade among industrialized economies. The other rules of GATT have, therefore, taken on increased importance, especially those contained in the new Tokyo Round agreements. This development is also reflected in the increasing importance of non-tariff measures in the commercial policy regimes of industrialized CPs.

The rule of non-discrimination is fundamental to the operation of the GATT. It is found in the requirement for *national treatment* and the *most-favoured nation principle, the two fundamental precepts* of the General Agreement. From the beginning there were agreed exceptions to the MFN principle that covered, for example, tariff preferences in existence when GATT was established, including those applied by Canada under the British preferential system. A broader and more philosophical exception to MFN was the provision for customs unions and free-trade areas contained in Article XXIV, a provision which subsequently facilitated the creation of regional trading blocs. Exceptions to the MFN rule have also been agreed to by the GATT Contracting Parties under special waivers from GATT rules for the particular arrangement concerned. An important example of such a waiver is one which permits developed countries to give tariff preferences to imports from developing countries as a group, known as the Generalized System of Preference.

The *second basic precept* of the GATT is that of *national treatment*, i.e., signatories will, once a product has been imported, accord it treatment no less favourable than the treatment accorded to products of domestic origin. This means that

protection is limited to measures at the border. National treatment, however, does not apply to purchases by governments for their own use and is limited to trade in goods. It does not, for example, apply to investment.

The provisions covering the use of *non-tariff barriers* to trade are basic to the General Agreement. The rules prescribe the conditions under which they may be used and are aimed at ensuring that tariff concessions are not undermined and the principles of national and most-favoured-nation treatment are preserved. When exceptions are made, they are of a temporary nature, or surrounded by limitations and conditions governing their use. Provision is also made for international scrutiny. Various GATT provisions, for example, are directed to prohibiting or controlling the use of non-tariff measures that could impair or nullify the access to import markets achieved by the negotiated reduction and binding of tariffs, including those governing valuation for customs purposes, the granting of subsidies, the use of quantitative restrictions, and the imposition of anti-dumping or countervailing duties. The Tokyo Round significantly expanded rules and procedures governing non-tariff barriers through a series of ancillary agreements.

The GATT permits contracting parties to take action in certain stated situations that are not consistent with the general principles outlined above. These *exceptions* include procurement for their own use by government agencies; the application of quantitative restrictions or surcharges to safeguard the balance of payments; the formation of customs unions and free-trade areas; and any actions necessary to protect essential security interests. The circumstances in which such actions can be taken are carefully circumscribed to prevent abuse and protect exporters.

GATT members may increase tariffs or impose other restrictions on the imports of a particular product in certain stated emergency situations for temporary periods where such imports "cause or threaten serious injury to domestic producers ... of like or directly competitive products", but such measures must be non-discriminatory among other members, and exporting countries directly affected may seek compensatory concessions or suspend substantially equivalent concessions to the trade of the CP taking the action, thus ensuring an element of discipline in the use of this provision. An attempt was made during the Tokyo Round to reach and codify further understandings on the rules and disciplines governing the use of such *safeguard actions*, but it was unsuccessful. This continues to be the major item of unfinished business remaining from the Tokyo Round (see below).

During the 1950s, trade in cotton textiles posed severe strains on the markets of certain GATT participants, including Canada, and led to the negotiation of a separate arrangement covering trade in textile products, under which bilateral agreements or unilateral measures to restrict imports may be put in place on a discriminatory basis, but under stated conditions involving "market disruption" in the importing country and subject to scrutiny by a Textiles Surveillance Body established for this purpose. This separate arrangement, known as the *Multifibre Arrangement* (MFA), has now been extended to the end of July, 1986.

In addition to action pursuant to the provisions in GATT for safeguard action, governments have in recent years resorted increasingly to measures not specifically

provided for in GATT which have a safeguard effect. These include so-called voluntary export arrangements and orderly marketing arrangements on either a government-to-government or industry-to-industry basis. Measures taken outside GATT lack the discipline and transparency of measures consistent with GATT and there is broad recognition that such measures should be brought within agreed international rules.

The various ancillary agreements concluded during the Tokyo Round substantially increased the coverage of the GATT and altered its juridical nature. The agreements relating to valuation, technical barriers, subsidies and countervailing measures, dumping, licencing, and the adjudication of disputes, which were discussed in detail in Chapter V, while they embody and clarify the various provisions of the GATT, at the same time also significantly expand the rules and change them from general principles to a detailed construction of international law to regulate national commercial practice. They reflect thirty-five years of experience with the original provisions. The aircraft and government procurement agreements provide improved access for the civil aircraft industry to participants' markets and open up some government purchasing to international competition. In both cases, the rules are more specific than those contained in the General Agreement.

The operation of the General Agreement involves an almost continuous series of meetings of GATT committees and other bodies, mostly at GATT headquarters in Geneva, attended by representatives of the Contracting Parties (CPs) and assisted by the GATT Secretariat. GATT was concluded initially as an interim contract and developed its *institutional character* only incidentally and over time to maintain the integrity of that contract once it became clear that the ITO would not come into being. Although GATT has a more tenuous constitutional base than most UN bodies, it has grown to resemble other such organizations, with a well-developed secretariat, a structure of committees and other bodies, and an imposing schedule of meetings and activities. On the basis of several GATT provisions relating to joint action, consultations, etc., among the Contracting Parties, this body of institutional arrangements and consultative procedures has evolved over the years and provides an increasingly firm basis for GATT activities.

Because trade concessions and obligations cannot be imposed on a contracting party without its consent, almost all *decisions are taken by consensus.* While there are procedures for voting, and these are used in a formal sense, for example, in the granting of waivers, they are rarely resorted to. Voting in most cases is either by simple majority rule or, in the case of waivers, by two-thirds majority. Votes are distributed on a basis of one vote per member, and developing countries, which constitute over three-quarters of the members, always have a majority.

The breaking of a GATT rule by a member country does not lead automatically to punitive measures, but rather establishes the right of other affected countries to withdraw equivalent concessions or take some reasonable compensatory or corrective action that is itself subject to approval by the Contracting Parties. Such actions are pursued within the rules established for *dispute settlement* where impartial parties join with the disputants in order to reach a mutually acceptable resolution. It is essentially *a system of self-help* and can only be set in motion at the initiative of an

aggrieved member. This method of enforcement of GATT rules is based on the principle that the General Agreement involves an exchange of rights and obligations and a balance of advantage, which, if upset by the actions of one member, should be corrected by its withdrawal or adjustment by that member or by countermeasures by others.

The GATT has evolved a unique set of mechanisms and procedures for the settlement of disputes involving infractions of GATT rules through a process of consultations and findings by working parties of CPs and by independent panels, with the objective of securing adherence to GATT rules by solutions that avoid retaliatory measures which could be trade-limiting in their effect. The procedures for dispute settlement in GATT were further strengthened by arrangements agreed to during the Tokyo Round. However, even with the strengthened procedures there are still many concerns about the effectiveness of the process including the composition of panels, the provision of legal advice by the Secretariat, the degree of emphasis on conciliation as opposed to adjudication, the handling of bad or disputed panel findings and the commitment of CPs to take action in response to unfavourable findings and recommendations. In the final analysis, however, it is not the mechanisms but the will to use them and abide by the results that will determine the effectiveness of the system.

An effective dispute settlement mechanism mitigates the disparities of power between Canada and its major developed trading partners and safeguards concessions negotiated and bound under the GATT. It is, of course, only one element in the management of the trading system and should not be overburdened or be expected to solve all problems. There are issues which are not susceptible to dispute settlement or where these procedures serve only to point to inadequacies in the framework of international rules. Nevertheless, resort to the dispute settlement procedures is an important and normal element in the management of the international trading system and contributes to the continuous development of the international trading agenda. Where a solution cannot be found though bilateral consultations, it may prove advantageous for countries like Canada to focus attention on the issue by means of the dispute settlement provisions. This may then stimulate multilateral discussion and eventually point to a basis for resolution by, for example, enlarging or changing the international framework of rules.

Throughout the early 1980s, as a result of straitened economic circumstances, there is likely to be an increase in the number of specific trade problems and disputes. These will be largely of a bilateral nature and will result in greater recourse to the institutionalized dispute settlement procedures of the GATT and will place pressures on that system to find adequate solutions. Since the conclusion of the Tokyo Round, Canada and other GATT members have already increasingly used these procedures. Canada has been party, for example, to five panels established in GATT since the conclusion of the Tokyo Round. Canada will wish to ensure that during the 1980s the GATT system remains effective.

The *developing country members of the GATT*, as a group, have since its inception been accorded a special status. This special status has expanded over the years. In 1965 three new articles were added to the Agreement (Part IV) dealing with the

particular trade problems and interests of LDCs. In 1971 the Contracting Parties permitted developed countries to extend generalized systems of tariff preferences to developing countries as a group, and another waiver was approved permitting exchanges of preferences among developing countries themselves. It should be noted that many newer CPs acquired their GATT rights as successors to the colonial regimes existing prior to their independence.

The Kennedy and Tokyo Rounds of tariff negotiations recognized, based on Part IV, the need to extend special and differential treatment to developing countries. Consequently, in the tariff negotiations, developing countries generally benefited (by virtue of the MFN principle) from concessions principally negotiated among the major CPs and in return made virtually no concessions of their own. Many developed CPs met many of the demands of the LDCs, while seeking few reciprocal concessions. During the Tokyo Round, growing concern with the expanding trade of newly industrialized countries led to demands for greater participation by these countries in the obligations of GATT, a concern which is likely to be an important issue in the 1980s. Indeed, in many ways, LDCs now enjoy most of the rights of GATT membership but accept few of the obligations. This is true not only for the GATT proper, but also for some of the ancillary non-tariff agreements concluded during the Tokyo Round.

There is one important exception to the generally more favourable treatment of developing countries. This is in the area of trade in textiles. As noted above, due to problems arising from rapidly expanding exports of textiles and clothing from developing countries, the GATT has since 1961 sanctioned a special set of rules to govern the discriminatory application of safeguards on trade in these products.

Issues for the GATT in the 1980s

Canada has an interest in ensuring that trade plays its role in returning the world economy to sustained growth. There have been repeated statements of political commitment to this principle, most notably at recent Summits and at Ministerial sessions of the OECD. These statements have recognized that extraordinary efforts will be required during the 1980s to contain and minimize the current sectoral pressures on the trading system. As a further expression of this political commitment, the GATT Ministerial Meeting in November, 1982, elaborated an agreed work programme for the decade.

At a time when the capacity of the world trading system to adjust to recession-inspired pressures is being questioned, a forward-looking and active GATT work programme, supplemented by constructive bilateral cooperation, is basic if governments are to inspire the necessary confidence needed for sustained, stable growth. Canada and other leading industrialized nations recognized, at the GATT Ministerial Meeting, the need to come to grips with the central problems confronting the world's trading nations. This will not be easy. To quote a recent GATT study:

> There is a need to recognize the complexity and, indeed, the long and slow historical growth of the causes of the economic malfunctions which now beset industrial economies. The policy chickens coming home to roost were not born yesterday. They are fully grown, and therefore tough.

The GATT safeguards system continues to provide members with the capacity to address problems caused by injurious imports but there have been strains on the system which need to be addressed. For some developing GATT members, improvement of the safeguards system is the single most important trade policy issue confronting the GATT. Efforts to negotiate a *safeguards agreement* have continued since the conclusion of the Tokyo Round but without reaching agreement on the basic objectives and parameters of such an agreement. Despite broad consensus on the need for such an agreement, and the shared conviction that any new agreement should clarify the provisions of Article XIX and place all measures with a safeguards effect under international discipline, it is not clear that a new agreement is readily negotiable. The increasing rise in protectionist pressures in the last few years has brought out in sharp relief the number of conflicting negotiating objectives some of the major participants are trying to achieve (e.g., transparency for the action of others but sufficient scope for one's own measures; the right to seek compensation but minimize payment; the right to act selectively but not be discriminated against, etc.). Achieving a satisfactory safeguards agreement is thus a major challenge facing GATT contracting parties.

The *GATT Government Procurement Agreement* provides that before the end of 1983 signatories will enter into further negotiations with a view to broadening and improving the Agreement. Preparatory work for such negotiations is now underway, and signatories are drawing up a specific negotiating work programme and defining their objectives. While the scope of the negotiations is not yet clear, Canada, during the Tokyo Round, identified a number of sectors where Canadian industry is internationally competitive and where government procurement effectively closes a number of foreign markets, e.g., telecommunications, power generation, transmission, and surface transportation equipment, and any new negotiations may provide scope for pursuing new opportunities for these industries.

The *GATT Civil Aircraft Agreement* also provides that by the end of 1982 signatories would enter into further negotiations with a view to broadening and improving the Agreement. To date there have been preliminary discussions on the scope and parameters for new negotiations. These discussions should clarify the position of all participants for the negotiations and provide the basis for seeking negotiating mandates. Civil aircraft and parts for civil aircraft are areas where Canadian industry is highly specialized and competitive internationally. Broadening the coverage of the Agreement could result in increased export opportunities for the Canadian aerospace industry. The scope of the potential negotiations is relatively modest and a majority of these products already enter Canada duty free when for use in civil aircraft.

It was agreed at the conclusion of the Tokyo Round that as experience was gained with the operation of the various other non-tariff measures agreements, areas for potential improvement would become apparent, and negotiations or discussions to this end would be initiated. In addition to the above preparations for further negotiations on aircraft and government procurement, priority attention is being given to a review of the *Subsidies and Countervailing Duties Code* and the problems posed by subsidization. This agreement was one of the major achievements of the Tokyo Round. It recognizes that while subsidies are a legitimate tool for the achievement of national objectives, they may have an injurious or adverse effect on the interests of

other countries. The agreement thus provides for improved international discipline in the use of subsidies.

In general, Canada has to weigh concern over the increased use of subsidies by its trading partners (because of its high dependence on exports) against its own need to use subsidies to promote social and regional development; the desire for a reasonably free hand to deal with allegedly subsidized imports must be weighed against the concern that other countries be restrained in their use of countervailing measures against allegedly subsidized Canadian exports. Canada signed the agreement because it represented a reasonable compromise of these conflicting objectives, and introduced a necessary degree of international discipline in the use of subsidies and countervailing measures by Canada's major trading partners.

Nevertheless, we remain concerned over the possible increased use of subsidies, particularly in the agricultural sector, not so much to carry out structural adjustment as to avoid the same. In this regard, we share the US concern with the high level of subsidization under the EC's Common Agricultural Policy and its impact on EC imports and exports. There is a need to recognize the trade distortions which have been created by the widespread use of direct and indirect export subsidies and to direct that work be undertaken to develop solutions on a priority basis. There is also a need to examine the problems of increased use of subsidies and the risk this poses as a new form of protectionism. At the same time, it is not in Canada's interests to retreat from the broad recognition that subsidies are important tools for achieving social and economic objectives, and that they are often a more visible (and, thus, desirable) means of industrial assistance, perhaps precluding resort to more restrictive trade measures. In this context, the issue of transparency becomes an important one. With the USA now applying an injury test, there should be a greater commitment to notifying subsidy practices under Article XVI:1 of the GATT, which would assist in maintaining a general discipline on their use, particularly in the industrial area.

In the tariff area, attention in the 1980s will focus on the implementation of the Tokyo Round, a process which will not be completed until 1987. As well, there remain a range of tariffs in various markets which may be amenable to further negotiation to improve access for Canadian exporters. The GATT work programme, for example, provides for specific attention to tariff escalation and to the access provided resource-based products. As part of the further internationalization and harmonization of trade, efforts are continuing to develop a truly international system of tariff nomenclature. The Canadian *tariff and statistical classification systems* are unique to Canada. The two systems are unrelated and each has been revised periodically to reflect new developments. Their shape today reflects the historical development of the tariff and of statistics gathering. Most other trading nations, with the exception of the USA, use the tariff nomenclature system developed by the Customs Cooperation Council (the CCCN), which is now being reviewed with a view to developing a comprehensive, modern classification system which can be used not only for tariff and statistical purposes, but for any related commercial purpose such as transportation, insurance, inventory control, etc.

For countries now applying the CCCN, adoption of the *Harmonized System* (HS) will be a relatively simple matter and is not likely to require major changes.

For countries like Canada and the USA, however, conversion to the HS would be a major task and requires serious consideration. While the long-term advantages of the HS are obvious (in terms of one system with wide application used universally by all trading nations), the process of conversion would be complicated and require major changes. Not only would Canada need to change its tariff classification system, but we may need to negotiate the consequent changes in tariff levels. The government decided in 1981 to work towards its adoption and further decisions will likely need to be made around mid-decade. An important consideration will be the need to move in harmony with our principal trading partner, the USA, as well as the need to provide for a sufficient period of time to arrive at satisfactory tariff adjustments.

The rapid increase in international transactions in the service sector, reflecting the growth in domestic service sectors, has resulted in increasing calls for a better understanding of what is involved in trade in services and for the elaboration of a framework of rules. There is no comprehensive framework of rules which provides international discipline on trade in services on a basis similar to the discipline on trade in goods provided by the GATT. As a result, work is now underway in both the OECD and to a certain extent in the GATT to improve international understanding of the issues involved in trade in services. Trade in services has been extensively studied and analyzed by a government task force to arrive at a better understanding of the service sector in Canada and Canada's place in international trade in services. Canada is, therefore, relatively well placed to participate in international consideration of this issue.

The USA has increasingly expressed concern about the *investment policies and activities* of its trading partners. The US request for a GATT panel to review certain FIRA practices is but one manifestation of that concern. The USA is convinced that so-called investment performance requirements and other restrictions on investment have a distorting effect on international trade and that their proliferation demonstrates a need to improve discipline in this area. US concern is not widely shared. Few countries are prepared to accept, for example, the US view that the free right of establishment is an established principle of international law. LDCs are concerned that the US push for new investment discipline is aimed at them and would affect their freedom to develop their economies as they see fit. They also question the competence of GATT in this area or the appropriateness of expanding the GATT into this area. Nevertheless, there is some support for undertaking a thorough international review of trade-related investment issues which would facilitate better understanding of the issues involved. Canada has indicated that any such review would need to take into account the practices of MNEs and home government policies which may themselves have a distorting effect on international trade and are often the cause of restrictive investment laws.

In the highly competitive market of the 1980s, export credit terms and conditions will be a major factor affecting trade flows. Recent high interest rates combined with intense competition for export markets have pointed to the inadequacy of international rules governing *officially supported export credits*. The practice of concessional export financing can adversely affect Canadian trade and industrial interests, both in the domestic market and in export markets. The OECD informal Arrangement on Guidelines for Officially Supported Credits (the "Consensus") has

not always proven sufficient to contain export subsidies and eliminate the damaging competition in export credits. Over the next few years there will need to be a major effort by the international community to bring this situation under greater control, either by means of the OECD consensus or under the aegis of the GATT Subsidies/Countervail Agreement. The competition in export credits is essentially a competition between national treasuries which Canada, with the smallest treasury among major trading nations, cannot hope to win. (See also Chapter VI).

The close relationship between domestic agricultural policies and border measures has meant that relatively less progress has been made in liberalizing trade in agricultural than in industrial products, particularly with respect to non-tariff measures. Canada's agricultural export potential relies importantly on improving the agricultural trading environment and bringing agricultural trade policies under greater international surveillance and discipline. Further reliance on export markets will make Canada increasingly vulnerable to international market fluctuations and foreign non-tariff measures. At the same time, international trade rules need to apply equally to all countries and domestic producers must be confident that the government will use all means consistent with its international rights and obligations to ensure protection from unfair import trade practices.

There has been a tendency for the traditional temperate-zone agricultural exporters to focus on the Common Agricultural Policy (CAP) of the EC as the prime example of what is wrong with agricultural trade. Initially, third-country concerns related mainly to the adverse effects of the CAP on their exports to the EC (particularly for those products subject to variable import levies, e.g., grains, meats and dairy products). More recently, however, concern has increasingly shifted to the effect of subsidized EC exports in third country markets such as Japan and even in the home markets of the traditional agricultural exporters. High levels of internal price support have resulted in the EC shifting from a net importer to a major net exporter of a number of products, including wheat, barley, sugar and beef.

It must be recognized, however, that many of the so-called traditional agricultural exporters also have import regimes which are at odds with existing GATT rules, particularly in respect of dairy products and beef import regimes. Indeed, the special exemption provisions in the GATT for agricultural products and the tendency for countries to implement import measures which stretch their GATT obligations can in some measure be traced to earlier US policies which provided support levels above world prices. The USA sought and obtained in 1955 a GATT waiver for its agricultural import quotas. Subsequently, the USA enacted a Meat Import Law in 1964. Although the USA discontinued direct export subsidies and eliminated some of its import quotas during the early 1970s, the fact remains that the tendency to treat agriculture as a special sector and for countries to discount GATT rules in drafting domestic legislation, particularly in the sensitive dairy, grains and beef sectors, originated in part with the USA.

Of major concern to the smaller agricultural exporting countries, such as Canada, is the current imbalance of GATT obligations between countries. The USA has its GATT waiver and the EC and Japan have not bound in the GATT much of their agricultural import regimes. The EC does not need recourse to import quotas,

countervailing or anti-dumping duties for those products covered by variable import levies which effectively insulate its production from either fair or unfair foreign price competition. In contrast, Canada has, under the GATT, bound the terms of access for most agricultural products. This is, nevertheless, counterbalanced to some extent by a greater reliance by Canada on import quotas in support of domestic supply management regimes, which are allowed under GATT rules, as well as restrictions on oleomargarine and certain grains and grain products, which predate the GATT.

In past GATT agricultural negotiations, Canada has to a large extent concentrated on binding, reducing and harmonizing its agricultural tariffs with the USA for those products which are traded both ways. This has made good economic and political sense in a North American trade context. While on a number of specific products, access commitments by the EC and Japan have also been negotiated, e.g., duty-free bindings on rapeseed, we have not been able to negotiate access to those markets comparable to that achieved with the United States. From a Canadian perspective, therefore, greater discipline under GATT for agricultural trade is an important objective, but one which will not be easily achieved.

Canada has long had a major interest in *fisheries trade.* The extension of the maritime economic zone to 200 miles had a dramatic effect on patterns of production and trade. Canada, for example, gained control of large fisheries supplies and now needs to export more to ensure the efficient development of the industry, at a time when the EC is moving to protect its fisheries interests through stricter control of access to its market. As a result, the GATT provisions and national practices affecting trade in fisheries are being scrutinized closely.

The results of the Tokyo Round negotiations in the fisheries sector were disappointing for Canada. Despite some successes (e.g., an important tariff rate quota for frozen cod fillets and blocks into the EC, and some tariff reductions in the USA and Japan), a number of fisheries products continue to face relatively high tariffs, especially in the EC, as well as a range of non-tariff barriers. Because of increased production, Canada will need greater access to the traditional markets of Europe, Japan, and the USA. To this end we successfully pressed for the inclusion of fisheries in the Work Programme adopted at the GATT Ministerial Meeting aimed at improving multilateral discipline in the fisheries sector and lowering tariff and non-tariff barriers. Work is also proceeding in the OECD Fisheries Committee with a view to developing common approaches to problems in fisheries trade.

The GATT Work Programme includes provision for a study of *trade in non-ferrous metals,* with particular attention to be focussed on tariff escalation. This echoes a proposal by Canada during the Tokyo Round for sector negotiations in the non-ferrous metals and forest products sectors. Developing countries are increasingly aware of the need for them to increase their participation in the processing and marketing of their primary resources. Canada has long expressed an interest in reducing *tariff escalation* (i.e., tariffs that increase with the degree of processing) and non-tariff barriers which frustrate the upgrading of resource-based products before their export.

An important Canadian industrial development objective is to encourage *further processing of resource products* prior to export where this can be done on an internationally competitive basis. The GATT Tariffs Committee is currently studying trade problems related to tariff escalation. Moreover, as the newly industrialized countries become increasingly significant in trade in processed resource products, we need to take into account that many of them maintain very restrictive import regimes. Nevertheless, the interests of these countries coincide in many respects with Canadian interests in seeking to ensure that barriers to imports of further processed resource products are addressed as an integral part of any GATT work programme.

The Tokyo Round did not develop new rules governing the export of raw materials despite the interest of large resource importers in increasing discipline on the use of *export charges and controls*. The GATT, however, did adopt an Understanding which noted that the GATT Contracting Parties would reassess the GATT provisions relating to export restrictions and charges in the context of the international trade system as a whole. Canada made it clear at that time that if any future reassessment were to indicate that negotiations on the issue were desirable, then it would be essential to deal concurrently with the directly related issues of the reduction and removal of trade barriers to imports of processed resource products. In this regard, the EC and some other European countries continue to see the need to have export restrictions and charges considered in the GATT in the 1980s.

The rapid dissemination of high technology and its application in industry will create challenges and opportunities in the management of international relations in the 1980s. In terms of *advanced technology*, the USA has suggested that there exists a common set of factors unique to trade in these products and has proposed that these be examined in GATT in order to identify its unique elements. US thinking in this regard has been influenced by the successful conclusion during the Tokyo Round of a sectoral agreement governing trade in civil aircraft. In the US view, for example, the rapid changes in advanced-technology products makes it difficult to negotiate tariff concessions. A particular product may be marketed for only a short period of time before it is superseded by a more sophisticated product which could be classified under a different tariff heading. Other countries may not be as advanced in their thinking as the USA, but it is apparent many are prepared to examine it seriously. For Canada, as a highly competitive manufacturer of a range of sophisticated telecommunications, transportation and power-generating equipment, such an examination may identify interesting opportunities for these sectors.

Preliminary work in defining the parameters of a *code covering trade in counterfeit goods* has progressed over the past few years. Consensus on the need for such an agreement, however, is much less advanced. The USA continues to pursue its objective of concluding multilateral negotiation of such a code. To date, the USA has refined its draft text through a process of bilateral and plurilateral meetings with selected countries and has received a measure of support from most industrialized countries. There remains, however, opposition on the part of a number of key LDCs and only limited interest on the part of others. Most other countries are not convinced there is an urgent need to resolve problems arising out of trade in counterfeit goods by means of an international agreement and would accept such an agreement

only if it received broad support. Under the GATT Work Programme, the Council will examine the need for any action within the ambit of the GATT.

Finally, the whole range of *North-South trade questions* will continue to command wide attention during the 1980s not only in GATT, but in UNCTAD and the UN as a whole. There will be two broad elements at play. LDCs have an interest in most of the issues described above and will, of course, bring their own perspectives and interests to bear upon them. In addition, there is a wide range of issues which are largely of a North-South character. For the GATT, the Ministerial Meeting mandated the inclusion of a number of issues of particular interest to them within the Work Programme, including improved access for tropical products, liberalization of trade in textiles and clothing, structural adjustment, and strengthening the implementation of Part IV of the GATT.

There is a growing concern among developed countries that the newly-industrialized countries must assume a greater range of obligations and responsibilities in the GATT commensurate with their stake in the international trading system. At the same time, developing countries will continue to be concerned with the extent to which industrialized countries adhere to their GATT obligations to extend special and differential treatment. There will also be pressure to develop new ideas for facilitating the trade of those developing countries which have yet to share fully in the benefits of international trade.

The IMF and Canadian Commercial Policy

Together with the GATT, the International Monetary Fund (IMF) and the World Bank (IBRD) have been the pillars of the post-war trade and payments system. It was recognized from the outset that all the problems in international trade cannot be addressed with trade measures. Some of these must be addressed with macro-economic and monetary policies within the ambit of the IMF.

The basic purpose of the IMF is to provide the institutional framework for international monetary co-operation and to encourage appropriate balance-of-payments adjustment by its members. It was designed to provide an institution and conditions which would allow an expanding volume of international trade thereby contributing to higher standards of living in all member countries. In line with this, the IMF has two closely related functions — general surveillance of the world monetary and payments system and the provision of temporary financing to members facing payments difficulties.

The IMF's Articles of Agreement establish member countries' obligations to collaborate with the Fund and with each other. Emphasis is laid on the obligations of members to pursue policies that will contribute to sound economic growth and a stable international monetary system. The Fund has the responsibility for monitoring compliance with these obligations. Under the 1978 amendment to the Articles, the scope of the IMF surveillance was broadened to include not just exchange rate practices but the more general policies that affect the external sector, in particular the pursuance by members of economic and financial policies that foster growth with reasonable price stability.

The second major function of the IMF is to provide temporary financing, under prescribed conditions, to all member countries, both developed and developing, who are facing balance-of-payments difficulties. Over the past 30 years it has provided some $70 billion to its members. The purpose in providing these funds is to encourage and assist countries to make timely and necessary adjustments without resorting to restrictive measures that would be unduly disruptive to national or international prosperity. This role differs from that of other international institutions. The Fund is not a development or aid institution with fixed groups of borrowers or lenders. (In fact almost all members, including Canada, have borrowed from the Fund at various times.) Many countries do, of course, have a need for long-term development financing, or in the case of poorer countries, unrequited aid transfers, a need that is met in good part through the World Bank and other international financial institutions as well as through bilateral assistance and private capital flows.

Under the rules of the IMF, exchange stability is the general rule, but exchange-rate adjustments within the IMF framework are encouraged. One of the most significant changes in the monetary system in the past decade was the breakdown of the par value regime and the move to floating exchange rates by major industrial countries. This was followed by intensive discussions on international monetary reform. The prevailing view, reflected in the 1978 amendments to the Articles of Agreement, was that there should be an evolutionary process of change that would accommodate the need for more flexible exchange rates, improve the adjustment process, and permit the system to evolve in a pragmatic way in response to changing needs.

In practice the Fund's success in promoting adjustment, particularly among surplus countries, has fallen somewhat short of expectations. As an intergovernmental organization the Fund's powers are limited to those which have been vested in it by the membership. The ability of the Fund to promote its objectives depends on the support and the cooperation that it receives from its members.

Another area of concern to the IMF, closely related to the adjustment process, is that of international liquidity, that is, the level and composition of the reserves available for meeting payments requirements. The Special Drawing Right (SDR) was created as an international reserve asset in 1969 in an initial amount of SDR 9 billion, allocated to members over the period 1970-72. A second allocation of SDR 12 billion over three years was approved by the Board of Governors in 1978. The IMF has authority to issue SDRs in amounts which must take account of the long-term global need to supplement existing reserve assets. Although SDRs currently form only a small part of international reserves, a number of steps have been taken recently to make them a more attractive asset. The long-term objective is to make the SDR the principal reserve asset of the international monetary system.

In establishing or modifying its facilities the Fund has endeavoured to preserve its non-discriminatory character while meeting the needs of members with varying economic characteristics. Thus apart from the Trust Fund which, given its special nature, was set up as a separate legal entity administered by the IMF, Fund facilities are open to all members irrespective of their level of development. Consequently the Fund has to take into account the possibility of potentially large demands on its

resources by major countries and, like other lenders, has to be concerned with the ability of borrowing countries to repay. The Fund's resources, unlike most of those of development assistance institutions, are continually revolving, and the amount of usable resources available at any given time depends on the amount of drawings outstanding and the Fund's holdings of the currencies of those member countries whose balance-of-payments position and reserves are strong enough for those currencies to be provided to members drawing on the Fund. Although its resources come primarily from quota subscriptions, the Fund can and does borrow to supplement these resources. The General Arrangements to Borrow were established in 1962 by the IMF and the ten largest industrial countries in order to ensure that the Fund's resources would not be seriously depleted by exceptionally large drawings by those countries. The Oil Facility, and more recently, the Supplementary Financing Facility have also been financed by borrowing from member countries.

Canada has been an active participant in the adaptation of the international monetary system through its membership on the Committee of Twenty on Monetary Reform in the early 1970s and its successor, the Interim Committee, as well as on the Executive Board which is responsible for the Fund's day-to-day operations. Earlier Canada had been a major participant in the meetings which drafted the Fund's charter in 1944. Our positions have been based on a number of general principles.

As an open economy dependent on both foreign trade and financial flows, Canada has a major stake in the international monetary system. Canada has promoted and supported measures which enhance the further multilateralization and liberalization of the trade and payments system in order to maintain an international climate favourable to non-inflationary growth and an expansion in world trade and financial flows. The system should promote global and non-discriminatory objectives which are aimed at serving the interests of the world economy as a whole. Changes in the system must be viable and durable and consistent with these objectives.

Canada has been a strong supporter of the IMF since its inception both as an institution responsible for the supervision and adaptation of the international monetary system and as a financial institution. Canada has traditionally been a net creditor in the Fund and, as a result, the Fund has frequently used its holdings of Canadian dollars and special lines of credit in its favour (such as loans to finance the Oil Facility and the Supplementary Financing Facility and our participation in the General Arrangements to Borrow) to finance drawings by other members facing balance-of-payments difficulties. Use of Canadian dollars has, however, been minimal in recent years because of developments in our own balance of payments. In supporting the Fund's financial operations Canada has promoted the creation and adaptation of facilities which, while as helpful as possible to individual members in need of assistance, were compatible with its fundamental objectives, particularly with regard to the promotion of the adjustment process in the balance of payments, the maintenance of an open trade and payments system, and the efficient use of the Fund's limited resources.

Throughout the 1980s, a major issue confronting the IMF is the growing indebtedness of developing and state-trading countries, now approaching $700 bil-

lion. This indebtedness, and the ability to repay the debt, was severely exacerbated by the recession and by recession-inspired trade restrictions. Efforts to manage this problem better are under way, but the issue will remain a major challenge.

The Place of the OECD in Canada's Commercial Policy

The Organization for Economic Cooperation and Development enjoys a key position in the world economic and trade system. It contributes significantly to cooperative efforts across a broad range of economic, social and scientific endeavours. Its twenty-four members comprise the western European democracies, the Commission of the European Communities, Turkey, Yugoslavia (as an associate member), Japan, Australia, New Zealand, the USA, and Canada. While representing only twenty percent of the world's population, this small "club" of the world's most highly developed and richer countries accounts for sixty percent of total industrial production and seventy percent of total world trade.

The OECD has a number of features which distinguish it from other international economic bodies. A primary distinguishing feature of the Organization from a trade perspective is that it is basically a *consultative* forum. With limited exceptions there are no binding elements in the Organization. This contrasts sharply with the contractual nature of the GATT. Furthermore, it provides a unique *multidisciplinary* approach to analyzing major international issues. The OECD is composed of directorates dealing with financial and macro-economic issues, trade, development assistance, social and manpower policies, science and technology, agriculture and energy. This range of activities enables the Organization to bring a variety of different perspectives to bear on major international issues. Finally, the OECD consists of a *restricted group* of like-minded countries.

The mandate of the OECD is to promote policies which are designed to achieve the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability; contribute to sound economic expansion in member as well as non-member countries; and contribute to expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations as embodied in the GATT. This is achieved through regular consultations and exchange of information, special studies, cooperation, and when appropriate, coordinated approaches or strategies. There are numerous specialized committees and working groups in the Organization.

The OECD's broad range of activities are illustrative of its contribution to the effective management of the multilateral trading order. The OECD periodically reviews issues in East-West and North-South trade and helps its members to develop common approaches. Its comparative analyses of members' industrial policies, and its studies of difficulties in the adjustment process assist member governments in developing policies responsive to rapidly changing competitive circumstances. The OECD has been very actively involved in investment issues and has developed a number of common policy positions. Similarly, it has evolved guidelines regarding the practices of multinational enterprises and restrictive business practices. The

establishment of the Steel Committee a few years ago was instrumental in resolving and containing problems in that sector. The OECD's work in the energy sector evolved into the establishment of the International Energy Agency.

For a middle-sized economic power like Canada, membership in the OECD holds several advantages. To the extent it performs effectively, the OECD decreases the temptation of major economic powers to settle problems among themselves. Furthermore, the Organization can occasionally provide a useful balance to our bilateral relations with major economic partners. Some of our problems with Washington, Tokyo or Brussels are also encountered by other OECD countries, and in such cases it can be distinctly advantageous to have the latter present at the same table to make common cause as necessary.

Generally the OECD serves well the need for a multilateral forum in which the world's highly industrialized countries can examine a wide range of mutual economic and technical concerns. The possibility of conducting these discussions in an atmosphere relatively free from political pressures provides an important alternative to multilateral fora elsewhere. Much of the work in the OECD takes the form of an exchange of views and a comparison of experiences with relatively little attempt being made to draw formal conclusions or to bring about binding agreement on the harmonization of policies.

OECD studies can offer an efficient way of examining a problem at hand. The quality of OECD work varies, but most of it is sound, and some has been outstanding. In the trade and investment field, for example, Secretariat studies fill an important gap. OECD studies may or may not provide important new insights for Canadians, but even when this is not the case it can be useful to have international affirmation of the importance of certain issues which may be difficult to have accepted domestically. Some studies are directly aimed at Canada, such as periodic reviews of the Canadian economy. In such studies, the OECD consults closely with the government, but reserves the right to arrive at its own conclusions, some of which can be critical.

Obviously the OECD has weaknesses. Like many international organizations, its Secretariat is large and, despite significant progress made in imparting greater flexibility to the Organization, it is still sometimes unwieldy. Furthermore, the OECD occasionally reveals a certain European bias, betraying its OEEC origins. Finally, from Canada's point of view, while our national interests on most economic problems are shared by other members, this is not always the case: in the commodity field, for instance, we are often in the role of producer/exporter among predominantly consumer members. A similar divergence is often apparent on investment issues.

Looking to the future, and to the increasing complexity of the world economy, the international community faces a growing list of important issues which cannot readily be addressed without going beyond a mere comparison of experiences, but instead may require the development of common approaches to managing policy issues, or occasionally joint action. Pushed by those who want to make more use of it to deal with hard issues, and pulled by the need to adapt to the changing world eco-

nomic environment and its demands upon policy-makers, the OECD will need to continue to be able to adjust to change over the next 5 or 10 years by assuming new roles and possibly a more activist character.

The role of UNCTAD and other UN bodies in the Conduct of Canada's Commercial Policy

While the GATT, IMF, and OECD are the three primary international institutions which provide the multilateral framework for the pursuit of Canada's commercial policy objectives, a host of other organizations, both inside and outside the UN family, exert their influence or make their contribution in more specialized ways, including the Food and Agriculture Organization in Rome, the Customs Cooperation Council in Brussels, the World Intellectual Property Organization in Paris, the Intergovernmental Maritime Consultative Organization in London, and the various regional Economic Commissions. Indeed, one of the major strengths of the UN system lies in the contributions made in their respective fields by the various specialized agencies and bodies. Since they are separate, autonomous intergovernmental organizations, each has its own deliberative and executive bodies, its secretariat and its budget. Their fields of responsibility are widely divergent, but each makes its contribution to the smooth operation and further strengthening of the multilateral trading order.

Within the United Nations proper, the most important organization for the pursuit of Canada's commercial policy objectives is the *United Nations Conference on Trade and Development*. UNCTAD emerged in the early 1960s as a response to the increasing frustration on the part of newly independent developing countries with the pace of their development and the limited contribution made by the GATT and other organizations. The Conference proper meets every four years, with subsidiary bodies functioning continuously in the interim, supported by a large international secretariat headquartered in Geneva. UNCTAD provides a powerful stimulus to the international consideration of trade and economic issues of primary concern to developing countries. As such it has contributed to growing international awareness of the problems facing these countries and to identifying solutions to these problems. Furthermore, it provides a useful universal consultative forum to consider these issues and develop consensus where possible.

Membership in UNCTAD serves two sets of Canadian policies and objectives: multilateral cooperation in general, and specific commercial and economic policy objectives including commodity trade, international financial and monetary issues, competition policy/control of multinationals, development assistance, and maritime policy. For some of these, especially commodities, UNCTAD offers the only universal forum where these issues are considered with any degree of depth. However, there are limits to what Canada can achieve through UNCTAD, given its general orientation towards the economic problems of developing countries. During the 1970s UNCTAD's most notable achievement lay in generating and promoting support for a Generalized System of Preferences. As a result all industrialized countries have now introduced such schemes in their tariff policies providing an important

margin of preference for imports from developing countries and expanding their ability to compete in industrialized markets. For Canada, the most important set of issues currently considered in UNCTAD revolve around trade in primary commodities.

Commodity Agreements and Trade in Primary Products

In view of the importance of production and trade of primary agricultural and industrial materials to the Canadian economy, Canada has major interests in international measures affecting trade in commodities. Despite the diversification of Canada's exports over the past two decades, primary commodities continue to account for a significant proportion of the country's exports and for a larger share of total exports than is the case for most developed and many developing countries (30 percent in 1981). At the same time, of course, Canada imports sizeable volumes of a number of commodities, in particular tropical beverages (tea, coffee, cocoa, orange juice) and foodstuffs, and certain industrial raw materials (tin, manganese, bauxite) not produced domestically.

In the first half of this century, governments entered into a number of inter-governmental agreements to manage international trade in primary products, including agreements covering sugar, wheat, rubber, coffee, tea, cotton, beef, rice, timber and tin. Most of these agreements were drawn up by producing and exporting countries in an endeavour to overcome difficulties arising from the accumulation of surpluses. The approach, however, was piece-meal and lacked uniformity. There was no systematic treatment and no related action with respect to these agreements. The majority did not, for example, provide for representation on the controlling bodies by importing or consuming countries.

During World War II extensive experience was gained in the international management of commodities. This experience was kept in mind by the architects of the post-war trade and payments system. A complete chapter of the Havana Charter for an International Trade Organization, for example, was devoted to intergovernmental commodity agreements. Although the ITO failed to come into being, the principles which governed the chapter dealing with primary commodities continue to animate multilateral consideration of this issue today.

The Havana Charter recognized that problems connected with primary commodities are of a special nature which do not apply to manufactured goods, particularly the wide fluctuations in supply, demand and, of course, price. It, therefore, provided a systematic approach to the solution of such problems. There was to be careful examination of all aspects of a commodity problem and such examination was to be conducted on a wide basis with adequate representation of both producing and consuming interests. Agreements would aim to stabilize prices of primary commodities at levels which are fair to consumers and provide a reasonable return to producers. Provision was made for coordinating the activities of various international bodies concerned with commodity matters and to ensure that countries did not make arrangements to improve their own individual position at the expense of others. With the failure of the ITO, UNCTAD and a number of independent commodity-specific organizations have become the main venue for such discussions.

Instabilities in commodity markets are due both to factors inherent in commodity trade, and to government intervention. For example, a frost which destroys much of one year's coffee crop will raise prices for that crop year. The higher price will encourage new plantings which may result in overproduction and attendant price decline in subsequent years. Lower prices will cause some growers to withdraw from the market, reversing the cycle. Generally speaking, the greater the amplitude of price movements, the more pronounced the supply response. The market for industrial raw materials is generally driven by fluctuations in demand resulting from the normal business cycle, and cyclical movements are frequently exacerbated by the slowness of the market in responding to change (due, for example, to the long lead time required to open a mine and the difficulty of temporarily closing it). The degree of fluctuation is importantly affected by available substitutes. The effects of government intervention in commodity production and marketing may be even more serious than these inherent factors. Agricultural support programmes can distort both domestic and international markets as can government programmes put in place to foster industrial development or to ensure domestic production of strategic materials.

Concerted international action can and has focussed on a number of objectives: price and supply stability; price enhancement; increased market transparency; improved access conditions; income or export earnings stability; and improved production and distribution. All have been considered and applied with varying degrees of success — some at the intergovernmental, others at intercorporate levels. Such action can take the form of producer cartels (such as OPEC), formal producer-consumer agreements (such as the International Tin Agreement), or less structured producer-consumer consultative groups (such as the Lead and Zinc Study Group). The nature of economic provisions included in international arrangements has traditionally been limited by the reality of the market and the characteristics of the product. Economic provisions which have been used in various combinations include: export quotas; international stocking arrangements; internationally coordinated national stocks; supply and purchase commitments, and, of course, regular consultations and exchanges of information.

Following the boom-bust cycle in commodity trade in 1973-74 and the early success of OPEC, commodity agreements received increased prominence, particularly in the context of the North-South dialogue, culminating in the establishment of the UNCTAD Integrated Programme for Commodities. This programme was an important cornerstone of developing country efforts to establish the "New International Economic Order" and was based on the conviction that there is need for a programme of global action to improve market structures in international trade in commodities of interest to developing country producers. It anticipated that market control agreements would be negotiated for some 18 commodities to counteract the markets' perceived built-in biases against developing country commodity exporters. The new elements and the principal features of the programme were agreement to negotiate a Common Fund to provide funding for commodity stabilization agreements, agreement to convene preparatory meetings on each of the individual commodities in the programme, with a view to preparing for negotiating conferences, and a timetable within which all such preparations and negotiations should take place.

Common Fund negotiations were concluded in June 1980, and it was anticipated that the Fund would come into effect by mid-1982. The ratification process has, however, proceeded very slowly, and it is not now expected that the Fund will come into effect for several more years. The pace of discussion on individual commodities has slowed considerably since the initial spurt from 1976 to 1978. There are five commodity agreements with economic provisions now in operation: tin, sugar, coffee, rubber, and cocoa. Canada is a member of all but the cocoa agreement.

Attention has recently focussed increasingly on export earnings stabilization. There already exist a number of such schemes including the STABEX operated by the EC under the Lomé Convention and the IMF's Compensatory Financing Facility operated largely in a balance-of-payments context. Neither of these meets the LDC commodity exporters' desire for a scheme which guarantees them a certain level of export earnings from these commodity sales regardless of market conditions. It is unlikely, however, that such a scheme will receive the necessary international support in the foreseeable future.

As a major exporter and importer of a range of commodities, *Canada's approach* to international commodity arrangements is relatively straightforward. It is based on the notion that the market system should be allowed to operate for commodities to the extent possible. Where problems are perceived to exist in the market for a particular commodity, then in the Canadian view such problems should be examined internationally on a case-by-case basis among producers and consumers with a view to determining whether the perceived problem is amenable to intergovernmental action. Generally speaking, Canada remains skeptical of the economic need for commodity agreements unless exceptional circumstances exist, but is prepared to work with others to develop common approaches and to ensure that such actions are consistent with Canada's basic economic interests.

World Economic Outlook and Competitive Environment

The boom years of the post-war period effectively ended in 1973. While for a time it was believed that the ensuing slow-down was a temporary phenomenon, it is now generally expected that an early return to a period of rapid growth is unlikely. This reflects not only the new energy situation but also the uncertainty inhibiting investment decisions, the deterioration in demand resulting from continued unemployment, and the continuing high level of inflation. Thus, while it is to be hoped there will soon be a return to a more steady pattern of growth than we have experienced since 1973, it is unlikely that we will match the heady performance of the 1960s in the foreseeable future.

Looking ahead through the 1980s, there is concern that an extended period of slow growth with economies operating below potential could further encourage protectionist pressures — undoing some of the trade liberalization of the past three decades and thereby lowering real incomes. Competition from newly-industrializing countries is likely to require adjustment, especially in the unskilled labour-intensive manufacturing sector of the market-oriented industrial countries, while other adjustments will be called for as comparative advantages shift over time.

One of the most basic developments of the past decade has been the rapid evolution of technology and its application to various industrial processes. This rapid development has been accompanied by the increased portability of technology and the further internationalization of industry. Multinational companies now consider the whole world as their stage and will locate on any continent to maximize cost advantages and stay ahead of the competition. Governments, concerned with employment, tax bases, and wealth generation and distribution etc., are responding with policies and programmes aimed at attracting new investment which assist their domestic private sector in this world-wide battle for industrial innovation, productivity and cost advantages through technological advances.

The wide application of semi-conductor technologies (micro-electronics, CAD/CAM, robotics) for assembly line production and small-batch production processes, as well as other labour-saving technologies, will be crucial to maintaining competitiveness during the 1980s, but will at the same time heighten unemployment concerns and increase pressures to move labour to information industries. More positively, these same technologies will offset to some extent the labour-cost advantages of developing country suppliers in a range of consumer industries. Access, and control of access, to the latest technologies will become key factors in maintaining competitiveness. Governments will play key roles in positioning their countries for the next generation of industries by supporting developments in biotechnologies, synthetic fuels, new materials, etc. Patent and copyright issues may thus emerge as the next generation of irritants in trade relations.

The rest of the century is thus likely to witness accelerated competition for world markets for the products of high-technology industries including new generation industries (e.g., robotics, CAD/CAM). The competition will be largely a three-way battle between the USA, Japan and Europe with the NICs unlikely to pose a challenge of the same scale as Japan posed in the 1960s and 1970s. In addition to battling for their own markets, competition will be fierce in third markets, both for products and investment. A factor in this competition already evident is the increased emphasis by governments on industrial research and less on basic research and development. While there will be room for everybody on the basis of specialization and the application of the latest technologies, the fear is that this is a zero-sum game and that the race is to the swift. This will add to the highly competitive atmosphere. Nevertheless, there will also be pressure to undertake cooperative developments in order to share risks and financial burdens (e.g., the European Airbus).

The first three post-war decades witnessed US leadership among the industrialized powers. The rest of the century should see a more balanced power relationship in high-technology industries with an increasingly three-way race between the USA, Europe and Japan in such traditional US strongholds as aerospace, computers, telecommunications and semi-conductors. There will be increasing emphasis on and competition in the service sector. The USA will thus be increasingly challenged to stay ahead. The increasing demographic weight of developing countries will have continuing effect on industrialized countries, both in terms of their potential as markets and as a source of competition based on labour-cost advantages. The newly industrialized countries are likely to continue to be a major competitive factor in consumer electronics and metal fabricating as well as in standard-technology indus-

tries and continue as export markets for capital goods and high technologies. Some have already shifted into heavy manufacturing and higher technologies (e.g., automobiles, shipbuilding). The power of OPEC is likely to be felt primarily in international money markets, possibly generating concerns about ownership in strategic industries. The emergence of some OPEC countries in petro-chemicals will have some impact on world markets, influenced by the extent to which new industrial complexes are oriented to serve growing demand in developing country markets. The USSR and China are unlikely to become more important in world trade for some time nor are there likely to be major shifts in East-West trading patterns except in some limited commodity areas (e.g., natural gas for the USSR and oil and consumer goods for China as exporters, and wheat as importers).

Over the rest of the century there will continue to be concern over the supply of economically available energy and natural resources. The uncertainties in the energy market are likely to continue to be focussed on OPEC but the emerging results of research and development into new forms of energy and the industrial application of energy-saving technologies suggest that another petroleum price shock is not likely. The rapid development of new materials and their widespread application will begin to put increasing pressures on some traditional resource products as the decade unfolds. Fibre optics, for example, will increasingly replace copper in communications equipment. Carbon fibres may replace many applications of steel. At the same time, LDCs will assume an increasingly important role in the supply of traditional industrial raw materials, such as iron, manganese, and coal.

The continuing increase in world population (expected to reach 8 billion by the end of the century) will put an increasing burden on world requirements for food proteins. North America should continue its dominant role as the world's bread basket, but the potential of Latin America will need increasingly to be tapped with Brazil, already a major agricultural producer, likely to emerge as the second largest exporter (e.g., soya beans, beef) after the USA. Food aid is becoming of increasing strategic importance in North-South relations. The enlargement of the EC with the inclusion of Spain and Portugal will put further strains on the mechanisms of the Common Agricultural Policy and is likely to increase subsidized exports from the Community.

Regional Trading Blocs

The development and enlargement of economic and political regional blocs was one of the principal developments of the 1960s and 1970s. Their development was reflected in the formation of various regional, political or consultative organizations which were often supplemented by regional trading arrangements. The motivations for developing these arrangements varied in both political and economic terms, but the common feature of regional trading arrangements is the provision of either preferential or free trade among the contracting parties. The result, of course, in most instances is discrimination against those countries which are on the outside.

This process has nowhere reached the level of sophistication achieved in Europe. The EC and its many associates now incorporate all of Western Europe. Greece

became the latest full member of the European Communities on January 1, 1981. The EFTA countries each have trade agreements with the EC providing for duty-free trade in non-agricultural products. Nevertheless, these countries continue to rely to a substantial extent on the rules of GATT for the conduct of their bilateral trade relations. Added to this is the Lomé Convention which provides special trade and aid links between the EC and former colonial dependencies of member states, as well as preferential trade agreements with countries such as Spain. Elsewhere in the world ASEAN (South-East Asia); COMECON (Eastern Europe); CARICOM (the Caribbean); and LAIA (South America) all attest to the tendency towards increased regionalism.

A provision for regional integration was built into the GATT from the very beginning. Its subsequent application, however, undermined to some extent the MFN nature of the post-war trade and payments system. For the first twenty years of GATT's existence, the political and security benefits of European integration for the USA, Canada, and other major non-European trading nations outweighed the disadvantage of chanelling an increasing amount of world trade into non-MFN channels. Furthermore, having encouraged European integration and tacitly accepted it, the major trading nations found it difficult to criticize regionalism outside Europe or the ever-widening set of ties grafted onto the original customs union of the Six. Now, however, when MFN trade constitutes less than half of world trade, serious questions are being raised.

The importance of this development for Canada is the increasing proportion of world trade which takes place within regional trade blocs and the fact that Canada does not participate in any of them. The increased importance of regional trading blocs has also led to the development of a multilateral trading order based on three principal trading entities: the USA, EC, and Japan. There is little influence that Canada can bring to bear one way or the other on the development of regional institutional arrangements, since the process essentially relates to relationships between third parties. It has been Canadian practice to ensure, to the limited extent possible, that these arrangements are consistent with the international trade rules laid down for such agreements, as embodied in the GATT. In this context Canada has engaged actively in negotiations with the EC and others, and received compensation for some of the trade effects on Canada of European integration.

CHAPTER VIII

MANAGING OUR TRADING RELATIONSHIPS

For a small country surrounded by larger countries and heavily dependent on trade with one of them, foreign policy should, in major part, be trade relations policy. Of course, other policy issues are also vital to Canadians, but if a small country dissipates its foreign policy bargaining power on issues that concern it primarily as a member of the international community, it might not have the resources, the credibility, or the leverage to protect its trade policy interests.

Rodney Grey, former Canadian
Ambassador to the Tokyo Round
Multilateral Trade Negotiations

Interdependence and Foreign Policy

The western economies today are more integrated and interdependent than ever before. This growth of interdependence has caused economic issues to assume an increasingly prominent role in the foreign policies of most industrialized countries. This has been particularly true of those "middle-level" industrialized countries which do not have the same range of strategic and other global interests as, for example, the USA, UK, or France, but who nonetheless must pursue broad foreign policies and are vitally dependent on access to larger markets.

Current levels of interdependence arise not only from increased trade in goods and services, but also from increasing international flows of investment, technology, and human resources. Economic interdependence among OECD countries is complemented by the continued economic links between the developing countries and the industrialized world, and by sensitive economic links between East and West. The political dependence of southern colonies on the metropolitan powers in the immediate post-war years has been replaced by more sophisticated and pervasive economic ties. The economic isolation of East from West also evolved into a sort of quasi-interdependence during the past decade — the Polish crisis has highlighted this fact.

The economic component of many industrialized countries' foreign policy has also become more important due to the trend towards an increased role by many governments in managing and participating in the economy. This action by governments is taking place at the same time as interdependence is growing. Thus, to a certain extent, the increased focus in most foreign policies on economic and trade questions represents an attempt by national governments to preserve their control over economic decision-making.

A further related factor which accounts for the rise of the economic component in the foreign policy of many countries is the growing requirement by many newly industrialized countries for state-to-state agreements covering important commercial transactions. The growth possibilities inherent in the NICs have pushed private enterprise to seek out government involvement in many of their transactions: without a government "umbrella", increased sales in many Third World countries would be extremely difficult.

It is clear that all economic actions, but especially those of the major powers,in some way affect the economic well-being of others. The making of US budgets is crucial to economic planning in Canada and Europe. European agricultural protectionism forces defensive action in Canada, Australia and the USA. Japanese technological breakthroughs make or break industrial developments in other countries. Canadian investment and energy policies and practices shape and are affected by business decisions in New York and Brussels. EC or US economic embargoes challenge Canada to follow suit or exploit new opportunities. In an interdependent world no one is strong enough or independent enough to ignore the reactions of neighbours.

It can be argued that the combination of interdependence and the enlarged role of government weakens national management and interferes with a nation's capacity to manage its own economy. Interdependence thus poses a challenge and underlines the need for a foreign policy approach which assists in the complex management of Canada's economic interests in an interdependent world.

The Trade Component of Canadian Foreign Policy

Foreign policy is the end product of an integration and balancing of the range of Canadian interests after the international environment in which these interests are pursued has been taken into account. In this balancing process, particular weight must be given to those elements of Canadian foreign policy which support the goal of economic growth. Attention must be given to actions which put these interests into jeopardy and to opportunities for expansion. At the same time, it is clear that Canada — like other countries — cannot pursue a one-dimensional foreign policy and that from time to time serious security, human rights and other considerations may assert their own primacy.

Expansion of trade and in particular the growth of Canadian exports is basic to economic growth and the achievement of a whole range of national objectives. It is important that Canada's foreign policy develop close relationships with those countries which are most important to Canada's economic development and which offer the best opportunities for long-term markets for Canadian exports. Canadian foreign policy must aim at building the appropriate frameworks for cooperation with these countries through which our trade, economic and other goals can be pursued. This requires the deployment of a variety of foreign policy instruments in support of the goal of the economic growth of Canada.

As a country with limited leverage, Canada has a disproportionate stake in the preservation of a strong and balanced international system governing trade and

financial flows. To safeguard these systems, priority attention must, therefore, be given to the nurturing and strengthening of multilateral institutions, notably the GATT and the IMF.

The need to pursue economic growth through trade as the government's first priority in the conduct of its foreign policy was recognized when early in 1982 the Prime Minister announced the reorganization of a number of government departments. The Prime Minister stated:

> The Government is transferring responsibility for all aspects of trade to a radically restructured Department of External Affairs. Trade and economic matters will be a primary focus of the new department. This will result in a greater priority on trade objectives in the conduct of our international relations, give greater emphasis to the international marketing of resources and services, and strengthen Canada's ability to adapt to changing world economic conditions.

The Framework for Managing Relations

Growing interdependence between states has meant that realization of domestic priorities and objectives for many countries is becoming more and more closely related to constraints and opportunities flowing from the international economic environment. Those countries which have been most successful in dealing with these complexities have demonstrated an ability to define their national interests clearly and to bring a large measure of coordination to their domestic and foreign policies. This has required a clear sense of direction and an understanding of where and by what means their interests should be pursued. It has also required the development of priorities in the use of scarce financial and human resources and, in terms of bilateral relationships, an understanding of which countries are most important to their interests. It requires a long-term and coherent approach to the cultivation of bilateral relationships. One of the challenges will be to develop forms of bilateral cooperation which do not lessen the role and importance of multilateral frameworks on which Canada is so dependent. Indeed, it should prove possible to strengthen multilateral cooperation through bilateral ties.

In the post-war era, the conduct of international economic relations has had a predominantly *multilateral* flavour, highlighted in recent years by the Tokyo Round of multilateral trade negotiations and the North-South dialogue. The Tokyo Round, for example, represented the most comprehensive and ambitious attempt yet, both as to coverage and the number of countries involved, to reach common agreement on the shape of the international trading framework. Despite their wide scope, however, much remains to be done. The international economic environment will thus continue to be shaped in the 1980s by what governments decide collectively to do as a result of the continuous give and take of multilateral discussions and negotiation.

Difficulties in the world economic situation have inspired various international meetings in recent years to grapple with the pressures on the multilateral trade and payments system. The focus on trade culminated in the meeting of GATT Ministers in Geneva at the end of November, 1982 and the establishment of a work programme aimed at addressing some of the pressures on the world trading system. The

decision to hold the 1982 meeting of the GATT Contracting Parties at Ministerial level grew out of an awareness that the time had come to provide new impetus to work in the GATT, and elsewhere, to deal with the trade problems of the 1980s.

Both the detailed preparations and the Ministerial meeting itself underlined the common perception of the need for a forward-looking trade agenda. The meeting did not inaugurate a major round of trade negotiations similar to the Tokyo or Kennedy Rounds, but rather provided an opportunity for Ministers to provide much needed political endorsement of the multilateral trading order and set in train a work programme to enlarge and solidify international trading discipline and trade liberalization.

We have now embarked on a second cycle of summits, with Canadian participation firmly established. While originally envisaged as a single event, summits have developed a semi-permanent character and are likely to remain part of the scene in the 1980s. Summits have proven their value in the management of the international trade and payments system. Both the summits themselves and the meetings of senior officials preparatory to them have provided a helpful, unstructured and informal basis for the seven major industrialized economies (as well as the Commission of the EC) to compare notes and work towards common solutions to the major economic problems faced by these countries. Because there is no permanent Secretariat and the host country assumes responsibility for organizing and preparing each session, Summits have retained the spontaneity of a unique annual event where leaders and their principal economic ministers can freely speak their minds. It is particularly important for the four European participants who at other international meetings frequently find their views diluted in order to maintain EC solidarity or because the Commission is responsible for advancing the interests of the EC as a whole. Summits have provided the seven major industrialized countries an opportunity to cooperate in providing economic leadership while at the same time avoiding stage-managing the affairs of the GATT, IMF, and OECD.

The developing countries do not participate in either the Summit or the OECD, are not fully integrated into the GATT, and do not perceive the GATT as being fully responsive to their needs, although they do attach considerable importance to the GATT. At the same time, industrialized countries are not prepared to concede that UNCTAD provides an appropriate forum for resolving many of the problems in the international trading system. Pressure therefore builds up periodically for a single negotiating conference to deal with a host of international economic problems from a North-South perspective. The initial meeting in 1964 of the United Nations Conference on Trade and Development, UNCTAD, was a response to such pressures. The 1976 Conference on International Economic Cooperation (CIEC) was a further response. In the past two to three years developing countries have sought a mandate in the United Nations General Assembly for "Global Negotiations". Preparatory work continues in the UN for such an initiative and while it is agreed in principle that there should be "global negotiations", their start is blocked by lack of agreement on the scope, mandate, and agenda for such negotiations. Should these negotiations eventually get underway, they could have an important bearing on the management of the international trade agenda. It is to be hoped that they will not duplicate

ongoing work elsewhere. For Canada, from a trade policy perspective, a main objective in any such negotiations will be to preserve the integrity of the open global trading system as well as the effectiveness of the institutions which serve it.

Trade is, of course, conducted on a *bilateral* basis. While the accent has been on multilateral events and issues, the development of bilateral ties thus remains crucial to Canada's economic well-being. The contractual framework for most of Canada's bilateral trade relations is, in the first instance, provided by the GATT, underlining the importance of the multilateral dimension. The bilateral dimension, however, requires careful management, especially the day-to-day management of the lively range of issues between Canada and its principal trading partners.

In recent years, particular emphasis has been placed upon developing bilateral mechanisms and consultative relationships which better respond to the complexity of contemporary economic interests. This aims at cooperation across the economic spectrum, reinforced by more highly managed political and cultural relations, in the fields of production, research and development, energy, agriculture, natural resources, as well as joint marketing arrangements and trade. The wide variety of countries with which Canada has and needs close economic relations dictates a different approach, depending in part, for example, upon the different mix of government and private enterprise involvement in the country concerned. The increasing trend towards regional trading blocs poses a particular challenge for Canada, especially given our small domestic market. The significant scope and complexity of relations with the United States overwhelmingly influence the options and prospects for Canadian trade policy. Different techniques and cooperative arrangements are in place with Japan and the European Community. Highly formalized government to government agreements and consultative mechanisms are critical to successful economic penetration of some developing and state-trading nations. The selection of the right instrument and of the most effective approach will vary but there is above all a need for balance, realism and coherence in the management of Canadian trading relationships. The significance of the trade component of our foreign policy is thus certain to grow in the decades ahead.

Trade with the United States, the European Economic Community and Japan accounts for approximately 85 percent of all Canadian trade. It is, therefore, these three trading relationships which must be regarded as fundamental. This is not to suggest that trade with other countries is unimportant. Indeed, this trade amounted to some 29 billion dollars in 1981. Nonetheless, this trade occurs with a diverse range of countries and the impact of even a sizeable change in our trading relationship with any one of these is clearly of a much lesser order of magnitude. Tables 25 to 29 illustrate the relative importance of Canada's leading trading partners.

The United States

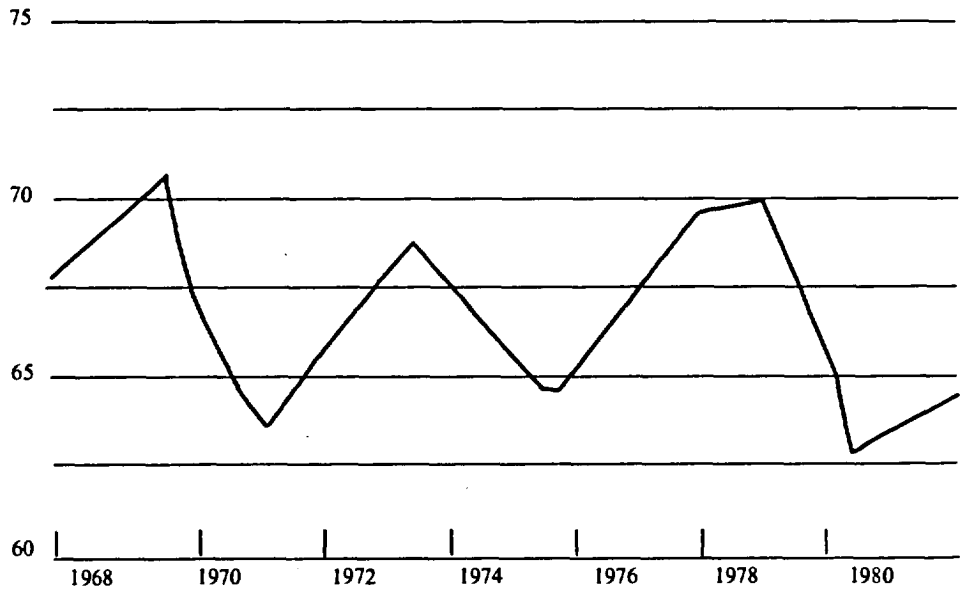
Canada's economic well-being is dominated by its bilateral relationship with the United States. In 1981 two-way trade totalled some $110 billion, a 14 percent increase over 1980. The USA accounted for 66 percent of our exports and 69 percent of our imports and is thus by far our most important trading partner. Canada

accounted for 17 percent of US exports and 18 percent of its imports and remains the US's most important trading partner. In the 1970s our trade with the USA fluctuated between 63 percent (1980) and 70 percent (1978) of our total exports. For the remainder of the 1980s this proportion is unlikely to change appreciably.

TABLE 25

CANADIAN EXPORTS TO UNITED STATES

Percentage of total merchandise exports



Source: Statistics Canada; The Conference Board of Canada

The leading Canadian exports to the USA currently are passenger autos and chassis; natural gas; newsprint and other paper; motor vehicle parts, except engines; trucks, truck tractors and chassis; crude petroleum; petrochemicals and hydro-carbon products; pulp; softwood lumber; and precious metals. The top US exports to Canada are motor vehicle parts; passenger autos and chassis; electronic computers; motor vehicle engines; trucks, truck tractors, and chassis; crude petroleum; aircraft; precious metals; coal; and other metals in ores and concentrates. (Tables 28 and 29).

Two-way investment ties constitute an important dimension of the relationship. US interests have an estimated $50 billion (end of 1981) in direct investment in Canada. Canadians have about $16 billion (end of 1981) in direct investment in the USA. This Canadian investment, which is largely in non-industrial sectors (real estate, mineral leases and banking), has less effect on trade than US investment in Canada which is concentrated in manufacturing and resources. Canadian investment in the USA also has nowhere near the same impact politically or economically as American investment in Canada, given the difference in size between the two economies.

Canada has traditionally had a favourable merchandise trade balance with the USA but this has been more than offset by large (and growing) deficits in service transactions, reflecting mainly interest and dividends, tourism, and royalties. The overall deficits on current account have in turn traditionally been offset in part by surpluses on long-term capital transactions. However, this situation changed markedly in 1981, when long-term capital outflows exceeded inflows, primarily as a result of take-over activity in the energy sector.

The Tokyo Round tariff cuts should result in substantial increases in bilateral trade and will open up new opportunities. One of the most important features of our trade with the USA is that, unlike our trade with the EC and Japan, it contains proportionally far more end-products, constituting most of the value-added in our total exports. With US tariffs on dutiable manufactured goods at almost half the Canadian level after the Tokyo Round cuts are fully phased in, we should be in a good position to expand this value-added. The challenge for Canadians will be to identify and exploit as many of these opportunities as possible while not diminishing our support for traditional exports. Canada will continue to enjoy the advantages of similar business practices, transportation, language, culture and corporate interconnections.

The implementation of the Tokyo Round non-tariff measures agreements will also open up opportunities and should make our access to the US market more secure by clarifying the rules and facilitating dispute settlement. We will have to ensure the adequacy of dispute settlement, which is especially important to the successful management of Canada-US trade relations. The Agreement on Customs Valuation has eliminated the American Selling Price, Final List, and other troublesome US methods of customs valuation. A bilateral understanding to manage the effect on each other of safeguard measures is currently being discussed. The Agreement on Trade in Civil Aircraft has broadened Canadian sales opportunities in the USA. The Government Procurement Code and its possible expansion after 1984 should also provide significant new trade opportunities in the USA. Our efforts to exploit these opportunities will have to be reconciled with domestic pressures to increase procurement from Canadian sources.

An important issue for Canada in the 1980s will be the extent to which the USA will, in response to our industrial and regional development policies, use countervail to limit our market access for specific products or sectors. On EC steel and New Zealand and Australian agricultural products, US definitions of subsidy and interpretations of injury have been extremely broad. On the other hand, the GATT subsidies/countervail agreement should considerably lessen the prospects of adverse findings against the products of Canadian industries benefitting from government assistance as the USA now requires an injury finding. This requirement resulted in the USA removing all of the countervailing duties it had previously imposed against Canadian products. Also, while Canadian lumber, potato and fisheries exports have lately been the object of protectionist pressures in the USA, the Administration has generally responded to them in a reasonably circumspect manner. It will be important throughout the 1980s to monitor US practice and jurisprudence in the area of countervail and continue our efforts, both bilaterally and in the GATT, to circumscribe the extent to which US countervailing duties can frustrate our industrial and regional development policies.

Political and economic changes taking place domestically in the USA could have great impact on US trade policy toward, and trade patterns with, Canada. The economic growth centres in the USA are shifting southwards and westwards to the Sun Belt, away from the north and northeast, which has long been the primary region for Canadian trade. This trend is likely to persist through the 1980s. Indeed, the results of the Tokyo Round should accelerate these shifts. The US "smokestack" industries are in decline, their competitiveness in world markets for products such as automobiles and steel having eroded to the point where it is unlikely to be restored quickly to former levels, at least not in the 1980s. At the same time, US high-technology industries, particularly computers, electronics and informatics, are growing at an enormous rate. Where we are closely tied to the Americans, both in traditional and new industries, we will tend generally to share US fortunes or misfortunes on world markets. The effects on bilateral trade will also be significant if import penetration from third countries remains high.

On the Canadian side, the pattern of trade with the USA reflects the regionalized character of Canada. The real trade interests of the provinces in the USA are reflected in the 1980 summary of shipments by region to the USA. Of the total of $46.7 billion, the origins were as follows: Atlantic $2, Québec $8.6, Ontario $21.8, Prairie Provinces $9.9 and Pacific $4.4. Historical attitudes towards freer trade with the USA continue to prevail with opinion in the Atlantic provinces and the West generally being more positive than in Ontario and Québec towards early and relatively comprehensive lowering of tariff and non-tariff barriers between the two countries. It is primarily in Ontario and Québec where the effects of US demographic shifts and economic restructuring would be most strongly felt.

Automotive products currently account for a quarter of Canada-US trade, a proportion that may decrease over the course of the decade. Little progress is likely to be made in renegotiating the Auto-Pact to take account of the imbalance in auto parts trade unless Canada is prepared to make sizeable concessions. Where the degree of Canada-US interdependence is less, e.g., steel, we will tend to do better or worse depending on the competitiveness of the Canadian industry in question, although even in this sector we can expect to encounter impediments in exporting to the USA because of some corporate, "America-first" policies in sourcing. There is, however, scope for joint governmental efforts to encourage reduced third country sourcing by major North American automobile manufacturers.

At the same time, interdependence and diminishing tariffs inevitably mean increased exports to the USA and spin-offs to third country markets where we are linked to dynamic US industries. One of the most dynamic, at least through the middle of the decade and probably beyond, will be the defence industry, given current and forecast US defence budgets. Through the Canada-US Defence Development and Defence/Production Sharing Arrangements (DD/DPSA) and intra-corporate relationships, Canada is well positioned to export components, and increasingly also complete systems, to the US market. Nonetheless, our preferential access has been eroding in recent years, the USA having concluded arrangements similar to the DD/DPSA with other allies. Congress has also passed a number of restrictive measures that have had the effect of reducing the access we formerly enjoyed.

The trade policy challenge in this sector will be to maintain our current high degree of access under the DD/DPSA, which as an executive agreement and not a treaty is vulnerable to override by Congressionally-inspired protectionist measures. The trade promotion challenge will be to exploit the many individual opportunities that will be opening up. Canada has traditionally supplied conventional products for the most part, but our manufacture of guidance systems for cruise missiles and the USA's positive response to our efforts to enter the military space market are examples of the potential for expansion into new areas.

Surface transportation (apart from automotive products) is an instance of an industry where interdependence is also high, but where Canada has the competitive edge. In 1978 the US Surface Transportation Assistance Act imposed Buy American preferences in this sector. A major goal of any Canadian trade strategy for the 1980s must be to improve our access to the US market for our mass transit products. The attempts to arrive at a bilateral arrangement with the USA have not so far borne fruit, notwithstanding our emphasis on the high proportion of US componentry in Canadian products, and prospects for success now seem best through expansion of the GATT Government Procurement Code. The problems engendered by the Bombardier sale to New York afford a good example of the need to reach a better understanding on cross-border trade in the urban transportation sector. The same would also appear to be true of the communications and heavy electrical generating equipment sectors. Should multilateral negotiations not result in adequate coverage of these sectors, the possibility of a supplementary agreement on a bilateral basis could be re-examined.

During the Tokyo Round, Canada had also sought to improve access to the US market for petrochemicals. The US industry continues to take a protectionist stance. This situation and current bilateral differences in the energy area would appear to preclude agreement on greater access at least in the short term. In the longer term, however, this sector continues to be a leading candidate for cross-border sectoral cooperation.

The sheer volume of cross-border trade almost guarantees that at the best of times the bilateral trade agenda will include a variety of irritants of one sort or another. This is the more so since trade actions taken by either Canada or the USA can have a far greater impact on the other than on third countries, even when originally directed at third countries. The high proportion of US-owned or controlled companies in Canada also exposes us far more than other nations to US assertions of extraterritorial jurisdiction. In the other direction, Canadian regional and industrial development policies affect mostly American interests.

The USA is no longer preeminent economically in the way it was in the first two post-war decades. At the same time, international trade is becoming increasingly important for the USA; the proportion of US GNP exported abroad has doubled in the last decade and is likely to continue to rise. Increased competition between Canada and the USA in some third markets will be one of the results. All these factors taken together will inform American trade policy-making towards Canada throughout the decade and beyond, regardless of the Administration in office.

World-wide, the USA will be seeking major adjustments to the trading system embodied in the GATT. Its policy thrusts for the 1980s include:

- liberalization of agricultural trade, bringing it under disciplines comparable to those governing industrial trade;
- removal of barriers to exports of high-technology products;
- improved international discipline governing trade in services;
- removal of barriers to investment and of investment-related trade distortions;
- improved multilateral discipline covering resort to safeguard measures; and,
- greater incorporation of the developing countries, particularly the NICs, into the GATT system.

We share most of these goals.

It is in the area of trade-related investment issues and investment, as such, that our respective policies are likely to remain in conflict throughout the 1980s and beyond, reflecting as they do divergent national interests. The Canadian goal of promoting greater Canadian ownership in particular sectors will continue to conflict with US interests. The Reagan Administration sees a direct relationship between US foreign investment and exports. The USA has calculated that, in trade in manufactured goods, its foreign direct investment generates two times more exports than imports. US direct investment abroad was approximately $213 billion at the end of 1980, compared to $65 billion of foreign investment in the USA. As the largest capital exporter in the world and host for a comparatively small amount of foreign capital, given the size of its economy, the USA has long been strongly committed to the freest possible capital flows. Approximately one-third of total US exports are to US affiliated companies abroad. About 40 percent of US manufactured exports represent sales to US affiliates abroad. US trade policy-makers have also calculated that 75 percent of its exports to the 300 largest companies in Canada are destined to the subsidiaries of US firms.

All these calculations lie behind the USA's definition of its national interest and of its trade policy objectives. These the USA sees in terms of the principle of national treatment for foreign investors, while paradoxically exercising extra-territorial jurisdiction over US subsidiaries abroad. The deliberate extra-territorial application of US law to US subsidiaries abroad to bolster US sanctions directed against the Soviet oil and gas sector is a case in point. There is also a tendency to see US investors as having a right of establishment abroad which, if infringed, is subject to retaliation.

Historically, Congress has played a major role in the making of US trade policy. The Danforth bill, embodying narrowly defined concepts of bilateral and sectoral reciprocity and the right to unilateral definition and action, represents the most recent attempt by Congress to impose US interests on the international community.

n the sense that each participant in trade negotiations seeks an overall balance ıetween what it gives and what it receives, reciprocity has always been an accepted ıart of the international trading system. The Congressional concept tends to be far ıarrower, however, being more country-by-country and sector-by-sector, not only in ;oods but in services and investment as well. Carried to an extreme, such an ıpproach would have serious implications, not only for our bilateral relations, but for he principle of most-favoured-nation treatment on which the international trading ıystem is largely based. Other nations share Canada's concern.

It is difficult to predict to what length the USA will ultimately carry this notion ɔf reciprocal treatment or to what extent the Administration may be prepared to retaliate against other countries for their failure to provide what it considers to be ıatisfactory access for US goods, services and investment. A great deal will obviously depend on the overall economic situation and the pressures brought to bear by domestic interests. In difficult economic times the Administration (and the Congress even more so) is particularly sensitive to the views of the US business community.

The management of the Canada-US relationship, of course, deals with more than bilateral irritants. Billions of dollars of trade flows without any problems being brought to the attention of either government. There are also matters of mutual advantage. There is the possibility, for example, of further expanding our cross-border trade, either on a general or a sectoral basis or in the context of working out solutions to specific problems. Greater emphasis will undoubtedly have to be placed on identifying such areas and following up the opportunities provided. Such activity will confirm that we are interested in managing our relationship in a positive sense rather than dealing with one another only where irritants arise. The same applies to the multilateral side. Since the war, we have shared the same interest in strengthening the international trading system and are continuing to work together toward many of the same objectives. There are other areas where we have been similarily affected by the policies of others and have cooperated in seeking appropriate solutions. Finally, issues are continually resolved to each others satisfaction, such as the cross-border trucking issue.

In its report of March, 1982 on *Canada's Trade Relations with the United States*, the Senate Standing Committee on Foreign Affairs suggested that our economic development would be advanced through the conclusion of a comprehensive and preferential free-trade agreement between the two countries. This idea has been raised on a number of occasions in the past, most notably in the US Trade Agreements Act of 1979 which required the President to report to Congress by August, 1981, on the possibility of such agreements with countries of the "northern portion of the Western Hemisphere". The President's report did not make any recommendations as to how this might be pursued nor did it suggest that such an agreement was either desirable or imminent at this stage. For a number of reasons, the proposal poses even more difficulty for Canada, at least in the foreseeable future. The fact that it has been put forward on both sides of the border, however, implies a recognition that the two countries share many interests and that there remain opportunities for cooperation to be explored. Furthermore, it denotes an interest on both sides of the border to emphasize the more positive elements and opportunities in the relationship.

The reasons adduced by various proponents of the free-trade option include the following:

- Much of Canadian manufacturing industry is not competitive internationally, having developed behind a protective tariff. Greater efficiency can be achieved through rationalization but the domestic market alone is too small to allow for such rationalization and the realization of available economies of scale.

- The United States is Canada's natural market for manufactured goods (as well as for many resources and agricultural items). Free trade between Canada and the United States would provide a large enough market and a necessary competitive stimulus for Canadian industry; it could thus induce greater efficiency, higher earnings and living standards for Canadians.

- The dislocation costs of free trade would be reduced by phasing in tariff reductions over an extended period. It may not be necessary to include agricultural items in a free-trade arrangement. The floating exchange rate would tend to cushion the adverse short-term impact of free-trade on the Canadian manufacturing sector and to reduce the risk of a major bilateral balance-of-payments deficit for Canada.

Opponents of bilateral free trade would, on the other hand, argue that adjustment costs would outweigh any short-term advantages and that the longer term gains for Canada predicted by international trade theory would not be realized in a Canada-US context for the following reasons:

- Canadian manufacturing industries enjoy few comparative advantages vis-à-vis the United States. Consequently, the removal of tariffs would simply lead to the replacement over time of Canadian manufacturing production by American. Canadian labour (and other factors) released from manufacturing would be drawn into the resources and services sector, would seek to emigrate or, most probably, would swell the ranks of the unemployed.

- Heavy US ownership in Canadian industry would, through the operation of "board room prejudices", tend to result in Canadian production being relocated in the United States even in those instances where Canadian production costs were lower.

- The exchange rate cannot be counted on as a regulator of relative competitiveness and location advantages between Canada and United States in the manufacturing sector. There are simply too many influences on the exchange rate.

- The structure of the Canadian economy following free trade would be less beneficial in terms of the future development of Canada. A strengthening of the resource sector at the expense of manufacturing might yield higher income but would stultify efforts to foster the indigenous technology and R & D capability necessary for Canada's longer term success as an industrial society.

Many Canadians, including a number of those who would accept the validity of the economic case for free trade, would reject a Canada-US free-trade agreement on the grounds that the process of managing the North American economy would lead inevitably to the formation of common institutions. Given its relative economic weight, the United States would tend to dominate these institutions. Canada's political sovereignty would, over time, be eroded. Proponents of bilateral free trade would note that the Canadian economy is already closely integrated with that of the United States and that inter-dependence is likely to increase in future whether or not governments seek to modify the institutional and legal aspects of the bilateral trading environment. The Canadian economy will, they argue, become increasingly more vulnerable to US policies and that arrangements to reduce the dangers of changes in such policies to Canadian exports would be to Canada's advantage.

A decision to negotiate a free-trade arrangement with the United States would constitute a major political undertaking by any Canadian government. Such a decision would obviously require the federal government's taking into consideration the views of all elements of Canadian society including the provincial governments. An important political step of this type would evidently have to be based on a sound assessment of the economic and political impact of free trade on the Canadian economy. The economic issues which would need to be examined in this context would include:

- productivity in and competitiveness of the Canadian manufacturing, resource, and agricultural industries;
- the effects of free trade (involving removal of tariffs and, where appropriate, NTBs) on prices, costs, employment, investment location and industrial structure;
- the consistency of free trade with Canada's economic objectives and programmes (e.g., government support for R&D, regional development and the extent to which free trade would necessitate the harmonization of Canadian and US policies and laws in such matters as regional development, taxation, competition, and industrial incentives);
- the consistency of any free-trade arrangement with trade policy objectives in offshore markets;
- US goals and objectives and the desirability and practicability of including Mexico in any free-trade association with the United States;
- the status of agriculture in any free-trade arrangement;
- institutional implications of free trade for Canada including the need for joint agencies to manage the association;
- the need for and nature of safeguard provisions; and
- the security of any free-trade arrangement in terms of the US legislative process; the risks of Congressionally initiated amendments or abrogation.

The free-trade option has been a contentious issue throughout Canada's history, due less to economic considerations than to issues of sovereignty and self-determination. The evidence to date of the need to proceed is not convincing, nor does a call for free trade command broad support. Most assessments tend to highlight the economic advantages for Canada without taking full account of the costs or consequences both policical and economic. It remains, however, an option and may garner broader support at some point in the future if changed circumstances lead to different attitudes. Many of the arguments favouring freer trade may be satisfied, however, by entering, gradually, into bilateral agreements to resolve particular issues of the type presented by US restrictions of Canadian sales of urban mass transit equipment and US tariffs on Canadian exports of petro-chemicals. Free trade with the United States on such a limited, sectoral basis would not raise the more difficult issues posed by the full free-trade option and would be consistent with the gradual movement by successive Canadian governments towards freer trade. Proceeding on such a basis need not necessarily be limited to Canada and the United States, but could include other interested countries.

Sectoral free trade is not a new idea (e.g., the Auto Pact), and the expansion of this concept may offer the most promising prospects for expanding Canada-US trade and for improving the economic base of a number of Canadian industries. In a number of sectors (e.g., textiles, urban transportation, petrochemicals) there is significant scope for furthering the rationalization within North America on which the private sector has already embarked but which is now inhibited by trade barriers on both sides of the border. An exploration of the possibilities for limited, sectoral free trade should thus identify ways and means to promote reciprocal trade expansion, to increase the efficiency of national industrial structures and to enhance regional economic prospects. It may also prove one way of meeting the shared problem of how to meet the competition from third countries and to slow down the exodus of production facilities from North America. A full examination needs, of course, to take careful account of the views of the private sector and the provinces, as well as an assessment of the likely US reaction.

Because we rely heavily on the US market for our economic well-being and because there are vast intra-corporate links, there is great sensitivity about any policies or practices which threaten the existing pattern. Yet, there are pulls in the opposite direction, and they are not related solely to sovereignty. Because we deal so heavily with the USA, our companies are inclined instinctively to look south first and *not* to look elsewhere. Thus the ease and familiarity of doing business in North America can become a liability preventing efforts to exploit prospects elsewhere. If the US market is indeed shrinking, this could become a real threat in the future. For that reason, efforts which emphasize market diversification will continue to command serious attention.

The two approaches are not mutually incompatible but rather represent two different emphases in a continuum stretching from continental integration to deliberate differentiation. The attraction of greater cooperation is that it recognizes the realities of geography and economics. The respective private sectors are already largely integrated; trade runs more easily north-south than east-west; and the US market is not greatly different from the Canadian market. Yet continentalism runs counter to

the drift of Canadian history — from the National Policy to the Third Option, Canada has evolved as a separate and different nation because its people wanted to be Canadians and wanted to build on traditional ties with Europe and our window on the Pacific. Thus there will always be tension between economic and political realities and ideals. That tension is what challenges the conduct of Canada-US relations in the 1980s — as it has in every decade in Canada's history.

The 1980s do not promise to be the best of times. The need for careful management will, therefore, be that much greater, containing the irritants and building on areas of cooperation. Canadian objectives in the Canada-US trade relationship in the 1980s can be described as follows:

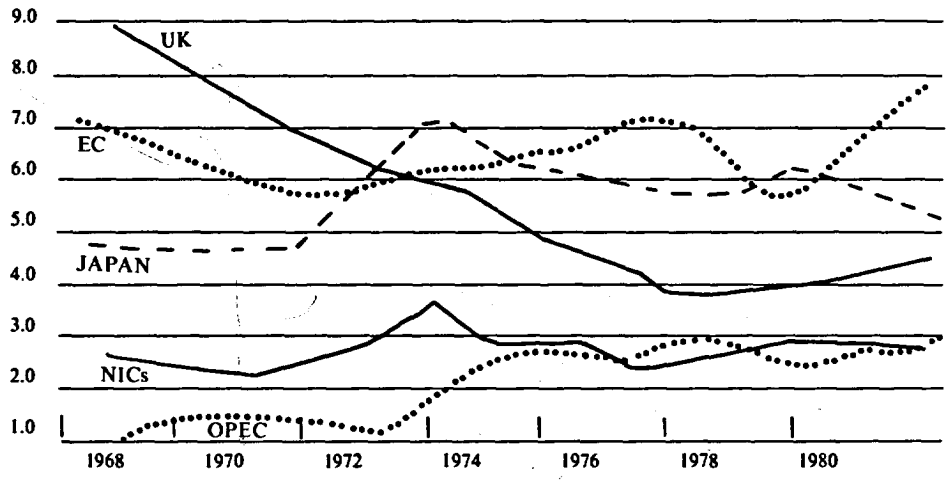
- working with Canadian industries to exploit trade opportunities in the USA, particularly those created by the results of the Tokyo Round;
- preserving security of access to the US market by vigorously opposing protectionist policies and working to ensure that the system of contingency protection is applied in accordance with international rules;
- pursuing opportunities for working out additional bilateral arrangements in particular areas to enhance Canada's export potential to the US and/or third markets;
- identifying and pursuing possibilities for increased cooperation with the Americans in the development of the international trading system, while at the same time safeguarding our position where our interests conflict, particularly on investment and ownership;
- containing irritants and resolving disputes arising from trade actions on both sides of the border while attempting, as in the past, to avoid linkages between unrelated issues;
- influencing the Canadian industrial policy-making process by assessing and factoring into domestic calculations international, particularly US, considerations; and
- both explaining Canadian political, economic and cultural realities and the process of change under way here, and defending Canadian economic policies and practices to influential US circles, including business and the media.

The task of managing the Canada-US trade relationship is fundamental to Canada's economic well-being and to relations with our other trading partners. While good relations with the USA is not an end in itself, a comfortable, basic relationship is an essential element of Canadian foreign policy. A comfortable relationship, however, does not necessarily mean the absence of conflict or an identity of views on all issues. Canadian views and approaches, while basically in harmony with US objectives, will continue to differ depending on circumstances and the national interest. It does mean that relations will be conducted in a spirit of cooperation, free of acrimony and confrontation.

TABLE 26

CANADA'S EXPORTS TO SELECTED AREAS, 1970-80

Percentage of Total Canadian Exports



Statistics Canada; The Conference Board of Canada

European Economic Community

The European Community is the world's largest trading entity and is a key player in international trade relations and in the GATT system. From its inception in 1957, the EC as a unit has participated actively in trade negotiations which have resulted in a considerable lowering of its external tariff on industrial goods. To a large extent, however, the EC is preoccupied by its own internal problems, in part resulting from enlargement and the management of its relations with its key trading partners in Europe and the Mediterranean area. Thus improving trade links with Europe poses a major challenge for Canadian foreign policy.

In 1981, the ten countries making up the European Community absorbed $8.8 billion or 10.8 percent of Canada's total exports. This represented only 2 percent of total EC imports. Accordingly, a dominant feature of the bilateral trade relationship is that it is more important to Canada than to the EC that the relationship be well managed.

The nature and prospects for our trade relations with the EC hinge on a number of factors which clearly distinguish Canada's economic links with Europe from those with the United States. These include:

- a significantly lower level of economic integration; most of Canada's trade with Europe is at arm's length as opposed to intra-corporate;
- even where corporate ties with Europe exist, distance and perhaps different market requirements prevent the type of rationalization in manufacturing that characterizes much of the intra-corporate trade between Canada and the United States; and

- transport costs are undoubtedly a deterrent in Canada-EC trade. However, they seem to have been significantly less influential in determining the pattern of Canadian exports than trade barriers which have protected European processing and manufacturing industries while facilitating entry of a high volume of unprocessed materials.

As a result, Canadian exports to the more distant EC market have tended to focus on items that move in bulk quantities and which require minimum investment in local sales and service efforts.

The perception of Canada as an economic partner varies as among Member States and in differing economic circumstances. For example, Canada will assume more importance as a resource supplier at a time of economic growth rather than during a recession. Nonetheless, European views of Canada may be summarized as follows:

- as a potential source of energy products. British, French, Dutch and Belgian interests have been involved in Alberta. West German and French companies are active in the Arctic;

- as an important and stable source of industrial materials. Because of past European investments and current close political links with many African countries, Western Europe will continue to look to Africa, and their Lomé partners generally, as a principal source of raw materials. However, European investments in mining in Canada are significant and political instability in Africa and in developing countries generally could encourage more intense European interest in Canada in an attempt to diversify its supply base;

- as a small but interesting market for manufactured goods;

- as a financial and technological partner in major industrial ventures (e.g., Airbus and nuclear reactors) where European governments and companies are seeking, through cooperative ventures, to meet US and Japanese challenges in world markets; and

- as a major agricultural producer, exporter and importer, Canada represents an important trading partner for the EC and competitor in world markets.

A wide variety of institutional arrangements are in place, both with the EC and with specific Member States. An agreement between Canada and the EC on Commercial and Economic Cooperation came into force in 1976. Semi-annual consultations provide a basis for regular dialogue at a senior level and for the resolution of bilateral disputes (e.g., access for seed potatoes to the Italian market). Separate consultative arrangements have been established with the UK, France, and, most recently, as a result of agreement between the Canadian Prime Minister and the German Chancellor, a special Management Team was created in Ottawa to facilitate progress on joint Canada-FRG economic projects and to foster greater awareness of the potential for broader economic cooperation.

There is a continuing belief that a more enhanced economic relationship with Europe should be pursued by Canada:

- to match the close political and security ties;
- to build on the significant foundation which exists;
- to blend longer term European requirements with Canadian supply capability (and development of plans and policies in Canada to sustain and expand our capacity for such supply);
- to provide an effective counterweight to our substantial dependence on economic relations with the USA; and
- to facilitate greater investment and technology exchanges both ways.

In the years ahead, the challenge for Canada vis-à-vis the EC will be to make the most of these objectives by making the EC more aware of Canada's potential as a partner in joint commercial and economic undertakings, despite an increasing tendency by the EC to project a regional rather than global political and economic orientation. The entry of Greece, Spain and Portugal into the Community will have a further impact on Canadian trade interests and will require negotiating efforts to preserve Canadian market access rights. It will be important to gauge carefully the manner in which Canadian resource, energy and investment policies, among others, can be tailored to advance our bilateral objective in Europe. We will also want to continue to implement and explore various techniques and instruments to stimulate more industrial cooperation, more business contact and generally a more mature economic partnership.

More specifically, the key issues in Canada's trading relationship with the Community in the 1980s can be summarized as follows:

Tariffs and other trade barriers — Canada has none of the special access arrangements with the EC that it has with the USA (Autopact, Defence Production) and our terms of access are largely determined by GATT agreements. In general, our access to the EC is better than to Japan, particularly in semi-manufactured and manufactured goods. Some major exports (e.g., asbestos and newsprint) face potential new problems of access in the 1980s because of environmental or economic measures in the EC. There is little chance of a significant improvement of Canada's general terms of access to the EC in the 1980s.

Resources and access — The EC wants access to Canadian resources ranging from energy (to diversify its sources of supply) to fish stocks. It has achieved, and wants to develop further, substantial markets in Canada, principally for manufactured products. On our side, we want to improve our access to Community markets and use the opportunities provided by trade to strengthen and diversify our economic base.

Industrial cooperation and investment — Industrial cooperation through joint ventures, technology exchanges, etc. provides a means whereby Canada can actively pursue closer economic links with the EC. This activity should generate two-way

trade. The 1976 Framework Agreement, and the institutional structures under it, are designed to facilitate industrial cooperation between the Canadian and EC private sectors. Although this activity has produced few tangible results to date in terms of joint ventures, the ongoing dialogue has led to some progress on issues such as standards where the EC has jurisdictional competence. The Community as such is not directly involved, financially, in European industries although it can certainly influence corporate behaviour through trade measures, e.g., steel. Member state governments, on the other hand, are involved as equity holders or creditors in key industrial sectors. The French government is a major participant in aerospace, computers, automotives, steel and shipbuilding, either as a shareholder or indirectly through ownership of the domestic banking system. Government involvement in industries is also high in Britain, Italy and Belgium. Although public financial participation in industry sectors of individual Member States provides the governments concerned with the means to intervene so as to facilitate cooperation with Canadian companies, the absence of such direct involvement does not preclude efforts on Canada's part to bring about cooperation between Canadian companies and those which are privately owned in European countries.

In the case of France, the Working Group on Industry and Agriculture provides a forum in which to discuss bilateral industrial cooperation. The Canada-FRG Management Team also serves this purpose with respect to cooperation with Germany. Canada's experience with industrial cooperation promoted through our offsets policy (the Leopard tank) or through direct government investment (the European Space Agency's L-SAT and potentially the Airbus A-320) can create corporate linkages and mutual knowledge of markets that have lasting consequences on trade. The NEP encourages joint ventures with up to 50 percent foreign participation in areas where European countries have special interests and capabilities.

Defence trade — Canada's defence trade is currently heavily based on the USA. There is scope for examining possible diversification towards Europe through new NATO initiatives of a general nature or through bilateral research and development agreements.

Fully manufactured exports — While there are problems, the European market holds considerable potential for higher value-added exports. For example, even as things stand, our exports of fully manufactured goods total 14.1 percent of our exports to the EC compared with 4 percent of our exports to Japan. The difficulties relate especially to tariff escalation on upgraded resources, and to the key role played by governments in purchases of transport and telecommunications equipment, two sectors where Canada is internationally competitive. Various efforts in the GATT are specifically aimed at reducing the impact of these factors.

Agriculture Trade — The EC is one of Canada's largest markets for agricultural products (15.8 percent of total wheat and 9.6 percent of barley shipments as well as oilseeds, tobacco and cheddar cheese). The Common Agricultural Policy (CAP) applies to nearly all of the Communities' agricultural production. Under this policy, returns to EC farmers are supported by a combination of levies on imports and internal support prices which are maintained as necessary by intervention buying with no quantitative limits on production. In addition, export refunds enable EC

exporters to sell on world markets when world prices are below EC price levels (as is generally the case). The CAP has probably achieved results beyond what was anticipated by its architects. For example, the EC is now a major exporter in a number of sectors (sugar, beef, poultry, grains). It is unlikely that any reforms of the CAP will result in a significant rollback in their position either on the export or domestic market for such products as grains, sugar, meat and dairy products. Accordingly, the CAP will remain the target for criticism by traditional agricultural exporters.

Fish — Managing fisheries relations with the EC will remain difficult with the implementation of the EC's Common Fisheries Policy (with production incentives and special protection for domestic fishermen); with the possible accession of Spain and Portugal with their large fishing fleets; and with the continuing tariff preferences enjoyed by Norway and Iceland. Trading access to Canadian fishing zones to obtain improved market access in the EC, which underlies the Long-Term Fisheries Agreement, may have diminishing returns as Canadian fisheries capacity expands.

Forest Products — Currently Western Europe consumes about 19 percent of Canada's forest product exports; 15 percent of softwood lumber; 28 percent of woodpulp; 9 percent of newsprint; and 19 percent of other paper. The duty-free entry enjoyed by Scandinavian countries in the EC and public assistance to fibre and paper production in the Member States, poses a threat to Canadian forest-product industries, particularly for newsprint. Canada's GATT rights in this respect may prove to be a valuable instrument to safeguard Canadian interests.

There would thus appear to be significant areas in which economic cooperation between Canada and the EC can be further developed. While Canada and the Community have somewhat different views on what needs to be done to improve international trade relations, particularly through the GATT work programme, it is important that every opportunity be sought to strengthen our cooperation with the EC in those areas where we have common interests. Doing so remains an integral part of the government's efforts to diversify our economic relations and to provide a broader base for developing the Canadian economy.

Japan

Japan, as one of the world's pre-eminent industrial and consumer economies, should offer significant scope for development of strengthened bilateral trade and economic relations. It is heavily dependent on world trade for its economic well-being. It imports vast quantities of raw materials and exports a broad range of sophisticated manufactures to a variety of world markets.

Although it falls far behind the United States in scale, Japan has been, since 1973, Canada's second largest national trading partner. Two-way trade reached $8.6 billion in 1981, a doubling in the past 5 years; over the past decade, Japan has been Canada's fastest growing export market among our major trading partners. With the exception of 1972, Canada has had a trade surplus of varying dimensions for over the past two decades — largest in 1979 at $1.9 billion, declining to $446 million in 1981. The bilateral exchange of goods is built heavily on the traditional complemen-

tarity between resource supplier and resource-poor industrial giant: fully 40 percent and 45 percent of Canada's exports are raw or semi-processed products respectively, while almost all of Japan's exports to Canada are fully manufactured. This make-up finds reflection in the regional prominence of Western Canada, which accounts for almost two-thirds of exports and receives most of the direct benefit; Central Canada, by contrast, accounts for only 12 percent of our exports and over half of Japanese imports, resulting in a frequently critical view of relations, especially as regards the immense bilateral deficit in trade in manufactured products ($1.4 billion in 1981). These criticisms stem in part from the fact that while Canadian tariffs and import regulations do not by and large represent a major constraint to overall Japanese marketing efforts, certain Japanese barriers restrain or prevent access for a range of products which Canada is either prepared to sell or could develop or produce (e.g., processed goods).

The management and shaping of a trading relationship of these major dimensions must be seen as part of an increasingly diverse economic relationship, encompassing Japanese investment (about $1 billion at the end of 1981) and loan activity in Canada, establishment of joint ventures in resources and manufacturing, the beginnings of third-country cooperation, and a recent expansion in the financial and banking sector. This in turn occurs against the background of a range of broader political-economic interests for Canada reflecting Japan's position as a world power and its dominance in the Pacific region where Canada is actively seeking to develop its own regional interests and presence. Because of the scale, diversity and importance of Canada's interests with Japan, the management of the trading relationship must fit securely and consistently within the totality of Canadian policy and approaches with Japan, in both their bilateral and multilateral manifestations.

Japan has clearly developed a sophisticated approach to economic and trade policy which has at the same time resulted in the evolution of a highly competitive industrial structure geared to both capital and consumer goods, which are marketed aggressively and effectively around the globe. Japan has derived tremendous advantage from the open multilateral trading system and, while formal barriers in Japan have been reduced, the domestic economy remains carefully insulated from both foreign investment and import competition beyond the modest levels regarded as acceptable by the Japanese. The main reason for the lack of success in exporting to the Japanese market may be the fact that Japanese manufacturers have developed close associations with Japanese suppliers of semi- and fully-manufactured products and that Japanese consumers instinctively prefer to support Japanese industries. Japanese vulnerability is on four fronts: reliance on offshore energy supplies, reliance on offshore raw materials, reliance on offshore markets for its manufactured goods, and dependence on the United States in terms of its national security interests.

Several factors specific to Japan make the management task critical to the achievement of Canadian objectives in the relationship. No other of our larger trading partners is as successful at economic planning and its implementation; no other industrial nation perceives and pursues its economic objectives — including its external trade elements — with such singleness of vision and purpose. The close collaboration between business, labour and government as exemplified in the consensus system, the homogeneity of Japanese society under a strong central government, the

thoroughness which Japanese planners and strategists bring to their tasks — all these features speak of the need for effective management on the Canadian side, perhaps more than with any other country. Moreover, our policies must be comprehensive and forward-looking to match the Japanese approach, and where possible have the concurrence if not the active support of the private sector and the provinces. Our management techniques must include a readiness to stick to a plan of action over time, since both patience and consistency are prerequisites for dealing with the Japanese system, especially where we seek to bring changes.

No situation tests the management function more than the treatment of bilateral trade issues. They have spill-over effects on other elements in the broader relationship, and short-term solutions are often pursued at longer-term costs. Canada has no export trade issue with Japan of major proportions, but a variety of barriers to Canadian products do exist, led by the ten percent tariff on dressed whitewoods, several tariff and non-tariff barriers (quantitative restrictions, standards, customs procedures) in the agricultural and fisheries areas, and tariffs on processed metals. Japan's major trade difficulty with Canada concerns the frequency and methods of our anti-dumping investigations and findings against Japanese goods. An import problem of serious proportions has been Japan's penetration of the Canadian (and US) automobile market and the threat this has posed to the domestic industry.

Several options exist for dealing with such issues. The most common is to employ consistent and high-level representations over a period of time, in which case a product-by-product approach is probably preferable to vague, generic challenges in dealing with the Japanese. Another means is to let the USA and/or Europe use their greater bargaining leverages to break down barriers common with Canada. Canadian weight is likely to add little to US or European efforts, but it will be necessary to ensure that Japan applies any improvements on an MFN basis, and does not discriminate against Canadian interests, intentionally or otherwise. A third means open to Canada is to vigorously pursue our rights under GATT and ensure that Japan lives up to its GATT obligations on matters of interest to Canada. A fourth course of action would be a bilateral approach wherein Canada uses its leverage on the supply to Japan of essential commodities (or access for Japan to Canada) should demands for improvements in access not be met. This approach could, however, raise serious regional and business objections within Canada. In the pursuit of any of these approaches it must be realized that Japan has successfully maintained a relatively closed economy despite pressures from the USA and Europe and will not likely change its approach quickly. In the end, long-term improvements in access into the Japanese market can best be achieved through a dynamic, multilateral system complemented by vigorous pursuit of specific bilateral issues.

Because of Japanese thoroughness, our success in shaping overall relations and treating specific issues more to Canadian liking depends upon a complete appreciation of Japanese strengths and weaknesses as well as our own. While Japan is Canada's second largest market, Canada is only Japan's twelfth largest destination for manufactured goods — we are important but not of central interest. On the supply side, Japan's policy of diversifying sources of raw materials and foodstuffs has eliminated excessive vulnerability to any one supplier and permits relatively easy shifts among them. For example, while they take almost all of their rapeseed from

Canada, soybeans from the USA or Brazil are a reasonable substitute. As either supplier or market, Canada's leverage vis-à-vis Japan is very limited and must be used with care.

A further strategic consideration with any trading partner is knowing how the relationship is likely to evolve given respective economic plans and the likely trend in economic forces. In the case of Japan, the direction of industrial strategy strongly suggests the fundamental complementarity of the Canada-Japan relationship will remain — we will continue largely to supply the lower-end of the Japanese industrial machine, with a movement to more processed and upgraded products as Japan phases out some of its energy-intensive industrial capacity (e.g., ferro-alloys, non-ferrous metals, pulp and paper, petrochemicals), and to buy Japan's increasingly sophisticated output. Furthermore, Japan's policy of developing alternatives to petroleum as an energy source identifies this sector as having high potential, especially for thermal coal exports, and its limits are more likely to be set by Canadian export capacity than by any Japanese considerations.

Japan's thrust to improve the domestic quality of life should have long-term benefits for Canada's lumber exports, provided we support an aggressive promotional effort against US competition. International pressures primarily from the USA and Europe should see some further opening of the agricultural market over traditional farming opposition, responding at the same time to growing Western taste preferences among Japanese consumers (e.g., beef, cheeses and processed foods) as well as to the more traditional demand for seafood. Here, however, marketing will be more dependent on concerted trade policy efforts to break down the barriers that stand in the way of competitive Canadian products.

Finally, Japan's continued leadership as an innovative and competitive manufacturer seems to rule out (along with the vast bulk of other trade), any quantum shift towards a greater proportion of manufactured goods in Canadian exports to Japan. There could be some increases, however, depending on the effort and imagination Canadians bring to their marketing. One area of promise will be Canadian recreational products, luxury items such as furs, and other consumer goods. Japan's aggressive R & D efforts in frontier industries should foreclose any great opportunities for sales in Japan of Canadian high-technology products, but there could be opportunities in specialized areas as components of, or complementary to, the products of Japanese innovation. An active government-to-government science and technology programme, backed by marketing support and monitoring of Japan's government procurement practices will assist industry's efforts.

Canada's objectives vis-à-vis Japan include, in the trade field, the further development of market opportunities for a range of Canadian goods and services, increasing the processing and value-added in Canadian exports, as well as the proportion of manufactured goods, and bringing about improved access for Canadian products where a potential market exists in Japan. These main thrusts have continued validity for the period ahead.

As regards the best means of achieving these objectives, following is a list of strategies and approaches:

- An aggressive and persistent marketing support as the ongoing mainstay of government effort, in recognition of both Japan's importance to Canada as a

market, and of the relatively greater difficulty foreign businessmen have in penetrating the Japanese system;

- continuing efforts in the Working Group on Resource Processing and elsewhere, to promote maximum benefit for Canada from Japan's industrial restructuring, especially as regards the upgrading and further processing of resources prior to export;

- greater emphasis on the high technology sector, so that Canada can better exploit complementarities with Japanese R & D and, through such linkages, benefit from Japan's growing technological leadership in many areas (there should also be a closer and more mutually supportive relationship with the inter-governmental Science and Technology programme);

- a determined effort to ensure that Canadian manufacturers have every assistance possible in opening and increasing sales in Japan; this involves educating the Japanese more about our specific skills and products and developing a more positive attitude in Canada towards marketing possibilities in Japan;

- persistence and flexibility in the ongoing campaign against access barriers to Canadian products, particularly those in the agricultural, fisheries and forestry sectors while avoiding approaches which damage trade in other areas or expose Canadian interests unduly in the broader relationship; as at present, this should be based on a three-pronged attack: multilateral, bilateral, and in concert with US and European actions;

- within the Joint Economic Committee and by support for the Canada-Japan Businessmen's Conference, the further development of a more diversified economic relationship through investment, joint ventures, financial and banking ties and other service sector links, tourism, and third-country cooperation; this will help increase Canadian exports, break down access barriers, and overcome structural incompatibilities that currently hinder trade (e.g. competition in smelting, pulp and paper, forestry); and

- because of the dimensions and importance of the general Canada-Japan relationship, careful management of the trade element within the economic sphere and, in turn, within the totality of our interests with Japan; while preventing negative effects from trade issues spilling over into other important areas, it enables the trade sector to benefit from an economic and general relationship of depth and value to both nations.

Other Trading Relationships

Canada's trading arrangements with Australia and New Zealand should be considered in the context of Canada's long-standing and close relations with these countries based on similarities of culture, history and political and economic institutions. As Pacific countries, like-minded Western partners, and Members of the Commonwealth, Australia and New Zealand share Canada's interest in a stable, economically

prosperous, Pacific region. Thus the retention of formal bilateral trading links should not only serve to promote the widening range of mutual economic interests but should also underscore a commitment to maintain and strengthen political ties.

Trade with Australia and New Zealand occurs both under GATT and within the framework of bilateral preference agreements between these two countries and Canada. These bilateral agreements resulted from the exchange of preferential tariffs under the British Preferential Tariff System. While these preferences remain important for small Canadian manufacturers and resource exporters, their relative importance has declined rapidly in recent years due to tariff actions by each country and the rapid growth of trade in goods at MFN tariff rates. Recent actions by the Government of Australia have, in particular, resulted in the loss of a large number of Canadian preferences into that market. At the moment roughly 40 percent of Canadian exports to New Zealand benefit from preferential margins as compared to roughly 15-20 percent of Canadian exports to Australia. The new Canada-New Zealand Trade Agreement has secured the status of preferential tariff margins in bilateral trade with Canada and frozen all statutory MFN rates. Eventual renewal of the Canada-Australia Trade Agreement would need to address the security of the remaining bilateral preferences and possible arrangements to secure important MFN tariff rates against increase and thereby to evolve an effective MFN trading relationship between our two countries. Attention will also need to be paid to broadening trading relationships and enhancing cooperation in areas of mutual interest, including industrial cooperation. From this perspective, particular attention will need to be paid to the role of Australia and New Zealand as partners in the Pacific Community.

Relations with the EFTA countries, Switzerland, Sweden, Norway, Finland, Austria, and Portugal, as well as Spain have developed on an MFN basis. The trading relationship has been harmonious, if modest, and no particular institutional questions appear to need to be addressed. The evolution of close free-trade relationships between EFTA and the EC has diminished our access into these markets. Spain and Portugal offer some further scope for fisheries products.

Developing and Newly Industrialized Countries

Our trade with developing countries has been growing in importance over recent years, although its share of our overall trade remains relatively modest when imports of oil are discounted. Our exports to the newly industrialized countries, for example, grew from 5 percent of total exports in 1971 to almost 8 percent in 1980. This trend is likely to continue over the coming decade as developing countries achieve higher levels of development and become more involved in the international exchange of goods and services. This will be particularly the case for the so-called Newly-Industrialized Countries (e.g., South Korea, Hong Kong, the ASEAN group, Brazil, Mexico and Venezuela) which are expected to continue to have some of the most dynamic economies in the world during the remainder of the century. The emergence of these countries as partners in world trade offers new opportunities for Canadian

exports. It also presents Canada with new challenges as these countries strive to expand their own exports, thereby increasing competition for Canadian producers both at home and in foreign markets. Increased attention will have to be paid to the management of our trade relations with the developing countries, and particularly the NICs in the 1980s, to ensure that Canada takes full advantage of the new possibilities they offer for trade and economic cooperation and finds creative solutions to the challenges they pose. Success in achieving these objectives will require deliberate efforts on our part to pursue trade opportunities, to maintain our competitive position in world markets and to work with others to ensure that the developing countries, particularly the NICs, are integrated into the world trade system to a degree commensurate with their economic strength.

Although still relatively modest in absolute terms, Canada's exports to developing countries are particularly important in terms of their value-added content. The majority is composed of fabricated materials and end-products (for example, 68.6 percent of our exports to the NICs in 1980) and it is in these categories that the prospects for expansion are the most interesting in the coming decade. While absolute volumes are likely to remain modest, they will become increasingly important to the economic well-being of individual firms. As LDCs continue to develop the basic infrastructure of their economies, new opportunities will present themselves in sectors such as transportation, telecommunications, and energy, in which Canadian firms have valuable experience and are particularly competitive. Although there will be possibilities for expanded trade with many lesser developed countries, it is naturally on the NICs that efforts should concentrate in the 1980s. Countries such as Mexico, Saudi Arabia, Venezuela and a number of Asian countries should be prime targets for expanded exports.

Because of the prominent role played by governments in the development process of LDCs, the private sector's initiatives can benefit from supportive action at the government level. The Canadian government's recent efforts to intensify relations with the NICs provide the framework for increased economic exchanges with these countries. The negotiation and implementation of trade and cooperation agreements, the multiplication of contacts at ministerial level and intensified consultations on a broad range of bilateral and multilateral economic as well as political issues can help to ensure that Canada is increasingly perceived as an attractive and capable partner. The choice of trading partners by developing countries often depends on a number of factors, in addition to price and quality of goods, such as the availability of financing, the provision of technical assistance or training facilities. The government will have to ensure that its policies and practices in these regards enhance export possibilities.

The emergence of the NICs not only means increased export possibilities but also increased competition for Canadian producers both on the domestic and foreign markets. The last decade has witnessed a tremendous development of standard-technology industries, beginning with textiles, clothing and footwear, in a small number of LDCs. These low-cost producers have succeeded in a short time in displacing industrialized producers in developed markets. This phenomenon created serious disruptions in Canada and other industrialized countries and necessitated the adoption

of safeguard measures to give time to the affected industrial sectors to adapt to the new international conditions. The NICs have already begun to develop other lines of production involving gradually more sophisticated technology. Some of these will be in direct competition with Canadian products at home and abroad. It is in the interest of Canada, as a country having a high stake in the open multilateral trading system, that this challenge be met in such a way as to preserve the principles of free trade rather than by recourse to protectionist devices. It will, therefore, be crucial for Canada to pursue policies which take account of the long-term prospects of international competition in various sectors and give priority to those sectors and sub-sectors in which it can develop and maintain a competitive edge. There may, nevertheless, be specific instances where temporary safeguard measures may need to be put in place.

As relative new-comers on the world economic and trade scene, developing countries have tended to view the GATT as an instrument designed primarily to benefit industrialized countries. LDCs argue that the fundamental principles underlying the GATT — Most-Favoured-Nation treatment, national treatment, and reciprocity — are not suited to their own needs and that the full application of these principles to developing countries would impede their economic development. The importance of trade for the economic development of LDCs and the need to allow the growth and strengthening of their nascent agriculture and industry has been recognized by the international community. LDCs now enjoy, under GATT, various types of differential and preferential treatment: they benefit from tariff reductions without reciprocal concessions; some of their products receive preferential access in developed markets; and they are permitted derogations to GATT rules with regard to export subsidies and the imposition of quantitative restrictions.

Taking advantage of these favourable conditions, a number of developing countries have managed over the years to achieve rapid industrialization and economic growth. These newly industrialized countries are becoming increasingly competitive in a broad range of products, as demonstrated by their performance on export markets, while continuing to maintain significant tariff and non-tariff barriers to imports. There is a growing feeling among developed countries that the NICs have now reached a stage in their development where they can and should start assuming obligations commensurate with the benefits they derive from the open multilateral trading system. This would mean progressive withdrawal of preferential treatment and a gradual opening up of their markets to foreign goods and services, in conformity with GATT rules.

This process of graduation constitutes one of the major challenges facing the world trading system in the coming decade. There is considerable resistance among the NICs to graduation. They argue that their economies are not sufficiently strong yet to bear the brunt of full international competition. Canada has an interest in promoting the further integration of LDCs into the world trading system. A progressive liberalization of their import regimes would increase trade opportunities for Canada. Furthermore, Canada could benefit from adjustments to make the system more responsive to LDC needs. Issues such as agricultural trade, dispute settlement, commodity trade, transfer of technology, investment, safeguards or tariff escalation, which are of particular interest to developing countries, are equally important for Canada.

State-Trading Countries

Eastern Europe and the PRC account for only a little less than two percent of Canada's total trade. They are, however, very important markets for grains. The USSR is in fact our single most important market for grains, followed closely by the PRC. Exports of other categories of goods remain very modest and depend, to a large extent, on participation in major capital projects. Canada traditionally enjoys a positive balance of substantial proportions in its trade with Eastern Europe and the PRC. This surplus contributed significantly to our overall positive trade balance in 1980 and 1981. Canadian imports from the area, of modest value, are composed almost exclusively of fabricated materials and end-products, a sizeable proportion of them in sensitive sectors such as textiles, clothing and footwear.

Trade with these countries operates under different conditions than that with other parts of the world, due to the nature of the state-trading system. Although the situation varies significantly from country to country, market access is considered to be generally more difficult and more complex than in western markets. Tariff schedules play a limited role (where they exist at all) and imports are controlled by such means as import licences and convertible currency allocations. Economic and commercial information is, in many cases, scanty and access to end users limited, thus preventing the full application of normal marketing and sales promotion techniques. The rules of the international trading system apply only imperfectly to these countries; for instance, the price formation mechanisms in state-trading countries make price calculations difficult for customs valuation and anti-dumping purposes.

Because of the overriding role played by governments in these countries in trade, it has proved useful to establish a dialogue at governmental level with these countries. Periodic consultations are held with most Eastern European countries and, in the case of the USSR, a mixed Economic Commission and sectoral working groups to promote trade and economic cooperation have been established. A joint trade committee exists with the PRC and meets at least every other year. In addition to these factors, inherent to the state-trading system, trade with these countries is further affected by political and security considerations which limit to some extent trade possibilities (e.g., trade in strategic goods).

Trade with Eastern Europe is heavily influenced by the overall climate of East-West relations, and political and security considerations. Restrictions exist on trade in strategic goods, and there is pressure from the current US Administration to tighten further these restrictions. There is also concern that western creditors not become over-exposed to borrowers in Eastern Europe. While we and our European allies, in particular, believe that mutually advantageous trade with Eastern Europe can be a stabilizing factor in East-West relations, trading relations are subject to political pressures. Economic sanctions have been imposed recently to indicate western objections to the Soviet invasion of Afghanistan and the imposition of martial law in Poland. Trade relations with Eastern Europe might well be further complicated in the near term if the Reagan Administration persists in its strategy to use economic relations to influence the conduct of Eastern Europe governments, particularly the Soviet Union.

Trade with the PRC bears many similarities to that with developing countries and, in addition to grains, involves a similar product mix. The initial euphoria created in the late 1970s regarding the potential of the Chinese market have given way to more realistic assessments which take account of the PRC's capacity to absorb new technologies and to pay for imports. The long-term potential, however, remains substantial, especially for capital equipment.

Prospects for continued substantial grains sales appear good as it is unlikely that our principal customers, the PRC, the USSR and Poland, will manage in the foreseeable future to reduce their dependence on imports. This trade may depend, however, more than in the past on the availability of credits. Prospects in other sectors are less certain. Economic growth in the East should continue to require the acquisition of western machinery and equipment and Canada's expertise in sectors such as energy, forestry, mining, transportation, etc. can make it an attractive supplier. However, the high level of indebtedness of Eastern European countries, reaching crisis proportions in certain cases, has led to a constriction of credits which limits their capacity to import. The creditworthiness of individual countries will have to be examined very carefully. Private banks are currently exercising caution about lending to Eastern Europe. The resulting increased recourse to counter-trade practices and the desire for bilateral balances impose additional constraints on trade which create particular difficulty for small- and medium-sized enterprises. This situation, combined with preoccupations over the long-term security implications of the extension of credits and the transfer of sensitive technology to the East, particularly the USSR, are likely to affect negatively Canada's prospects for expanded trade with the area.

TABLE 27

TRADE OF CANADA BY COUNTRY: IMPORTS AND TOTAL EXPORTS

Value in thousands of Canadian dollars

TOP 40 COUNTRIES

Country	Total Exports 1981	Imports 1981	Total Trade 1981	Trade Balance 1981
TOTAL	83,677,966	79,129,343	162,807,309	4,548,623
United States	55,378,174	54,350,280	109,728,454	1,027,894
Japan	4,521,694	4,038,388	8,560,082	483,306
United Kingdom	3,346,963	2,376,588	5,723,551	970,375
USSR	1,866,805	77,669	1,944,474	1,789,136
Germany FR	1,321,144	1,611,460	2,932,604	-290,316
Netherlands	1,208,535	295,763	1,504,298	912,772
China	1,006,822	220,013	1,226,835	786,809
France	1,004,120	878,587	1,882,707	125,533
Italy	928,386	702,177	1,630,563	226,209
Belgium-Luxembourg	856,302	297,089	1,153,391	559,213
Venezuela	829,193	2,385,295	3,214,488	-1,556,102
Australia	827,618	499,184	1,326,802	328,434
Mexico	734,185	996,354	1,730,539	-262,169
Brazil	690,113	430,779	1,120,892	259,334
Saudi Arabia	460,661	2,272,750	2,733,411	-1,812,089
Cuba	452,787	196,219	649,006	256,568
South Korea	446,874	608,183	1,055,057	-161,309
Norway	428,149	169,137	597,286	259,012
Algeria	380,170	424,339	804,509	-44,169
India	348,218	107,011	455,229	241,207
Poland	333,050	73,956	407,006	259,094
Iraq	321,364	1,031	322,395	320,333
Switzerland	271,784	424,013	695,797	-152,229
South Africa	261,641	402,723	664,364	-141,082
Taiwan	236,996	729,194	966,190	-492,198
Sweden	233,011	445,164	678,175	-212,153
Spain	207,693	237,770	445,463	-30,077
Colombia	201,823	83,394	285,217	118,429
Hong Kong	190,604	674,535	865,139	-483,931
Argentina	177,664	79,389	257,053	98,275
Singapore	149,280	174,629	323,909	-25,349
New Zealand	140,797	145,740	286,537	-4,943
Ireland	138,379	117,898	256,277	20,481
Israel	132,022	51,402	183,424	80,620
Egypt	132,022	6,604	138,626	125,418
Malaysia	127,086	100,031	227,117	27,055
Chile	124,191	110,551	234,742	13,640
Thailand	117,602	33,067	150,669	84,535
Libya	112,221	149,629	261,850	-37,408
Trinidad-Tobago	109,559	75,402	184,961	34,157

TABLE 28

DOMESTIC EXPORTS BY COUNTRY: MOST IMPORTANT EXPORTS MOST IMPORTANT COUNTRIES

Value in thousands of Canadian dollars

Country	1979	1980	1981
ALGERIA			
Wheat	70,231	221,447	163,412
Prefab. buildings & structures	14,142	6,536	46,782
Lumber, softwood	11,201	52,646	38,701
Dairy produce, eggs & honey	25,913	37,593	36,244
Primary iron & steel	0	2,035	20,534
AUSTRALIA			
Motor vehicle parts, except engines	78,231	46,023	49,017
Lumber, softwood	74,970	63,112	73,469
Sulphur	14,969	53,199	70,191
Newsprint paper	51,449	66,073	53,212
Drilling, excavating & mining mach.	3,097	7,344	39,926
BELGIUM-LUXEMBOURG			
Zinc in ores, conc. & scrap	76,745	47,777	104,736
Other metal in ores, conc. & scrap	43,046	108,398	91,089
Wood pulp & similar pulp	83,662	112,678	73,090
Nickel & alloys	60,195	97,008	57,977
Precious metals in ores conc. & scrap	2,042	19,257	39,544
BRAZIL			
Wheat	85,559	465,594	242,348
Sulphur	17,025	58,865	81,160
Newsprint paper	40,246	54,792	59,168
Coal & other crude bitumin. substances	25,365	38,131	55,822
Fertilizers & fertilizer materials	40,117	81,833	45,692
CHINA			
Wheat	411,498	527,363	686,558
Wood pulp & similar pulp	38,145	74,171	88,454
Fertilizers & fertilizer materials	23,074	47,782	61,637
Newsprint paper	22,994	24,302	37,307
Sulphur	11,974	30,750	28,087
CUBA			
Wheat	105,865	156,376	161,349
Hard spring wheat flour	86,476	77,290	71,986
Other cereals, unmilled	15,772	65,562	41,967
Vegetables & vegetable preparations	981	9,758	41,936
Other cereals, milled	0	26,532	27,813
FRANCE			
Other inorganic chemicals	2,037	144,356	213,299
Wood pulp & similar pulp	127,930	182,565	172,841
Lumber, softwood	44,730	98,576	61,338
Fish, whole, dressed, fresh or frozen	49,335	40,078	42,916
Copper & alloys	26,454	43,356	37,749

DOMESTIC EXPORTS (cont'd)

Country	1979	1980	1981
GERMANY FR			
Wood pulp & similar pulp	175,449	262,319	276,612
Copper & alloys	36,484	81,977	69,238
Flaxseed	52,121	42,080	68,661
Iron ores & conc.	51,397	75,900	58,830
Newsprint paper	32,974	38,851	49,046
INDIA			
Newsprint paper	42,846	40,291	70,144
Sulphur	11,149	17,593	62,854
Oils, fats, waxes, extracts & derivatives	49,579	83,625	50,453
Fertilizers & fertilizer materials	22,731	57,447	42,735
Asbestos, unmanufactured	23,461	26,703	32,417
IRAQ			
Passenger automobiles & chassis	126	3,374	131,631
Wheat	67,857	112,170	42,505
Other end products	516	13,567	35,732
Other motor vehicles	2,466	703	26,594
Other iron & steel & alloys	573	1,860	17,389
ITALY			
Wood pulp & similar pulp	178,152	230,241	236,140
Wheat	96,341	155,135	153,188
Barley	51,337	51,133	56,756
Iron ores & conc.	46,162	48,241	54,089
Petroleum & coal products	23,275	60,112	42,748
JAPAN			
Coal & other crude bitumin. substances	569,893	588,989	680,758
Wood pulp & similar pulp	349,024	457,611	399,906
Rapeseed	369,044	311,582	389,356
Lumber, softwood	458,272	501,355	365,102
Wheat	287,784	303,075	354,442
MEXICO			
Dairy produce, eggs & honey	21,930	52,439	100,848
Newsprint paper	9,532	23,745	53,005
Motor vehicle parts, except engines	9,422	17,443	42,739
Railway & street railway rolling stock	2,133	24,728	41,295
Sugar & sugar preparations	17,449	0	35,057
NETHERLANDS			
Organic chemicals	147,621	200,722	255,197
Petroleum & coal products	163,058	257,036	143,662
Iron ores & conc.	150,634	158,430	133,566
Wood pulp & similar pulp	79,109	97,945	94,721
Oils, fats, waxes, extracts & derivatives	40,794	40,737	63,177

DOMESTIC EXPORTS (cont'd)

Country	1979	1980	1981
NORWAY			
Nickel in ores, conc. & scrap	103,628	157,389	233,625
Copper in ores, conc. & scrap	25,522	50,203	55,238
Other metals in ores conc. & scrap	34,409	31,821	34,800
Ships, boats & parts	19,965	9,068	9,755
Oilseed cake & meal	80,108	11,001	10,335
POLAND			
Wheat	110,542	257,279	289,935
Barley	68,943	12,969	26,920
Aircraft, engines & parts	2,119	3,602	4,083
Fish, preserved, except canned	1,986	312	1,023
Pulp & paper industries mach.	14,817	10,382	926
SAUDI ARABIA			
Passenger automobiles & chassis	92,680	134,596	175,370
Trucks, truck tractors & chassis	3,387	3,618	64,594
Lumber softwood	8,660	20,289	35,972
Metal fabricated basic products	16,850	19,149	27,085
Prefab. buildings & structures	22,077	16,877	21,193
SOUTH AFRICA			
Sulphur	23,018	67,190	59,692
Motor vehicle parts, except engines	13,996	26,718	22,364
Wood pulp & similar pulp	12,321	15,166	25,675
Office machines & equip.	2,205	4,417	10,868
Combine reaper-threshers & part	829	5,405	8,221
SOUTH KOREA			
Coal & other crude bitumin. substances	55,558	66,224	125,853
Wood pulp & similar pulp	38,769	49,400	57,327
Fertilizers & fertilizer materials	17,331	25,428	42,770
Copper in ores, conc. & scrap	17,320	9,888	29,234
Sulphur	12,956	26,534	29,082
SWEDEN			
Copper & alloys	14,406	19,535	19,738
Coal & other crude bitumin. substances	8,933	10,149	19,224
Wood pulp & similar pulp	829	3,650	12,616
Other telcom. & related equip.	6,829	9,884	10,374
Fish, whole, dressed fresh or frozen	12,869	13,385	10,655
TAIWAN			
Sulphur	9,481	33,001	37,747
Copper in ores, conc. & scrap	411	20,303	20,856
Coal & other crude bitumin. substances	3,356	7,600	20,375
Raw hides & skins	15,951	18,656	15,117
Fertilizers & fertilizer materials	5,842	20,859	14,039

DOMESTIC EXPORTS (cont'd)

Country	1979	1980	1981
UNITED KINGDOM			
Wheat	263,142	284,616	352,957
Newsprint paper	196,680	250,930	351,716
Iron ores & conc.	163,204	124,374	191,748
Lumber, softwood	223,020	234,516	180,332
Wood pulp & similar pulp	165,432	203,612	176,043
UNITED STATES			
Passenger automobiles & chassis	3,962,002	4,279,068	5,008,557
Natural gas	2,889,054	3,983,850	4,370,050
Newsprint paper	2,608,062	2,925,741	3,303,468
Motor vehicle parts, except engines	3,243,093	2,611,394	3,117,703
Trucks, truck tractors & chassis	2,637,534	2,315,107	2,796,274
USSR			
Wheat	304,182	1,027,142	950,314
Barley	98,655	136,450	444,023
Other cereals, unmilled	24,560	124,197	242,372
Hard Spring wheat flour	0	0	89,913
Sugar & Sugar preparations	0	0	21,516
VENEZUELA			
Motor vehicle parts, except engines	207,855	175,223	260,706
Motor vehicle engines & parts	260	432	16,362
Newsprint paper	34,711	47,783	65,111
Other general purpose industrial mach.	3,893	2,713	26,022
Synthetic rubber & plastics materials	9,226	19,391	15,870

Statistics Canada — External Trade Division.

TABLE 29

IMPORTS BY COUNTRY: MOST IMPORTANT IMPORTS MOST IMPORTANT COUNTRIES

Value in thousands of Canadian dollars

Country	1979	1980	1981
ALGERIA			
Crude petroleum	87,226	11,786	423,102
Other special transactions-trade	30	68	1,221
Other beverages	17	0	14
Books & pamphlets	0	0	1
Aircraft parts, except engines	0	0	1
AUSTRALIA			
Raw sugar	80,965	198,313	166,190
Other metals in ores, conc. & scrap	100,465	65,430	78,426
Aluminum ores, conc. & scrap	84,867	79,804	76,257
Meat, fresh, chilled or frozen	99,115	76,034	60,705
Fruits, dried or dehydrated	20,748	27,410	16,093
BELGIUM-LUXEMBOURG			
Structural shapes & sheet piling	26,252	21,201	41,820
Natural & Synthetic gem stones	21,929	25,756	36,610
Organic chemicals	23,134	21,961	29,431
Plate, sheet & strip, steel	12,820	4,967	24,482
Aluminium, including alloys	8,469	2,038	14,402
BRAZIL			
Coffee	43,179	56,185	81,573
Orange juice & conc.	43,532	38,837	61,838
Aluminum ores, conc. & scrap	7,458	40,771	49,531
Footwear	14,014	21,716	36,361
Other iron & steel & alloys	13,119	12,923	17,011
CHINA			
Outerwear, except knitted	31,324	33,679	36,238
Other oil seeds, oil nuts, oil kernels	344	603	32,776
House furnishings	18,007	19,254	27,215
Cotton broad woven fabrics	23,810	17,866	16,955
Other apparel & apparel access.	15,435	15,967	14,744
CUBA			
Raw sugar	68,752	140,111	175,701
Fish & marine animals	34,133	18,888	13,348
Refined sugar, molasses & syrups	0	1	2,861
Precious metals, including alloys	0	0	2,417
Tobacco	1,169	1,969	521
FRANCE			
Other beverages	61,038	67,325	71,689
Plate, sheet & strip, steel	18,991	18,386	61,038
Other special industry machinery	17,648	14,262	42,296
Other transportation equip.	59,181	55,541	40,221
Passenger autos & chassis	33,575	55,153	34,075

IMPORTS (cont'd)

Country	1979	1980	1981
GERMANY FR			
Passenger autos & chassis	262,171	288,249	226,070
Plate, sheet & strip, steel	48,641	27,554	137,023
Wheeltractors, new	52,608	51,890	58,275
Organic chemicals	46,733	38,286	55,772
Other special industry machinery	27,592	30,669	33,929
HONG KONG			
Outerwear, except knitted	77,604	99,162	129,553
Outerwear, knitted	51,497	68,609	70,578
Games, toys & children's vehicles	41,125	38,457	60,345
Watches, clocks, jewellery, silverware	39,651	47,111	54,470
Aircraft, complete with engines	0	0	47,758
ITALY			
Footwear	79,449	73,359	73,910
Claybricks, clay tiles & refract.	26,632	26,482	31,227
Other beverages	28,457	30,157	30,259
Broad woven fabrics, mixed fibres	32,404	25,328	27,230
Other special industry machinery	16,573	20,758	21,015
JAPAN			
Passenger autos & chassis	254,750	591,244	994,785
Other telecom. & rel. equip.	225,435	262,920	408,190
Other photographic goods	126,013	168,048	208,006
Trucks, truck tractors & chassis	45,291	91,919	203,193
Other motor vehicles	131,364	136,338	199,383
MEXICO			
Crude petroleum	0	129,573	749,355
Other telecom. & rel. equip.	19,976	21,286	38,680
Tomatoes, fresh	11,420	8,682	20,947
Coffee	30,240	22,231	18,851
Other crude non-metallic minerals	16,185	20,719	13,715
NETHERLANDS			
Organic chemicals	21,161	17,884	23,932
Plate, sheet & strip, steel	10,296	112	21,558
Other oil seeds, oil nuts, oil kernels	162	5,774	19,416
Misc. equip. & tools	10,138	11,349	12,982
Other crude vegetable products	9,273	10,193	12,211
NORWAY			
Crude petroleum	0	0	96,817
Nickel & alloys	9,524	15,400	9,999
Other iron & steel & alloys	8,738	7,949	7,244
Ships, boats & parts, except engines	15,151	6,795	5,843
Fish & marine animals	2,777	2,541	4,052

IMPORTS (cont'd)

Country	1979	1980	1981
SAUDI ARABIA			
Crude petroleum	1,240,451	2,450,789	2,260,965
Other special transactions-trade	1,495	861	11,761
Other end products, inedible	0	0	6
Other personal & household goods	0	0	6
Other telecom. & rel. equip.	1	0	4
SINGAPORE			
Rubber & allied squms, natural	59,517	51,171	46,603
Televisions, radio sets & phonographs	19,274	15,311	21,681
Air conditioning & refrig. equip.	16,743	12,905	13,977
Other crude animal products	3,698	7,477	10,547
Games, toys & children's vehicles	3,594	5,757	6,975
SOUTH AFRICA			
Raw sugar	55,324	116,113	11,985
Other metals in ores, conc. & scrap	19,463	71,123	107,369
Other end products, inedible	19,438	32,971	20,441
Other iron & steel & alloys	20,900	17,149	19,781
Wood pulp & similar pulp	11,118	11,199	18,596
SOUTH KOREA			
Outerwear, except knitted	82,051	70,441	99,261
Footwear	35,307	43,988	65,587
Televisions, radio sets & phonographs	65,311	48,085	63,080
Outerwear, knitted	32,967	27,208	47,874
Other apparel & apparel access.	32,095	24,766	30,134
SPAIN			
Structural shapes & sheet piling	4,686	9,981	23,146
Plate, sheet & strip, steel	2,578	2,637	21,629
Other transportation equip.	13,642	20,219	21,358
Coffee	6,400	16,454	16,062
Footwear	19,742	12,952	13,579
SWEDEN			
Motor vehicle parts, except engines	39,570	59,420	57,441
Plate, sheet & strip, steel	28,945	25,633	28,190
Drilling machinery & drill bits	19,116	26,791	26,980
Passenger autos & chassis	15,620	19,168	20,529
Other special industry machinery	22,268	19,160	15,823
SWITZERLAND			
Organic chemicals	70,336	48,389	83,763
Precious metals, including alloys	18,812	174,746	49,020
Other end products, inedible	11,604	28,710	29,093
Watches, clocks, jewellery, silverware	16,653	16,781	16,398
Switchgear & protective equip.	10,200	16,752	15,645

IMPORTS (cont'd)

Country	1979	1980	1981
TAIWAN			
Outerwear, Knitted	85,408	83,818	104,746
Footwear	47,565	57,875	71,339
Other telecom. & rel. equip.	27,148	39,579	59,100
Televisions, radio sets & phonographs	35,538	43,632	42,707
Outerwear, except knitted	33,559	28,548	42,439
UNITED KINGDOM			
Crude petroleum	14,359	69,898	406,639
Ships, boats & parts, except engines	16,723	10,152	147,521
Plate, sheet & strip, steel	90,418	23,211	75,404
Aircraft engines & parts	38,534	45,036	74,188
Other end products, inedible	53,919	78,539	69,835
UNITED STATES			
Motor vehicle parts, except engines	6,771,171	5,946,334	7,086,840
Passenger automobile & chassis	3,748,530	3,387,675	3,718,786
Electronic computers	1,015,189	1,559,589	2,205,110
Motor vehicle engines	1,034,184	1,077,979	1,206,721
Trucks, truck tractors & chassis	1,724,991	1,037,548	1,177,051
VENEZUELA			
Crude petroleum	1,436,119	2,013,828	2,209,516
Fuel oil	47,884	188,892	160,227
Plate, sheet & strip steel	0	0	4,458
Aircraft, complete with engines	0	2,810	3,768
Pipes & tubes, iron & steel	0	0	2,923

Statistics Canada — External Trade Division.

CHAPTER IX

CONCLUSIONS

> If Canadians say they want a distinct country, it is not because they think they are better than others. It is because they want to do things they consider important and do them in their own way. And they want Canadian actions and life styles to reflect distinctly Canadian perspectives and a Canadian view of the world.
>
> **Mitchell Sharp**

International trade has played and will continue to play a vital role in the Canadian economy. The international environment of the 1980s will be highly competitive characterized by the ever increasing interdependence of national economies and it will thus be crucial to improve our productivity performance and face the world with a leaner and tougher economy. Our trade performance will depend on the degree to which investment, R&D etc., lead to a more efficient and internationally competitive domestic economy. This will require that domestic and trade policies adapt to changing circumstances, including increased sensitivity to regional interests and concerns, and a supportive environment for productive investment and technology. It will be equally important to build greater awareness among all Canadians of the benefits of international trade.

Trade and trade policy have always played a key role in promoting the efficiency and competitiveness of each sector of the Canadian economy. A principal feature of that policy has been its consistency: successive governments have pursued a policy of gradual movement towards freer trade. Central challenges of a sound and balanced trade policy will be to continue to enhance the opportunities of various sectors of the Canadian economy and its regions to expand investment and production facilities and create jobs offered by further penetration of world markets. Canada's future trade performance will thus continue to reflect Canada's economic strengths: the continuing importance of resource development and of resource-based products, at various stages of processing, as our principal export earners; the growing importance of a strong, outward-looking secondary manufacturing sector; and the gradual development of an export-oriented services sector. Equally important will be the need to encourage the process of adjustment in Canada to facilitate, on an equitable basis, the phase-out of non-viable, non-competitive industrial sectors and companies.

Canadian trade policy is not established in a vacuum. It affects other government policy options and, in turn, is affected by the other economic policies being pursued by the government. Equally factors external to Canada condition the kind of objectives and policies which the government can pursue. Achieving more efficient and internationally competitive Canadian resource, manufacturing and service industries may require a greater coordination and coherence between trade policy objectives, broader foreign policy objectives, and various domestic policies such as

taxation, regional industrial development, transportation, competition, manpower, business/labour relations and various other government regulatory activities. The regulatory regimes may need to be amended to reflect the requirements of an efficient and internationally competitive environment. Similarly, there is a need to maintain links between macro-economic and trade policy objectives and the means to achieve them in order to foster an outward-looking economic environment.

The capacity of Canadians to take advantage of market opportunities, both at home and abroad, will be increasingly dependent upon more direct investment, a greater capacity to develop new products, an increased commitment to innovate through the industrial application of the latest technologies, and by a stronger R&D performance. There is a need to convince both Canadian and foreign investors that Canada is a reliable and profitable place to invest. Equally, there is a need to convince and encourage Canadians that investment in technology and R&D pays long-term dividends.

The instruments of Canadian trade policy have developed over a period of decades and are continuing to evolve in response to changing circumstances. They have been and will continue to be key tools of economic development and should contribute to the development of a more efficient and productive economy. In a situation where the norm is not free trade, it will be necessary to maintain an adequate level of tariff protection to promote viable domestic production and an adequate safety net of contingency import protection, within the framework of Canada's international rights and obligations, and in a manner consistent with Canada's economic objectives. The current overhaul of the Canadian import regime, when completed by mid-decade, is designed to meet this objective and be responsive to changing circumstances.

Substantial gains have been made over the years in improving market access for Canadian products but significant barriers to particular Canadian exports remain. Preserving and improving foreign market access conditions and using available access to the markets of the USA, Europe, and Japan for agriculture, fisheries, processed industrial resource products, a range of manufactured and advanced-technology goods and related services will remain a central condition for sustaining and enhancing profitability of producers and achieving the necessary economies of scale.

Canadian export development programmes, both federal and provincial, have achieved considerable success. There is room for improvement but such programmes do not substitute for aggressive and sustained marketing activities by the private sector. They need to be geared to such activities such as providing export assistance and attracting more firms to export to a wider range of markets. They need to concentrate resources effectively on new markets with strong growth prospects. Government programmes to encourage and assist Canadian firms to find buyers for their goods and services abroad will thus continue to be a central element in pursuit of the government's trade policy objectives.

Canadian exporters will face fierce international competition in their pursuit of markets in the 1980s. Government programmes and policies should thus ensure that efficient Canadian producers are not at a competitive disadvantage due to the poli-

cies and practices of other governments. Export credits from both private and public financial institutions are an increasingly determinant competitive factor in both export and domestic markets. While Canada cannot win a war of national treasuries, we must continue to meet the competition, especially for those exports from sectors with long-term growth potential. Meanwhile, efforts must continue to contain competition for government-sponsored export credits within multilaterally agreed guidelines and to encourage the greater participation in the delivery of export credits by the private financial institutions.

The multilateral trade and payments system embodied in the GATT and the IMF has basically served Canadian interests well. It has proven an effective means for Canada to improve access to world markets and to manage relations with larger trading partners in a system designed to promote stability, predictability and the rule of law. Over the next decade it will be important that we continue to seek to strengthen this system, concentrating on issues and sectors of primary importance to Canada's economic development, building on the results of the GATT Ministerial meeting. It will be equally important that Canada assert and observe rights and obligations deriving from the multilateral trading system. The role of the IMF is equally important and it too needs modernization to ensure that it has the resources to promote the necessary monetary stability.

It is essential that the government's trade objectives be given greater prominence in the pursuit of Canadian foreign policy interests in the 1980s. In the past, bilateral agreements and cooperation with particular trading partners have contributed to the development of a healthy trading environment. To this end we will need to strengthen the substance, character and tone of bilateral relations with each of our major trading partners — the USA, Japan and the European Community and pursue, where feasible, closer commercial ties with these entities. We will furthermore need to increase two-way trade between Canada, the developing countries, and smaller traditional trading partners.

In the case of the USA, we will need to give greater recognition to the fact that a positive and stable relationship is fundamental to achieving many of Canada's economic objectives and to the pursuit of productive relations with others. Forging closer trade links and improved trade flows with the United States can be achieved in a number of ways. Free trade remains an option, but is likely to continue to be offset by considerations of sovereignty. At a more realistic level, limited or sectoral free trade offers real opportunities which could seriously be considered in the decade ahead.

All regions of the country have benefitted from international trade and Canadian trade policy in the 1980s should continue to foster further economic development in all regions. In an era of increasing interdependence of domestic and international policies as well as federal and provincial programmes and activities, substantive and ongoing consultations with provinces, the business community, labour, and other interested groups, at all levels and through various committees and mechanisms, will be a matter of priority in order to:

- Enhance the effectiveness of Canada's trade policies and the conduct of trade relations and their responsiveness to domestic needs;

- Further improve the awareness and sensitivity of Canadian policies to regional and sectoral priorities and concerns;
- Enable the provinces to take into account the impact of international trade developments;
- Contribute to a better understanding of the importance of an effectively functioning internal market; and
- Demonstrate convincingly that Canada is a stable and competitive supplier of a range of advanced technology and resource products.

External Affairs
Canada

CANADIAN TRADE POLICY REVIEW: HIGHLIGHTS

The government's decision to undertake a comprehensive review of Canadian trade policy underlines the priority which this government attaches to a strong trade performance. Exports have been, and will continue to be, one of the main engines of growth and job creation in the Canadian economy. Canadians need to appreciate more fully that exports are the key to further economic development and that continued export success will depend on Canadian producers being competitive and productive and seeking out new markets around the world. The results of this review of trade policy provide a framework of basic trade policy principles to guide future decision-making.

I. The Importance of Trade to Canada's Economic Well-being

Canada is a major trading nation. A strong trade performance is vital to the health of the Canadian economy. Trade contributes significantly to the economic development of the regions. The contribution of exports to our GNP has steadily increased from 20% in 1965 to nearly 30% at present. In absolute terms, Canada's exports have increased five-fold since 1970 - from less than $17 billion to nearly $85 billion last year. A great many people in Canada depend on exports for their livelihood.

Trade is, of course, a question of both exports and imports and its two-way nature contributes importantly to the efficient development of the economy. We trade essentially in order to increase the wealth and to improve the economic well-being of Canadians. Exports contribute significantly to increased employment opportunities for Canadians. We sell products in which we are competitive, efficient producers and where we enjoy a comparative advantage. Imports of goods not produced in Canada (either competitively or in sufficient quantities to meet the needs of various industrial users) play an important role in the development of an efficient industrial structure. Consumers also benefit from access to a wider range of consumer goods and essential commodities. Similarly, access to foreign technology, knowledge and investment has been instrumental in sustaining a high standard of living and diversified economic structure. The health of our economy thus depends heavily on a strong trade performance and our small population, hence small domestic market, necessitates a disproportionate emphasis on both exports and imports.

II. What is Canada's Trade Policy

The broad objectives of Canadian trade policy can be briefly summarized as follows:

- The development of a stronger, more efficient, productive, competitive, and non-inflationary domestic economy, with increased employment opportunities benefiting Canadians from all regions of the country; and

- The promotion of a more stable and open international trading environment within which Canadian and foreign firms alike are encouraged to plan, invest and grow with confidence.

Beyond these basic objectives, however, the conduct of trade policy is about day-to-day decisions affecting the tariff on a single product, a quota which can make or break an industry, a countervailing duty which will determine profits for years to come, the availability of government-guaranteed export credits; it is about complex relationships between unequal trading partners and between economic policy and trade performance. Meeting these day-to-day challenges requires a framework of basic trade policy principles based on a thorough knowledge of what has gone before and a full appreciation of what may or may not work. To a large extent Canadian trade policy has been, and will continue to be, developed as a trade-off between the objective of improved access to foreign markets, the need to promote efficiency and competitiveness, and the need to provide protection through the tariff and, on occasion, special temporary measures for those Canadian industries subject to competitive pressures.

The fundamental message of the review is that the open trading system continues to be the best and most practical option available to enable Canadian producers and consumers to benefit and to improve their standard of living. As a major trading country with limited political clout it is important that Canada assert our rights and observe our international obligations on trade, not to be 'a better boy scout' than others but to ensure that efficient Canadian producers continue to operate in a predictable climate and not a law of the jungle in world trade. To this end the Government will:

a) give first priority to efforts to stengthen the multilateral trade and payments system (to broaden both its scope and its discipline);

b) seek to ensure that foreign laws, regulations and practices do not adversely affect access to export markets of Canadian producers;

c) exercise fully Canada's rights under bilateral and multilateral trade agreements so as to safeguard access to export markets;

d) work more closely with Canadian producers and provincial governments to search out and to develop new export markets and to derive maximum potential from existing markets; and

e) expedite new legislation intended to ensure that Canadian producers benefit fully from Canada's rights under international agreements to deal with unfair and injurious imports. It is the government's belief that Canada's procedures for dealing with such imports should be as responsive, efficient and effective as those of our major trading partners.

III. Trade and Domestic Policy: The Interrelationship

A successful trade policy and trade performance can play a major part in the government's fundamental economic development strategy but the interrelationships between trade and domestic policies are critical and require careful coordination and coherence. Domestic economic policies can have a more powerful impact on trade performance than do international trade negotiations, changes in the tariff and exercise of other trade policy instruments. Policies which secure greater market access for Canadian producers can be undermined not only by adverse trade measures but also by domestic policies which affect the capacity of efficient Canadian producers to compete internationally (e.g. taxation, environmental, transportation, competition, technological development, manpower, regional industrial development, supply management, pricing, government regulatory activities and inconsistent provincial and federal measures which tend to fragment the Canadian common market).

A clear consensus on economic development, one which emphasizes expansion and which, above all, improves the climate for business decisions, is of singular importance to the success of Canada's trade performance. An overriding priority therefore is to create a climate of certainty and predictability; to stimulate sectors with the greatest capacity for sustained growth; and to ensure that efficient Canadian producers/exporters are not disadvantaged by domestic policies. Trade considerations need to be taken fully into account in deliberations on domestic economic policy.

We face a period of even more rapid structural change, of increased innovation hence more intense international competition. These changes will directly affect resource production and secondary manufacturing which will continue as the heart of our economic development and of our export potential. A policy which encourages investment (foreign and domestic) and technological innovation will be central to efforts to ensure improved productivity, expansion and a healthy environment for business.

IV. Competitiveness

The key to a successful trade performance in a much tougher world environment will be improved productivity and competitiveness of Canadian producers. To that end it is vital that we continue to be guided by the principles underlying the Government's "6 and 5" policy. We will be looking to the provinces to adopt a similar approach in areas for which they have jurisdiction.

V. Protectionism

One of the hardest political choices of all involves decisions to provide relief or respite to beleaguered Canadian industries. The judgments are particularly difficult in times of high unemployment. Protectionist actions can carry a heavy price for consumers and exporters and short-term palliatives may only delay necessary adjustment for non-competitive industries and delay even further necessary shifts in priorities and in investment. Nevertheless, there are occasions when extraordinary measures are required, at least temporarily, to maintain employment or to permit vital sectors of the economy to adjust to increased competition. The review offers neither easy answers nor individual prescriptions. It suggests that we rely on the tariff and on an effective safety net of contingency protection within a generally accepted international standard, i.e. similar to that of our competitors, but that we avoid breaking new ground on protectionism, that we accept the longer-term objective of removing restrictions and that we allow and facilitate necessary adjustment.

At the Williamsburg Summit Canada, along with its major trading partners, agreed:

- to halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers;

- to actively pursue the current work programs in the General Agreement on Tariffs and Trade (GATT) and Organization for Economic Cooperation and Development (OECD);

- to work to achieve further trade liberalization negotiations in the GATT, with particular emphasis on expanding trade with and among developing countries. We are currently engaged in negotiations to improve the coverage of the GATT Agreement on Trade in Civil Aircraft and the government will be consulting with the private sector and the provinces on Canadian objectives in negotiations to broaden the coverage of the GATT Agreement on Government Procurement.

VI. Radical Shift?

A radical shift in the Canadian trade policy framework is neither warranted nor practical. There are no magic alternatives to the open multilateral system which has guided Canadian trade policy and performance in post-war years and which provides a basis on which bilateral trade relations are conducted. This system, embodied in the GATT, has served Canada well. We need only look at the dramatic growth in our exports and the increasing contribution of trade to our GNP as evidence of the benefits to the Canadian economy of the agreed multilateral rules. They give us improved access to export markets and the certainty and predictability which the private sector needs in making investment decisions. We stand to gain through efforts to strengthen both the capacity and the credibility of the system. We stand to lose if actions are taken which weaken or undermine its principles. It is not a matter of choice but of sheer necessity for Canada. In a one-on-one trade world, we would be at a decided disadvantage with larger trading partners.

The basic conclusion is that we can do better in ensuring that our practice is within this framework and that we need to do more through multilateral and bilateral channels simply to preserve our existing stake in trade.

VII. The Importance of the U.S.A.

Successful management of our relations with the USA is fundamental to the achievement of Canada's economic objectives and to the success of all of our trading relationships. The review addresses the significance and complexity of the Canada-USA trade relationship and analyzes

various possible initiatives. The Government believes that in current circumstances there is no convincing evidence of the need for a radical shift in approach, such as, for example, pursuing the option of a full free trade or customs union. However, we will pursue new initiatives within the existing trade policy framework:

- careful consideration will be given to the advantages and disadvantages of limited free trade arrangements with the USA in particular sectors, such as urban mass transit equipment and textiles and clothing, where Canadian producers are internationally competitive or could significantly rationalize or improve their efficiency as a result of improved access to the USA market. This examination will be done in consultation with the provinces and the private sector.

- an open and constructive dialogue will be pursued with the USA with a view to promoting better understanding of domestic policy objectives and resolving bilateral trade issues; and

- joint efforts will be undertaken with the USA and others to strengthen and to improve the open multilateral trading system.

VIII. Other Trading Partners

The Review also recommends that Canada build on traditional ties with Western Europe and Japan in order to

- obtain better access conditions for Canadian products, particularly agricultural products, fish, forestry and manufactured products, and advanced-technology equipment;

- achieve a greater diversification in Canadian exports, particularly processed-resource, manufactured and advanced-technology products; and

- seek opportunities for close co-operation with European and Japanese industry through joint ventures, exchanges of technology and innovative ideas, and mutually beneficial investment.

As well the Government will encourage an expansion of commercial relations with our other partners, such as those in the Pacific Rim.

IX. Export Development Assistance

The review emphasizes that export development assistance programs are not substitutes for the competitiveness (in terms of price, quality, service, etc.) of Canadian producers. Nonetheless, there is a need for concentrated and more coordinated efforts by federal and provincial governments with the accent on growth markets and competitive sectors of the Canadian economy. The Government intends to continue to give high priority to export development assistance and has taken decisions which will enable our financing organizations to respond more flexibly and more quickly to competitive situations. At the same time, the Government intends actively to pursue efforts to contain competition for government-sponsored export credits within multilaterally agreed guidelines. It is not in Canada's interest to become involved in a subsidy war with our major competitors.

X. Future Consultations

The government intends to continue to work more closely with the provinces and with the private sector to ensure that we have a clear consensus on trade policy, one which will stimulate a healthy economy and create needed jobs. A successful trade performance is vital to all regions and sectors of Canada and should not be undermined by partisan or short-term approaches. It is essential that all Canadians and all levels of government work hand in hand to achieve a tougher and more competitive economy and to ensure that trade continues as a main engine of growth.