

Statement

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**"CANADA'S TRADE POLICY FOR THE 21ST CENTURY:
THE WALLS OF JERICHO FALL DOWN"**

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Ladies and gentlemen:

It is impossible to have watched the course of events over the last year without recognizing that something fundamental is happening to the international trading system. Twelve months have witnessed the birth of NAFTA [the North American Free Trade Agreement] and the World Trade Organization [WTO]. APEC [the Asia-Pacific Economic Co-operation forum] has agreed, against all predictions only a year ago, to reach free trade between its developed economies by 2010 and between its developing economies by 2020 – that is, if any of APEC's members will still be defined as developing in 20 years' time. Not to be outdone, the countries of the Western Hemisphere have set 2005 as their target date for free trade in the region, while Canada, the United States and Mexico have launched immediate discussions for the accession of Chile to NAFTA. At the same time, the European Union [EU] has proceeded with its own plans for expansion both northward and eastward – all the while observing anxiously the dynamism of Asia and the Americas.

So far, many of these initiatives may be seen as little more than statements of good intentions. A sudden downturn in the business cycle, say, or a new trade war between Japan and the United States, could well dampen enthusiasm for free trade and cast doubt on our best-laid plans. Yet behind the public pronouncements there are more fundamental forces at work. Like the sudden collapse of the Berlin Wall in 1989, trade and investment barriers the world over seem to be crumbling under the weight of their own contradictions. What we may be witnessing today is the birth pangs of a new international economic order – a messy, haphazard scramble toward a system of global free trade.

Something fundamental is happening to the trading system because something fundamental has already happened to the global economy. Semiconductors, fibre optics, satellite communications – these and a myriad of other technological innovations are fashioning a world economy from the bottom up. Countries could always devise ways to prevent grain or steel from crossing borders; they have far less control over the transnational movement of information, know-how or ideas. Yet these are the very "products," if this is the right term, that are now driving the global economy forward at such a breathtaking pace. If "knowledge is power," to borrow Francis Bacon's famous aphorism, then one of the defining characteristics of globalization is that this power is more diffuse than ever before. Just as the Soviet Union discovered to its cost that ideas are ultimately unstoppable, we too are discovering, in a less cataclysmic way, that the advent of the knowledge economy is somehow circumventing and diminishing the influence of national governments.

It would be salutary if policy makers could take the credit for constructing this global economy. But the reality is that trade liberalization is following as much as leading the underlying economic trends. Where there is free global movement of capital,

investment and ideas, there must eventually be free movement of production and distribution. Indeed, in some ways globalization bears out Marx's most important insight: that technology shapes the course of history. Changes to the means of production are changing the relations of production, which in turn are altering the institutional superstructures – in this case on a world scale.

What we are seeing in the expanding web of bilateral, plurilateral and multilateral free trade agreements are the efforts of national governments to come to grips with economies of regional and global proportions. Once trade policy was about regulating commercial relations between national economies, largely through the negotiation of tariffs; now it is about establishing the ground rules of a transnational economy in areas that were once quintessentially domestic: standards and regulations, investment, competition policy and so forth.

This expansion of free trade, moreover, has generated its own competitive momentum. In a world in which national barriers are becoming so many self-inflicted wounds – a sure way of being isolated from increasingly global investment and production decisions – we are all facing irresistible pressures to keep pace with market liberalization. Countries enter into free trade relations to increase their competitive edge, only to find others joining the race for fear of losing out on investment, technology and market access. The result is a kind of global chess match, one in which bilateral and regional trade initiatives become part of an overall drive to liberalize further and faster – yet the cumulative effect is to advance worldwide free trade. There are trade strategies at work here, but not in the sense meant by Paul Krugman and other new trade theorists. This is not a zero-sum game; it is an ongoing dialectic generating dynamic growth.

Much of this momentum was generated by the original Canada-U.S. Free Trade Agreement [FTA], and the subsequent trilateral agreement with Mexico. The aim was to push forward in such areas as dispute settlement, investment, trade in services, or procurement, where our degree of economic integration seemed to call for a more comprehensive regime of rules and procedures than could be achieved in the larger and slower-moving multilateral arena of the GATT [General Agreement on Tariffs and Trade]. But in pursuing free trade with our neighbours, we sent a clear signal to our other trading partners that North America was committed to a more open, more structured international economic order, and that we were prepared to leave behind those countries unwilling to move in this direction. Not surprisingly, many of the trade policy advances made in the FTA and NAFTA were subsequently reflected in the final outcome of the Uruguay Round of the GATT.

Now it is time for NAFTA to advance again. On one front, Canada is working hard to expand the agreement to other countries - to widen the circle and to spread the rules. The addition of Chile to NAFTA will represent more than access to a market of 14 million; it will provide us with a critical link with South America, it will push the pace of overall hemisphere integration, and it will help ensure that the NAFTA architecture remains fundamentally open and dynamic. With Chilean accession will come the need to replace the name "NAFTA" with "AFTA" [American Free Trade Agreement] or some other such acronym, and this is more than merely a semantic change. It will reflect real progress made toward hemispheric free trade within 10 years. Equally, we are working to deepen what we have already achieved in NAFTA. We are beginning the process of negotiating an expanding range of difficult issues. Of these issues, none is more important to Canada than our efforts, in two NAFTA working groups, to achieve mutually agreed trade rules that can reduce or eliminate the arbitrary application of trade remedy laws - laws that really have no economic rationale in a free trade area. What underpins this overall strategy - deepening the rules as well as broadening the membership - is the central idea that only by moving forward will NAFTA remain a building block, rather than a stumbling block, for eventual global free trade.

The dynamic we have created with NAFTA - and now with the Western Hemisphere free trade area - has spread ripples into Asia and beyond. There can be little doubt that the APEC initiative was launched at least partly in response to concerns of being left outside of an expanding NAFTA. Yet here too regionalism is developing its own momentum. APEC's commitment to trade liberalization in Indonesia last November is nothing short of revolutionary: free trade between the United States and Japan in 15 years; free trade between the United States and China in 25. Indeed, the very dynamism of the Asian economies gives APEC a special significance. This region has become the focal point of immense shifts in the global economy. Beyond the continued and rapid growth of Japan and the "Asian Tigers," the region is the cradle for the emergence of two enormous and hitherto closed economies: China and India. More quickly, I suspect, than most realize, their emergence will send shock waves through the global economic system - shock waves that will need to be managed and ultimately absorbed, principally through membership in the new WTO but also, at least in the case of China, through membership in APEC. This will make the Asia-Pacific region, almost by definition, a key arena in which the trade policy issues of the future will be played out.

APEC is important too because it bridges both sides of the Pacific. Although some may question the ability of two and potentially three economic superpowers - the United States, Japan and China - to co-exist within the same bloc, APEC has the potential, if managed properly, to provide an interface between

the two continental economies. It can act as a geopolitical buffer reducing the possibility of creating a fault line through the Pacific by regional integration within Asia or by the extension of free trade throughout the Americas. This role is not unimportant to Canada, a relatively small trading power but with significant interests on both continents. Here too our goal is to keep the momentum building, to push for a broadening and deepening of the architecture, and to ensure that the collective focus is outward and expansive.

An increasingly central issue now is how long Europe – or at least the key economies in Europe – can afford to remain outside this dynamic interplay between Asia and the Americas. It is true that Sweden, Finland and Austria have recently entered the European Union, and criteria have been established for eventual accession of much of Eastern Europe. Nevertheless, the addition of a Finland or an Austria does not compensate for Europe's potential loss of competitive access to Asia or Latin America. Already there are signs that Europe feels itself in danger of being isolated by events outside its borders; hence its recent overtures to explore ways of establishing a closer economic association with Mercosur beyond that offered by the new World Trade Organization.

The related issue, of course, is how long North America can afford to turn its back on Europe. Now that we have committed ourselves first to free trade with Latin America and later to free trade with much of Asia, the continued existence of barriers to trade with Europe seems increasingly anomalous. This is especially true since Europe represents our second-largest trade partnership – a partnership, moreover, defined not simply by the traditional exchange of goods and services but by an increasingly intricate web of transatlantic investment and technology. It is this concern about a possible drifting apart of our two continents that lies behind the Prime Minister's recent challenge to the European Union to consider free trade with NAFTA. Indeed, the goal would not simply be to secure market access but to help build the competitiveness, dynamism and critical mass of the transatlantic economy – in his words, "to re-energize our economic relationship."

In raising the question of transatlantic economic relations, difficulties immediately come to mind, not the least of which is the negotiation of agriculture. But why set out to stumble? Why not commit ourselves at the outset to a much larger, more far-reaching undertaking, leaving detailed negotiations to those specific issues on which countries cannot agree? For a start, we could propose the removal of all industrial tariffs by a specified date, mirroring in many ways the commitments we have already jointly undertaken in various regional fora. Investment is another area where progress might be more meaningful in a transatlantic context rather than on a broader, less homogeneous

front. This approach could also lend itself to ambitious work on a code of conduct defining fair rules of competition.

Such a possibility raises an intriguing question. Could a possible EU-North America deal provide the core of a new approach? Can we move further and faster toward free trade - and maintain the dynamic of competitive liberalization - while avoiding the inherently exclusionary nature of regional blocs? It is clear that regionalism has helped push the trade agenda forward in a manner and at a pace not easily achieved in the traditional GATT framework, but at some point it is reasonable to ask where all of these disparate paths are leading. Does the rapid expansion of NAFTA, APEC and the EU signal the triumph of regionalism? Or is expansion itself a sign that the regional blocs must ultimately build toward a more comprehensive trading order? Are we coming to the realization that global firms operating in global markets will sooner or later need global rules?

Sometime in the not-too-distant future we will need to confront the issue of how the various regional blocs interact and how, when rules and structures overlap, an eventual convergence might be orchestrated. In an ideal world, of course, all paths would lead back to the World Trade Organization - and indeed this remains Canada's objective. But at this time it is probably unrealistic to assume that the hundred-plus members of the WTO could, in unison, liberalize sufficiently to catch up with the regional blocs; it would be equally unrealistic to assume that the regional blocs would willingly open themselves up to the rest of the world on a strict most-favoured-nation basis. Not only would this fail to address the issue of "free riders," it might even weaken the competitive dynamic that is helping drive the global trade agenda forward.

There is another approach. Since we are committed to free trade in the Americas, free trade in APEC and possibly free trade with Europe, at some point there is potential for a new trade arrangement that bridges all the blocs - a kind of WTO-plus. Membership in such a grouping would depend not on region but on a willingness to commit to more intensive, more comprehensive rules-based trade and investment. One obvious advantage of this approach is that it would iron out many of the complexities of a world of multiple free trade agreements. At a minimum we would go a long way toward ridding ourselves of an increasingly complex patchwork of rules of origin. The continued existence of low tariffs, coupled with rules of origin, impose a transaction cost on cross-border trade out of all proportion to the purported benefits to protected industries. It is time to acknowledge that the era of the tariff is finally over, and to get on with other, more pressing and difficult issues.

But the real virtue of a WTO-plus approach is that it would mitigate the "them-versus-us" mentality associated with regional blocs. Although it would be salutary to think that the world's major economic powers will embrace a universe of free trade with enthusiasm and confidence, I am less than sanguine. There is still strong pressure for governments to be mercantilist, especially in the area of high technology. Listening to Lester Thurow or Laura Tyson, one would assume that we are already engaged in a life-or-death struggle with Europe and Asia for technological supremacy - a struggle in which so-called strategic trade policy will play a major part. Even those governments that embrace the ideas of Adam Smith often have a rather selective reading of comparative advantage, interpreting it to mean that it is their destiny to supply the world's high-tech goods and services, while the rest supply cheap labour and raw resources. Ironically it is the knowledge-intensive sectors that are probably least susceptible to government manipulation, but this will not stop governments from trying. In a world delineated by regional blocs, there is greater danger that trade competition may dissolve into trade conflict.

A more worrisome aspect of regionalism is one identified by Sylvia Ostry: the problem of "system friction." Even if we manage to strip away all external barriers to trade, we will still expose societal differences - in legal systems, in financial regulations, in government structures - that in turn shape our economies. It does not require much imagination to realize that even legitimate systemic differences might well be labelled as unfair trade practices by some, especially when they appear to confer economic advantages. Indeed, already there are undertones of "system friction" in current trade tensions between the United States and Japan. One solution, of course, is to seek greater harmonization, to push nations toward uniform approaches to a variety of economic regulations and systems. Indeed, trade policy has already moved a considerable way in this direction in an effort to root out rules and regulations that serve as little more than hidden barriers to trade. But there are also dangers of travelling too far down a road toward harmonization, of trying too hard to "level the playing field." In so doing, we may well erase the very differences, strengths and innovations - the comparative advantages - that generate a free market. What a sad irony if in the name of greater freedom, including market freedom, we build the scaffolding for the universal homogeneous state.

An alternative is to recognize that economies, like societies, will always differ to some degree, and to try to create the institutions and rules that can allow these differences to co-exist while managing any tensions that may arise. Here perhaps we can learn something from a couple of European ideas: first subsidiarity, the notion that decision making and the administration of rules should be conducted by the level of

government closest to the local community, while still remaining efficient; and second the notion of mutual recognition whereby partner countries agree to accept a system of integration in which the rules need not be the same – or harmonized – so long as they achieve the same ends. But to reach such a consensus it is clear that the future trade policy agenda will need to advance on an inter-regional – as much as an intra-regional – basis.

I suggested earlier that policy makers cannot take all the credit for the movement toward global free trade. What we can do is ensure that the rules governing this new global reality reflect our mutual interests and are not simply imposed by the larger players. What we have, in other words, is a responsibility for ensuring that the transition to globalization is as fair and equitable as possible. This is not just a statement of principle for Canada; it is a statement of national interest. When 80 per cent of our trade is with one partner, it is axiomatic that we should seek a structure of rules and obligations to give discipline to the relationship. Our policy, almost by definition, must be primarily about the United States. We negotiated the FTA and subsequent NAFTA to build such a structure. But there is more than one way to harness an elephant. Free trade in NAFTA has helped catalyze free trade in Asia, and will perhaps lead to a stronger trade relationship with Europe – all reinforcing a global regime centred on the WTO. This strategy of building an architecture of overlapping circles of free trade not only strengthens the world economic system, it strengthens our critical relationship with the United States.

Canada is well placed to help construct this new architecture. We played a leading role in advancing the idea of a World Trade Organization in the 1980s, building on the many concepts put forward by people such as Sylvia Ostry. We have been active and creative partners in NAFTA and APEC in the 1990s. We are now seeking new bridges to the European Union. But beyond these initiatives, we as a country are committed to the overarching ideal. The notion that the rule of law is the essence of civilization, both within and among nations, is central to Canadian values and Canadian culture. Remaining in the vanguard of those countries working to expand the international rule of law is perhaps Canada's most important and enduring contribution to the new global civilization.

But to play the role we must articulate our interests in a focused and co-ordinated way. As the Prime Minister well understands, when he promotes exports in China, or proposes the reinvigoration of relations with Europe, or hosts his G-7 colleagues in Halifax, he is doing more than conducting foreign policy in the traditional sense. In many ways he is the prism through which our collective interests and aspirations are reflected in the evolving international arena. He is Canada's delegate to the New World Order, a personification of the extent

to which domestic policy is now foreign policy and vice versa. At the same time the Prime Minister is underscoring one of the most persuasive arguments for a robust federation.

Is the picture I have just painted too optimistic? Perhaps. But then I have reason to be optimistic. There were times when I felt myself to be among a small, even shrinking, band of idealists. I believed then, as I do now, that free trade was not just a practical necessity but a guiding ideal. Only if trade among nations is free will we maintain the foundations of political and other freedoms. I believed then, as I do now, that the free exchange of ideas and capital, the open exchange of goods and services, and the security of agreed rules and common institutions is the basis of civilized intercourse between nations. In short, I was then and I am now a liberal as first defined by Adam Smith and David Ricardo, and as exemplified by Canadian Liberals from Sir Alexander MacKenzie to Lester Pearson and Jean Chrétien. And yet even I am amazed by the speed with which the ideal of free trade is being transformed into a global reality. If nothing else, I now fully expect to be amazed in the years ahead.

Thank you.