Canada-United States Relations

VOLUME II
Canada's Trade Relations with the United States

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THE STANDING SENATE COMMITTEE ON FOREIGN AFFAIRS

Chairman: The Honourable George C. van Roggen

Deputy Chairman: The Honourable Allister Grosart

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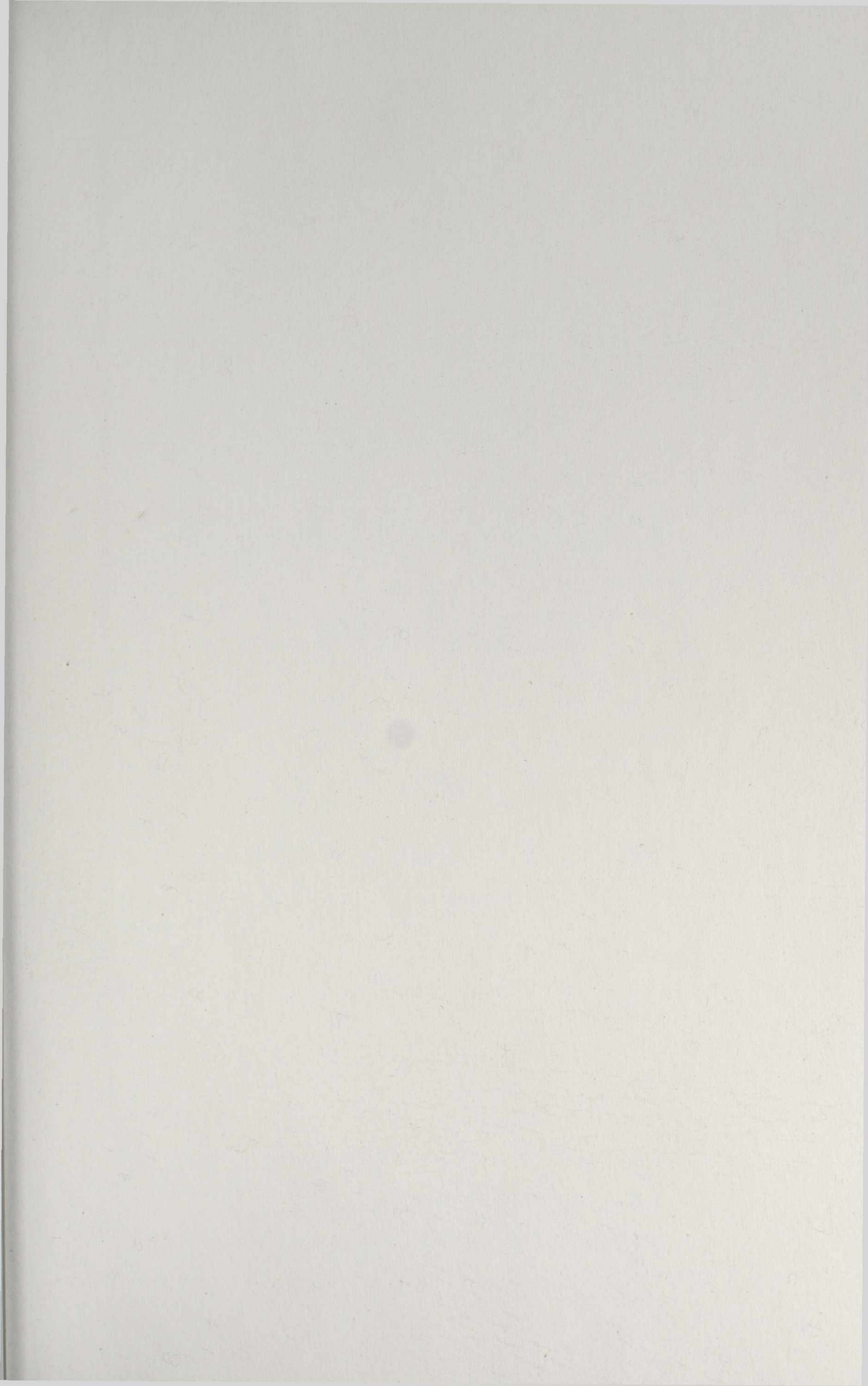

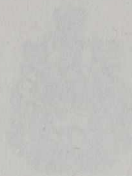

June 1978

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VOLUME II

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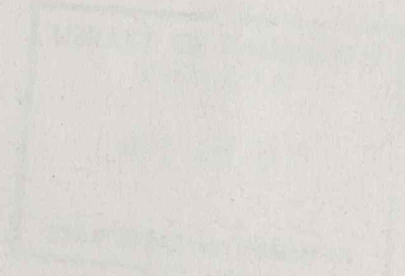

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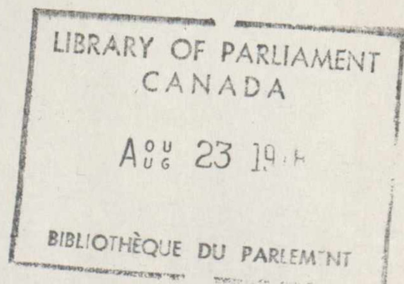

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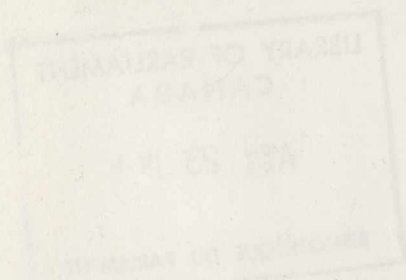

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MEMBERSHIP OF THE COMMITTEE

(21 June, 1978)

THE STANDING SENATE COMMITTEE ON FOREIGN AFFAIRS

The Honourable George C. van Roggen, *Chairman*

The Honourable Allister Grosart, *Deputy Chairman*

and

The Honourable Senators:

Asselin	Hastings	McNamara
Barrow	Lafond	Petten
Bélisle	Laird	Riel
Cameron	Lang	Rowe
Connolly (*Ottawa West*)	Macnaughton	Sparrow
Croll	McElman	Yuzyk

Ex Officio Members: Flynn and Perrault.

(Quorum 5)

Note: The Honourable Senators Carter and Deschatelets also served on the Committee.

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, Thursday, November 3, 1977.

"With leave of the Senate,

The Honourable Senator van Roggen moved, seconded by the Honourable Senator McElman:

That the Standing Senate Committee on Foreign Affairs be authorized to examine and report upon Canadian relations with the United States;

That the Committee be empowered to engage the services of such counsel and technical, clerical and other personnel as may be required for the purpose of the said examination, at such rates of remuneration and reimbursement as the Committee may determine, and to compensate witnesses by reimbursement of travelling and living expenses, if required, in such amount as the Committee may determine;

That the papers and evidence received and taken on the subject in the three preceding sessions be referred to the Committee; and

That the Committee have power to sit during adjournments of the Senate.

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, 20th June, 1978,

"With leave of the Senate,

The Honourable Senator van Roggen moved, seconded by the Honourable Senator McElman:

That the Standing Senate Committee on Foreign Affairs be authorized to publish and distribute Volume II of its Report on Canadian relations with the United States as soon as it becomes available, even though the Senate may not then be sitting.

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Thursday, 29th June, 1978,

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Petten:

That the Honourable Senators authorized to act for and on behalf of the Senate in all matters relating to the internal economy of the Senate during any period between sessions of Parliament or between Parliaments be authorized to publish and distribute Volume II of the Report of the Standing Senate Committee on Foreign Affairs on Canadian relations with the United States.

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate

REPORT

of the

STANDING SENATE COMMITTEE ON FOREIGN AFFAIRS

on

CANADA-UNITED STATES RELATIONS

VOLUME II

"Canada's Trade Relations with the United States"

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Acknowledgements

In the preparation of this report, the Committee has received the fullest cooperation from witnesses in the business community, labour organizations, various associations, government officials and individuals. This type of study would have been impossible without their informed and frank testimony and the Committee is very grateful for their assistance.

To all members of the Committee I wish to record my thanks, and most particularly to the Deputy Chairman, Senator Allister Grosart, whose wise counsel has helped focus us on the important issues of the inquiry.

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The Library of Parliament provided assistance through its Research Branch and, through its Reference Branch prepared an index of the proceedings of the Committee on which the report is based. This index is available from the Clerk of the Committee.

George C. van Roggen.

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George C. van Roggen.

CANADA'S TRADE RELATIONS WITH THE UNITED STATES

I 1. Introduction

This is the second report on Canada-United States relations by the Standing Senate Committee on Foreign Affairs. The first report was published in January 1976 and dealt with the institutional framework for the relationship. This report deals with Canada's trade relations with the United States.

It was recognized that this would be a complex and lengthy undertaking. In addition to examining the strengths and weaknesses of Canada's trade with the United States, the enormous concentration of Canada's trade with that country, involving all sectors of the economy meant that Canadian commercial policy and national economic policy are to some extent encompassed in the study.

The Committee was aware from the beginning that many Canadian industrial sectors were in difficulty. As the hearings progressed, the evidence exposed a far more disturbing situation than had been generally perceived. Fortunately, in the interval, various economic analysts and the media have done much to call attention to these facts. These have been particularly valuable in pinpointing problems in individual sectors.

One of the clearest indicators of trouble was the growing uncompetitiveness of many Canadian industries. Was this a result of serious but temporary problems in Canada's industrial sector, or was it the expression of a more deep-rooted structural malaise? In order to determine the answer, the Committee sought out a series of business and labour witnesses, representing a broad segment of the major industrial categories in the country.* These witnesses were asked to provide comparative data on factors affecting Canada's and their specific industry's competitive position. As a result, the Committee's record of proceedings includes an important collection of statistics on the degree to which certain Canadian industries have priced themselves out of the U.S. market and of commentary on the basic causes.

Clearly, with the wide variety of complex problems involved in Canada-United States trade, there was no possibility that one study could produce a general solution for all sectors. Nor would it have been anything but rash to try to make pronouncements on remedies for specific industries when the details in a situation can change from plant to plant and month to month. This report is an overview and the reader should keep this in mind when reading sections which touch on areas of his or her particular expertise.

In spite of the predominantly bilateral focus to the study, the Committee has taken account of changing international factors which have such an important

* See Appendix 5 for a list of witnesses. In the report, witnesses have been identified in the position they held at the time of the hearings although this may have changed since then.

impact on Canadian-U.S. trade, namely, the formation of large economic trading blocks of which Canada is not a member, the evolving international investment picture, the problems of other major trading partners with high inflation and unemployment rates, and the emergence of efficient low-cost, manufacturing centres in developing countries. These developments have increased the challenges and stresses for Canadian industry and frequently have compounded the problems of trading with the United States. Nor has the warning of the Science Council been ignored that, while comparisons of Canadian industry's performance with that of U.S. industry may be cause for alarm, it is also important to remember that U.S. industry itself has been experiencing a severe deterioration in its competitive and innovative capacities vis-a-vis countries such as Japan and West Germany. This makes the situation in Canada all the more serious.

In summary, the Committee has taken a broad look at Canadian-U.S. trading relations, a closer look at some particular problem areas, and attempted a cross-section assessment of the structure and performance of Canadian industry in relation to the United States. It has tried to ask some hard questions such as whether there is a future for manufacturing in Canada and, if so, in what areas? It has sought to look at both the short-term situation and the longer-term solutions to problem areas.

Recognition and analysis of problems of the Canadian economy must not be confused with despair or negativism. Canada, unlike many countries, is blessed with enormous natural wealth and unspoiled land and water, which together can provide the highest quality of life for its people. Canada is in every way in charge of its own destiny and only requires a collective discipline to reach its full potential. This report is designed to help in making the correct choices.

Food and Energy Sectors Excluded from the Study

Two areas of the economy were excluded from consideration—food production (agriculture and fishing) and energy. In the food production sector, third country markets are far more important then either country's market for sales of major products such as grains. In general, while similar types of agricultural products are grown in the two countries, the United States can, because of a wide range of climate, produce many fruits and vegetables which have a much shorter growing season in Canada or may be unproduceable in the colder climate. This seasonal fruit and vegetable trade creates quite special problems and results in special regulatory provisions. But while the U.S. is a major source of fruit and vegetables, Canada supplies a good deal of fish and fishery products and distilled alcoholic beverages to bring the food products category of bilateral trade into a rough balance. Trade in meat and dairy produce is substantial, but it is complicated by off-shore imports and by the existence of Canadian marketing boards. The latter may deserve a study in themselves. For these various reasons, the Committee set aside this sector, but the basic statistics are set out in Table 1 of the Statistical Appendix.

As for cross-border energy trade, the situation has been changing rapidly in recent years due to actions taken by both Canada and the United States. After the Organization of Petroleum Exporting Countries (OPEC) action of 1973, Canada reassessed its inventory and future needs and announced it would gradually phase

out oil exports to the United States. It has already moved to reduce them. While existing gas export contracts to the United States are being honoured, supplementary exports are closely regulated and no new long-term export licences have been granted since by the National Energy Board. Moreover, prices for both oil and gas have moved swiftly up, not in relation to costs, but to the international OPEC price level. Since the normal energy trade pattern has been massively affected by these extraordinary factors, the Committee decided the energy sector merited a separate study which would look at bilateral trade in coal, electricity and uranium, as well as oil and gas, and probably encompass pipeline arrangements, refining, petrochemicals, exploration and investment.

Nevertheless, this trade represents, in dollar terms, about 15 per cent of all Canadian exports southward. Moreover, the United States ships a significant amount of coal to Canada. The energy trade therefore cannot be excluded when considering the overall balance of payments picture and the effect on the economy of invisible flows. In 1974 Canada netted $3.9 billion in sales of various forms of energy with the United States. This included refined products, liquid petroleum gases and radioactive ores as well as natural gas, crude petroleum, coal and electricity. By 1977, this had moved to $3.7 billion. Energy trade statistics are given in Table 2 in the Statistical Appendix. These demonstrate that Canada at present is relying significantly on energy exports to the United States to alleviate its balance of payments problem.

2. Background

Next year, 1979, will mark the 100th anniversary of the introduction of the 'National Policy' of 1879—a tariff policy which has shaped Canada's subsequent commercial and economic development in a major way. Designed to form a protected national market, it was supported by other national policies including the development of east-west transportation facilities and the encouragement of western settlement. Their common aim was to promote national unity and strengthen the new federation to the point where it would be independent of its dynamic and at times acquisitive neighbour.

Whatever its economic benefits, the protective tariff has not had the unifying influence that was hoped for. Instead, it has become a focus of resentment within the western and the Atlantic provinces. The central provinces were seen to enjoy an enormous advantage in producing manufactured goods for the Canadian market behind a protective tariff, whereas resource goods were exported free of duty. The Atlantic and western provinces considered that they—as consumers of high cost, domestically-produced goods and imported products made more costly by the tariff—paid the price of protection, while gaining none of its advantages in terms of tax revenues or employment opportunities. From time to time, Canadian governments have considered a major policy change in the direction of free trade with the United States. In 1911 reciprocal free trade was the main issue in the election campaign. But the basic thrust of the National Policy persists, albeit with periodic changes in the level of tariff protection.

In the early 1930s, largely in response to the U.S. Smoot-Hawley tariff, Canadian tariffs were raised to their highest point. Since 1935 there has been a gradual dismantling and reduction of tariffs through international negotiations, most notably through a series of conferences under the aegis of the General Agreement on Tariffs and Trade (GATT). There remains, nonetheless, a residual degree of protectionism not only in the remaining tariffs of Canada and other countries, but also in a variety of non-tariff measures as well. Together they serve as an important factor influencing the volume and mix of goods traded between Canada and the United States. The current Tokyo Round of the GATT multilateral trade negotiations (MTNs) is committed to further liberalization of both tariff and non-tariff barriers.

In 1974 the United States Congress passed a Trade Act which included a specific authorization for the President to "enter into a trade agreement with Canada aimed at eliminating or moving to eliminate trade barriers between the two countries on a reciprocal basis".* In other words, the U.S. President was empowered to conclude a free trade arrangement with Canada. Such a Congressional initiative directed to Canada might have been expected to stir widespread debate in Canada. The surprise is that the move barely gained public notice. The following year the Economic Council's three and a half year study of Canada's trade strategy, "Looking Outward", concluded that Canada would reap particular benefits in a bilateral free trade arrangement with the United States. While the Council's report aroused some interest and concern in the business community, it was largely ignored at the political and official levels.

Canada's present economic and trade outlook is far from promising and there is no agreement on remedies. The international trading world is consolidating itself into trading blocs. Canada has not joined in this process, and yet such is Canadian sensitivity even to suggestions for continental trading arrangements that the idea of a North American trading unit has not received reasoned public and political consideration. In Canada business and labour circles there is considerable nervousness over the more immediate consequences which GATT tariff reductions might have on their industries. A dramatic increase in Canadian plant investment has taken place in the United States in the past several years as both Canadian-controlled and subsidiary firms have expanded or relocated south of the border. Against this background the Committee decided to give serious consideration to Canada's trading relationship with the United States with the bilateral free trade alternative in mind. Further, the Committee considered that it was appropriate for it as a parliamentary body to respond to the specific resolution directed to Canada by the U.S. Congress.

* U.S. Congress, Official Summary of the Trade Act of 1974, p. 3

II A PROFILE OF CURRENT BILATERAL TRADE

In general terms, trade relations between Canada and the United States at the present time can be characterized as friendly, with none of the rancor and ill-feeling which marked the relationship in 1971 and 1972 in the wake of President Nixon's surcharge. Currently there are few serious bilateral trade issues causing concern between the two countries. This may be due in part to the fact that a number of tariff and non-tariff issues which would normally be dealt with on a bilateral basis are being negotiated at the multilateral levels, in the GATT multilateral trade negotiations in Geneva. In this forum both governments have committed themselves to the objective of further liberalization of trade barriers. Considering the enormous volume, variety and complexity of the trade between Canada and the United States, the trade relations are remarkably positive and bilateral trade continues to expand. In 1977 the value of merchandise goods traded between Canada and the United States was over $60 billion, more than between any two other countries in the world.

1. The Basic Facts

For both trading partners the trade relationship is of major significance. For the United States, Canada is its most important customer. With only one-tenth the population of the nine European Community (EC) countries, Canada buys as much from the United States as do the EC countries combined and more than twice as much as Japan. Canada is currently a market for over 22 per cent of U.S. exports and a source of 20 per cent of its imports. It is second to the Netherlands as a source of the largest amount of direct investment in the United States. Until very recently, Canada has been the prime location for direct investment by Americans.

From a Canadian point of view, this bilateral trade is of overwhelming economic importance. Approximately 70 per cent of Canadian exports go to the United States and a similar percentage of imports come from the United States. This preponderance of Canada's trade with the United States is in contrast to the 10 per cent of its trade with the European Community, the 5 per cent with Japan and the 15 per cent with the rest of the world which even includes the huge grain shipments to the Soviet Union and China.

At least 15 per cent of the nation's Gross National Product (GNP) is generated by Canada's exports to the United States and one out of every two jobs in the goods-producing industries is dependent on exports to the United States in one way or another. The United States is the largest market for all major Canadian commodity sectors, except agriculture. Bilateral trade in automotive products alone reached $20 billion in 1977, which was by itself significantly more than Canada's trade in all items with the European Community and Japan combined.

2. Merchandise Trade

A glance at the accompanying charts 1 and 2 reveals the pattern of Canada-United States trade. Detailed statistics for the various trade categories are set out in Table 1 of the Statistical Appendix.

Trade in agricultural products is limited despite the fact that both countries are producers of a wide range of products. After oil and gas, iron ore and concentrates constitute the next most important Canadian export in crude materials, while United States supplies a significant amount of coal to Canada. In this category the dollar value of exports has remained constant in the $5 billion range during the three year period 1975 to 1977 with the increased natural gas prices masking the volume declines in the petroleum exports. Adjustments in terms of trade have been to Canada's disadvantage since 1975 due to the fact that prices for such important export commodities as unwrought nickel, copper and zinc have not kept pace with the prices of manufactured goods of which Canada is such a heavy importer from the United States.

In the fabricated materials category, three main items of trade stand out; forest products, non-ferrous metals and chemicals. Half of Canada's exports of fabricated materials (17.4 per cent) are in forest products, underlining the importance of these shipments of lumber, wood pulp and newsprint to the United States. Iron and steel and alloys, aluminum and alloys, copper, nickel and zinc metals go mainly from Canada to the United States, while chemicals and chemical products are important U.S. exports to Canada. Fertilizers are the main chemical product which Canada exports to the U.S.

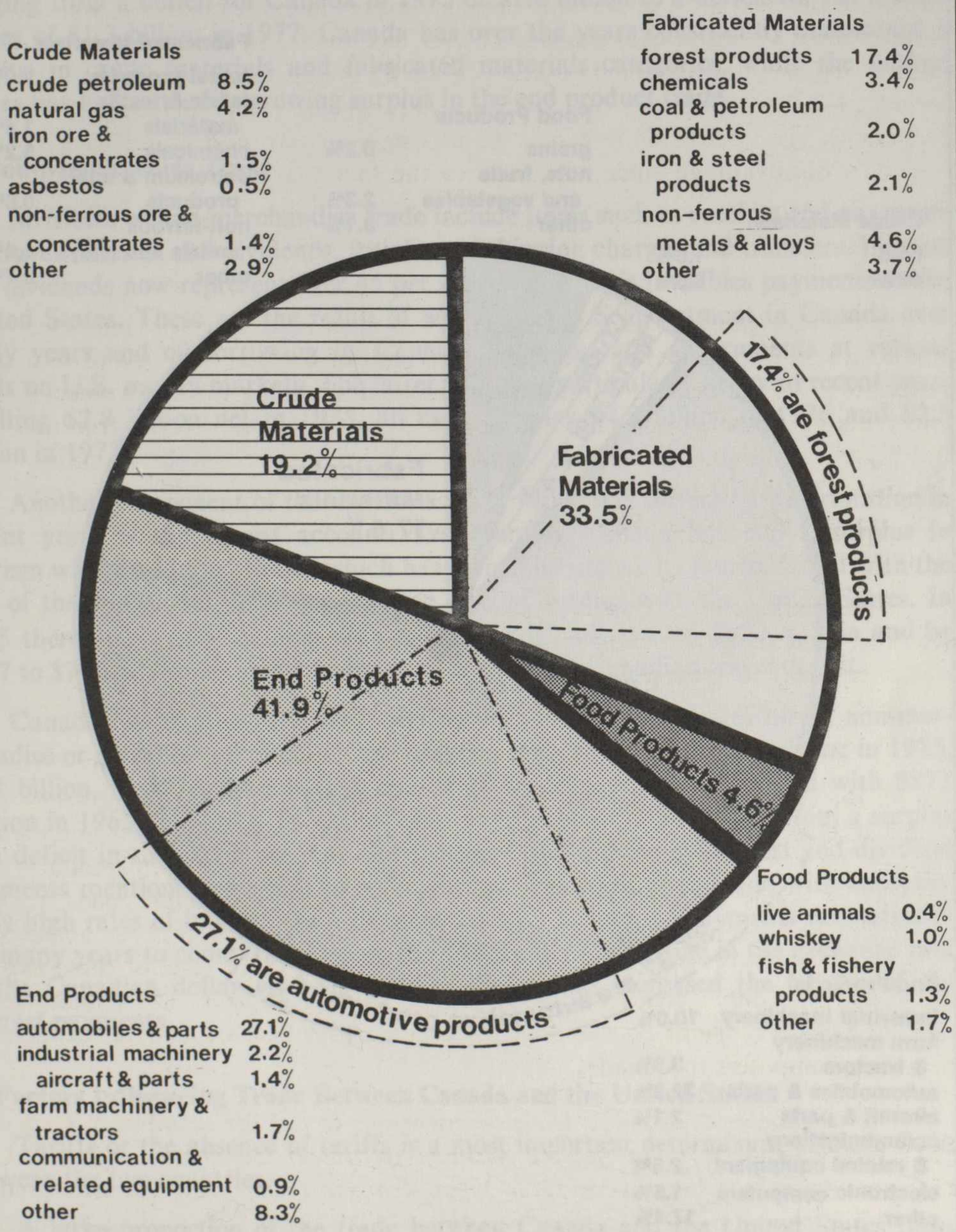
The strong point of Canada's merchandise exports to the United States lies in the fabricated materials category. The value of these exports has risen from $1.7 billion in 1960 to almost $11 billion in 1977, giving Canada consistently strong payments balances in this category. In 1976 Canada's surplus was $3.9 billion and in 1977 it was $5.9 billion.

In the end-product category, automotive products constitute the principal item traded in both directions, amounting to two-thirds of Canadian exports and close to one-half of U.S. end product imports to Canada. Aside from auto products, the majority of goods exported by Canada in this category are capital goods, such as equipment and machinery of all kinds. While a notable growth has been achieved in Canadian machinery exports to the U.S. in recent years, the level of these exports still constitutes only about one-quarter of the level of imports. The United States supplies a wide range of consumer items and has also become a major exporter of electronic computers to Canada.

The weakness of Canada's trade performance lies in the inability of Canadian end products, aside from automotive products, to counter the increasing flow of U.S. and other imports, which are in many cases displacing Canadian domestic production. While the value of Canadian exports in this category, excluding automotive products, rose impressively from $271 million in 1960 to $3.6 billion in 1977, the inflow of U.S. products rose in comparable proportion from $1.6 billion in 1960 to $10.3 billion in 1977, leaving Canada with a massive payments deficit of $6.7 billion

Chart 1

Canadian Exports to United States by Category (as % of total Canadian exports to United States, average over period 1971-77)

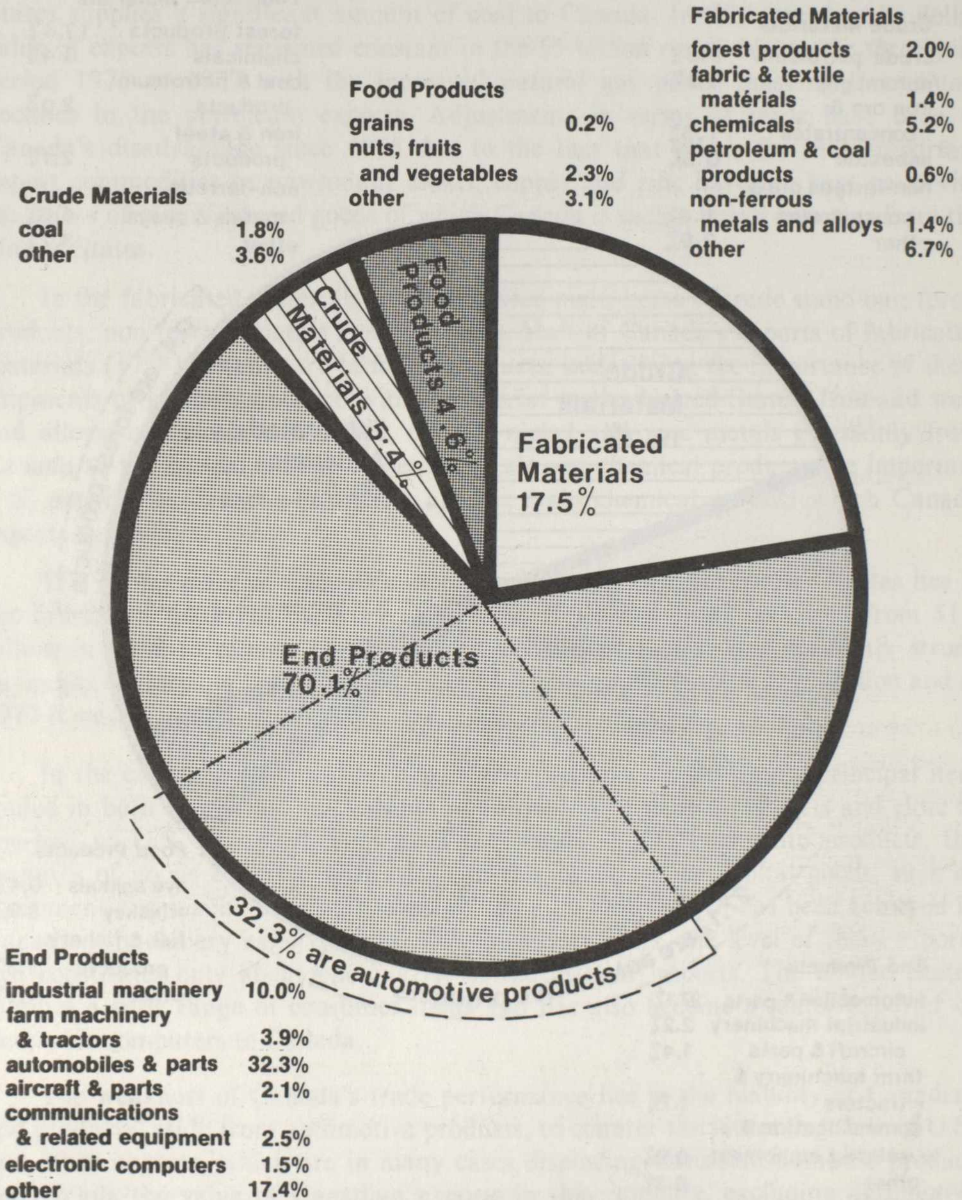


*Percentages for the segments in the main circle do not add to 100 because Special Transactions are excluded. This category includes items such as private donations of goods, settlers' effects and imports for diplomats.

Source: Statistics Canada

Chart 2

Canadian Imports from the United States by Category (as percentage of total Canadian imports from US, average over period 1971–77)



*Percentages for the segments in the main circle do not add to 100 because Special Transactions are excluded. This category includes items such as private donations of goods, settlers' effects and imports for diplomats.

Source: Statistics Canada

in this category. If the deficit in the automotive trade is added to this, the total Canadian deficit is $7.6 billion in end products in 1977.

It is difficult to find a definite pattern developing in the merchandise trade payments balances between the two countries. In the past 18 years, since 1960, Canada has had a deficit in nine years and a surplus in nine years (Chart 3). The last few years have witnessed wide fluctuations in the bilateral trade balances ranging from a deficit for Canada in 1975 of $1.8 billion to a deficit for the United States of $1.3 billion in 1977. Canada has over the years consistently maintained a surplus in crude materials and fabricated materials categories, while the United States has had a steadily growing surplus in the end product trade.

3. Non-Merchandise Trade

Invisibles or non-merchandise trade include items such as receipts and payments for travel, interest and dividends, freight and shipping charges and transfers. Interest and dividends now represent over 45 per cent of Canada's invisibles payments to the United States. These are the result of widespread U.S. investment in Canada over many years and of borrowing by Canadian business and governments at various levels on U.S. money markets. The latter has been particularly heavy in recent years totalling $2.8 billion net in 1975, an extraordinary $4.9 billion in 1976 and $2.5 billion in 1977.

Another component of the invisibles trade which has suffered a deterioration in recent years is the tourist account. Traditionally Canada has had a surplus in tourism with the United States which has helped it balance its tourist deficit with the rest of the world. But 1974 was the last year of surplus with the United States. In 1975 there was a $250 million deficit, in 1976 it had risen to $600 million and by 1977 to $770 million or about 45 per cent of the total Canadian travel deficit.

Canada has consistently had a deficit with the United States on its non-merchandise or invisibles account. This deficit has risen sharply in recent years; in 1975, $3.7 billion, in 1976, $4.5 billion and in 1977, $5.6 billion, compared with $871 million in 1965 (Table 1). This deterioration reflects both the change from a surplus to a deficit in the travel account and the increased burden of interest and dividend payments mentioned above. The recent borrowings have been made with exceptionally high rates of interest and will raise the level of interest payments dramatically for many years to come. In addition, the 1977 and 1978 decline in the exchange rate of the Canadian dollar vis-à-vis the U.S. dollar has increased the burden of the interest payments.

4. Factors Influencing Trade Between Canada and the United States

Tariffs or the absence of tariffs is a most important determinant of trade flows between the two countries.

A large proportion of the trade between Canada and the United States flows freely with no tariff barriers. In terms of the dollar value of trade, the institution of reciprocal free trade under the Automotive Agreement in 1965 has had an enormous impact on the stimulation of this two-way trade which has increased twenty fold

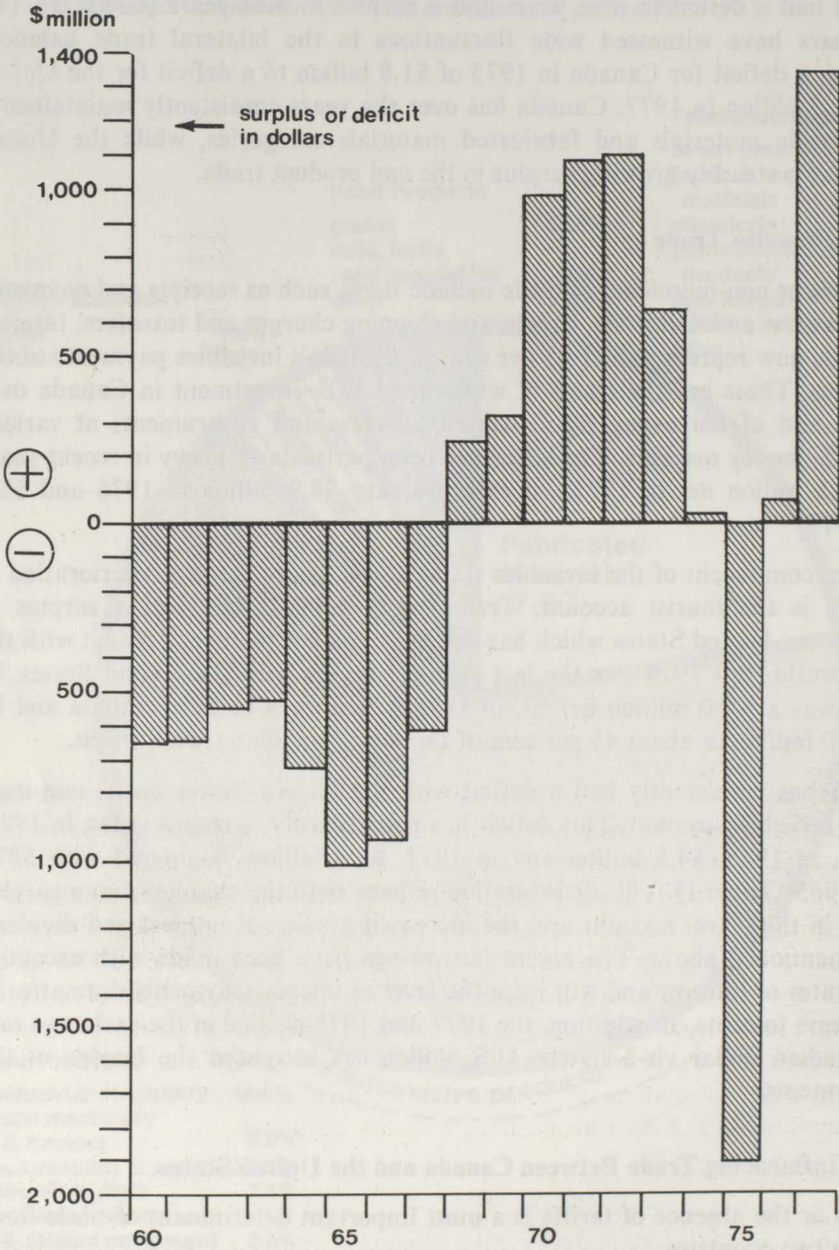


Chart 3
Canada's Balance of Merchandise Trade with the United States
$ million
1,400
1,000
500
0
500
1,000
1,500
2,000
surplus or deficit
in dollars
60
65
70
75
Source: Statistics Canada

($ millions)

	Average 1971-77	1976	1977
Receipts			
Travel	1256	1346	1509
Interest & Dividends	458	497	465
Freight & Shipping	837	959	1141
Other Service Receipts	894	1082	1128
TOTAL:	3445	3884	4243
Payments			
Travel	1415	1956	2278
Interest & Dividends	2098	2580	3181
Freight & Shipping	957	1198	1354
Other Service Receipts	2159	2749	3076
TOTAL:	6629	8483	9899
Balances			
Travel	— 159	— 610	— 769
Interest & Dividends	— 1642	— 2083	— 2716
Freight & Shipping	— 119	— 239	— 213
Other Service Receipts	— 1264	— 1667	— 1948
TOTAL:	— 3184	— 4599	— 5646

Source: *Statistics Canada*

between 1965 and 1977, from $1.2 billion to $20 billion. Another stimulant has been the Defence Production Sharing arrangement under which defence purchases have been traded, duty free, for almost 20 years. In the farm machinery sector an important amount of trade is duty free under long-standing measures instituted by both sides. In addition, Canada unilaterally permits free entry for machinery of a class or kind not made in Canada. Officials pointed out that due to the special provision in the Canadian tariff which allows for importation free of duty for products not made in Canada, the total value of finished manufactured goods imported duty-free from all countries into Canada, even excluding automotive goods, is higher than the total value of manufactured goods imported duty-free into the United States, Japan and the European Community combined.

In total then, over 60 per cent of U.S. imports enter Canada duty-free. If automotive products are excluded, this figure falls to 44 per cent. About 70 per cent of Canadian exports, including automotive products, enter the United States free of duty; if automotive products are excluded this falls to 57 per cent.

Existing levels of tariffs shape the size and stage of manufacture of each country's exported products. Generally speaking, Canadian tariffs are somewhat higher than those of the United States, but there are a number of peaks in the U.S.

tariffs. The United States has higher tariffs on raw materials and on some semi-processed materials such as non-ferrous metals, nickel, copper, lead, zinc and aluminum than does Canada. While pulp and newsprint face no tariffs either way, trade in paper manufactured products is affected by significant duties. U.S. tariffs on end products are usually lower than Canadian levels. In both countries, considerable protection is provided to chemicals and chemical and plastic products, toys, footwear, clothing and clothing accessories.

In addition, both countries have a range of non-tariff measures including countervail, export subsidies, quotas, government procurement policies and consumer and health standards which affect the trade flow. However, officials told the Committee that tariffs are, at least at present, the more important determinant of conditions of access between Canada and the United States than non-tariff measures. This is not the case in respect to trade with Japan or the European Community where non-tariff measures are a much greater barrier and, if the GATT negotiations reduce tariffs significantly, it will not be the case even with the United States.

5. Areas of Concern

Despite the see-saw of trade balances between the two countries over the last two decades, which might seem to indicate a certain equilibrium of trade flows, a number of specific areas emerged during the course of the Committee's study which appear to be cause for concern to Canada. Some of these problems are well known, others have not been widely discussed. All are having or could have serious future ramifications. Most of these problems relate to Canada's trade performance rather than to specific trade issues or disputes between the two countries. They include:

- the growing Canadian current account deficit,
- the large imbalance of end product trade, including deficits in automotive and machinery trade,
- the deterioration in the travel account,
- the relocation and expansion in the United States of companies including both Canadian controlled companies and U.S. subsidiaries.

a) The Current Account Deficit

In financial terms a problem is posed by the very large Canadian current account deficit with the United States since 1975. The current account surplus or

Table 2

Canada's Current Account Deficit with the United States

(millions of dollars)

1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
—1301	—744	—877	—227	—215	—272	—933	—1632	—4796	—4206	—3940

Source: Department of Finance, Economic Review, 1977, 1978, p. 198.

deficit combines the surplus or deficit on merchandise trade with the surplus or deficit on invisibles. It does not include the balance on capital flows between the two countries. For the last three years, Canada's current account deficit has averaged over $4 billion. The cause has been the growing deficit in the invisibles or service account. As a result, even in years of large merchandise trade surpluses, such as 1977, the invisibles deficit has been only partially offset. If the merchandise trade account should slip into deficit, as it has done frequently in the past, the current account deficit would mount alarmingly.

b) Imbalance in End Products

As noted above the trade deficit in end products with the United States has grown sharply in recent years. Imports have more than doubled since 1972 whereas exports, while growing rapidly, started at a low base and the absolute gap has steadily widened. The deficit has spiralled from $2.8 billion in 1972 to a peak of $8.2 billion in 1975, dropping to $7.6 billion in 1977.

The imbalance in end products was originally attributed to a weakened demand for Canadian products during the 1974-75 period of cyclical recession in the United States, while imports continued strong into Canada due to a relatively less severe recession. It was argued that when the United States economy improved, demand for Canadian products would pick up. This has not happened. In fact, in 1977, a comparatively good year for the United States, the dollar value of Canadian end products exported to the United States, excluding automotive products, actually declined despite inflated prices. It is evident that the trend in manufactured end products is going against Canada for other more deep-seated reasons.

Two sectors of secondary manufacturing are of particular concern; the machinery sector and the automotive sector. Of these, the latter has received much more attention, but the disequilibrium in the machinery sector is greater and deserves particular notice.

In 1975, Canada's overall deficit in the machinery sector* was $3.8 billion. With the United States alone the deficit in this sector was $3.1 billion in 1975, rising to $3.5 billion in 1976. Compared to this last figure, Canada's 1976 automotive trade deficit with the United States of $1 billion looks much less disturbing, particularly when it is realized that the $3.5 billion deficit was on a total bilateral trade of $5.7 billion whereas the $1 billion automotive deficit was out of a total of $20 billion in cross-border automotive trade. Not only the deficits but the trends in machinery trade are also cause for concern. Despite the fact that there has been considerable growth in machinery manufacturing in Canada in the past ten years and an increase in exports, imports are nevertheless taking an increasing portion of the Canadian machinery market, rising from 53 per cent in 1970 to 62 per cent in 1975.

Automotive goods trade between the two countries is by far the largest single item of bilateral trade. Canada has had a substantial imbalance in this trade which

* This includes machinery and equipment used by Canada's resource, processing, and manufacturing industries including mechanical equipment for power generation. It includes agricultural equipment but not electrical and transportation equipment.

has persisted since 1974, with a deficit that year of $1.2 billion, in 1975 of $1.9 billion, in 1976 of $1 billion and in 1977 almost $1 billion again.

The main problem is the automotive parts industry, in particular the trade in those parts known as the original equipment parts which become part of the assembled motor vehicle, as distinct from after-market parts which are the service or replacement parts available separately. In the parts trade, as distinct from trade in assembled vehicles, Canada's deficit has grown from $1.9 billion in 1974, to $2.4 billion in 1975, $2.5 billion in 1976 and over $2.9 billion in 1977. While Canadian surpluses in assembled vehicle trade have partly offset the deficits in the parts trade for these years, an overall imbalance remains. Underlying problems are related to a shift in the sourcing of parts by the automobile manufacturers and concern that Canada may not be participating in the unprecedented technological changes and major restructuring which are imminent in this industry.

c) Deterioration in the Travel Account

As noted above a major trouble spot in the invisibles account is the tourism and travel account, with its recent and fast-growing deficit with the United States. In the Canadian economy, tourism ranks with petroleum, minerals, automotive products, forest products and wheat as an important earner of U.S. dollars. Total tourism receipts in Canada in 1976 amounted to $1.9 billion and 88,000 jobs directly or indirectly are attributable to its operations.

The trend seems to be for fewer Americans to come to Canada, and to come for shorter periods, while at the same time they have been travelling overseas far more than in the past. Canadians, for their part, are increasing their visits to the United States, and at the same time travelling less in Canada. In 1976 for example, there was an increase of 6.8 per cent in Canadian visits southward but an 8.6 per cent decrease in American visits to Canada. Although it was felt at the time that the 1976 figures reflected the pull of the bicentennial celebrations in the United States, the trend persisted in 1977. In that year, U.S. visitors decreased by 1.4 per cent while Canadians going to the United States rose by 5.5 per cent.

Two particular factors are seen as having contributed to these developments: the uncompetitively high Canadian costs in the hospitality industry and the 1977 U.S. legislation which has adversely affected U.S. convention business in Canada.

d) Relocation and Disinvestment

The past two or three years has seen a relocation trend by Canadian producers which has serious implications for Canada-United States trade. A growing number of Canadian manufacturing companies have chosen to locate facilities in the United States, or are contemplating a plant expansion in the United States rather than in Canada. The period of the Committee inquiry was punctuated by media reports in which business representatives explained why Canadian corporations found the U.S. business environment more favourable for investment and expansion than the Canadian. The U.S. Conference Board reported a four-fold increase in the number of new Canadian investment projects in the United States during 1976 as compared to 1975. The exodus continued during 1977.

Figures published by the U.S. Commerce Department show the rise in Canadian investment in the United States. Canada was third after West Germany and Japan in the amount of direct investment in U.S. companies in the first half of 1977; 16 U.S. companies were bought by Canadian interests during this period. Most investments were in U.S. manufacturing industries. Preliminary data for uncompleted acquisitions for the second half of 1977 showed Canada in the lead in U.S. acquisitions.

The relocation or failure-to-expand decisions by U.S. multinationals with subsidiaries in Canada are also showing an unwelcome increase. In 1977 for the first time in the U.S. Commerce Department records, figures show that U.S. parent companies took more funds out of Canada than they committed in direct investment. The net loss for 1977 was $440 million compared to an annual average net inflow of $500 million during the past decade.

The recent invasion of the United States by Canadian real estate and development companies constitutes a separate case, not readily comparable with the movement southward by manufacturing companies. Their products are primarily entrepreneurial and organization skills rather than a product to be manufactured. While press reports of assets controlled by large Canadian developers in the U.S. market reach $2 billion or more, the actual Canadian outflow of dollars when one allows for mortgage financing is undoubtedly much less. Furthermore they do produce an invisible return to Canada.

In analyzing this trend of business expansion southward, it is important to distinguish the underlying rationale behind the Canadian companies' decision-making. It is understandable that successful Canadian companies may, at appropriate times, decide to go multinational and break into the U.S. market through direct investment in subsidiary plants in the United States. Such companies are merely following the proven prescription for efficiency and cost competitiveness, by getting closer to the larger market, and Canada will benefit in most cases from the production of components and from invisibles flowing back. What is alarming is that some Canadian companies have decided, after an assessment of comparative costs of doing business in the two countries, that they can no longer afford to expand their Canadian plants or divert new investment into production facilities in Canada, whereas they can do so in the United States. Companies such as ATCO and Northern Telecom explained to the Committee that they are going to supply off-shore countries from their lower cost U.S. plants rather than their Canadian plants, in order to remain competitive and retain the off-shore markets. Others suggested that they might even find it economic to supply Canadian markets from the United States.

III BASIC CAUSES OF THE PROBLEMS

1. Loss of Competitiveness

The fear that Canada is pricing itself out of international markets, and particularly the U.S. market, was expressed by many witnesses during the hearings. Concern over the declining competitiveness of Canadian industry led the Committee to devote a number of hearings during 1976 and 1977 to explore the reasons and any remedial measures that might be proposed. In the meantime the problem has been documented by a number of other studies and commented on extensively in the media. Some of the detailed analysis prepared by the Committee is published as Annexes A and B to the report.

a) Comparative Wage Rates

Throughout the hearings the most frequently cited concern of the majority of witnesses was the rapid growth in Canadian labour costs, largely brought about by higher wage settlements in Canada than in the United States. Between 1970 and 1976, compensation per hour in manufacturing in Canada increased by 82 per cent compared to 59 per cent in the United States. By mid-1975 the average level of wages in this sector in Canada surpassed that in the United States. In 1976 this trend continued and by the end of that year average hourly earnings in Canadian manufacturing stood at $5.98 compared to $5.34 in the U.S.

However, significant differences were reported in individual industries. In forest products, electrical machinery, business forms, and telecommunications equipment, Canadian wages were substantially higher than U.S. wages; in carbon steel and automotive assembly approximate parity existed; in a number of other areas such as auto parts, farm machinery and specialty steels, Canada retained a wage cost advantage.

Simple hourly wage differentials may present a somewhat biased picture of comparative labour costs in the two countries, as there are some basic differences in the bases employed in calculating wage increases. Further, testimony by witnesses indicated that in some industries fringe benefits are more generous in the United States as compared to Canada. For example, Du Pont's management reported that in a similar fibre plant, Canadian wages are 109 per cent of U.S. wages but the total remuneration *including benefits* to a Canadian worker is 98 per cent of the U.S. level. The figures for a similar petrochemical plant are 106 per cent and 95 per cent respectively. Important social benefits which are paid, in part, by contributions from employers in the United States are provided by the state in Canada. In any comparison it is necessary to remember that some part of the higher wages paid to workers in Canada is taxed to help finance these programs.

Despite this, money wages increased so much faster in Canada than in the United States that an anusual combination of forces must have been at work. No thoroughly convincing explanation why Canadian manufacturing wage rates rose so dramatically was presented to the Committee, but several contributing factors were suggested. These factors were in two broad categories: a) those related to the "tightness" of labour markets, i.e., the balance between aggregate demand for and supply of labour, and b) those related to changes in the structure of labour markets such as social security, minimum wages, and unionization.*

The Committee finds that:

a) The "tighter" Canadian labour market during the period from 1970 to 1975 created upward pressure on wages in Canada relative to the United States. The numbers employed in Canada increased by 19.5 per cent compared to 8.5 per cent in the United States.

b) Both monetary and fiscal policy were more expansionary in Canada than in the United States from mid-1975 on. The resulting price increases had the effect of accelerating wage demands.

c) The public sector in Canada expanded much more rapidly in Canada than in the United States from 1970 to 1975, generating increased demand for labour and putting pressure on wage levels. In Canada employment in "public administration" grew at an extraordinary 30 per cent in this period compared to 18 per cent in the private sector. Furthermore, wages in the Canadian public sector were pushed up by a dramatic expansion in the number of public employees covered by collective bargaining.

d) In Canada during the 1970s the unemployment insurance provisions were liberalized in respect to duration, level and qualifying periods of benefits much more rapidly than in the United States. This created increased friction in the labour market and pushed Canadian wage rates higher.

e) Over the decade from 1967 to 1976 the average federal Canadian minimum wage was increased by 180 per cent while the United States federal minimum wage was increased by 65 per cent (Table 6 on page 75). By mid-1977 the overall average Canadian minimum was 15 per cent higher than the U.S. federal level and much higher than in many contiguous U.S. states. Increased minimum wage rates put pressure on wages just above the minimum and eventually on all wage rates. (see pages75 to77 for a fuller discussion of minimum wages, particularly as they affect the tourist industry.)

f) Canada's average of days lost due to strikes during the decade 1966 to 1975 was 38 per cent higher than that of the United States. In 1976 Canada lost 2.27 working days per worker whereas the United States lost only 1 day per worker.

g) Contributing to this deterioration of labour relations in Canada was a variety of factors including:

* See Annex A for the detailed analysis.

- rapid inflation from 1973;
- the fringe benefits enjoyed by public sector employees which became objectives for the private sector unions;
- the perception of Canadian business by 1975 of the softened world markets and even stiffer import competition;
- the different pattern of collective bargaining in Canada as compared to the United States;
- the increased expectations which resulted from the buoyant state of the economy from 1972 to 1974.

The various factors cited above combined during the mid-1970s to push up Canadian wage rates. Since wages constitute a large component in the cost of production, this became an important reason why Canadian products were increasingly at a competitive disadvantage, especially during the years 1975 and 1976. By 1977, however, the situation improved. Increases in new wage settlements came down from 17 per cent in 1975 to 10 per cent in 1976 and to under 8 per cent in 1977. This last level was roughly parallel to the U.S. level. There was also a dramatic improvement in the strike record, with 70 per cent less man days lost than in 1976.

Provided the phasing out of the Anti-Inflation Board (AIB) in April 1978 does not result in a new wave of disproportionately high wage settlements and so long as the depreciated Canadian dollar remains at or below .90 cents U.S., Canadian industry will be in roughly the same competitive position it was in 1970.

b) Differences in Productivity

Undue emphasis on wage levels, however, should not obscure the fact that lower productivity levels in Canada are also a major contributor to the uncompetitive cost of many Canadian products. For manufacturing industries in Canada, labour productivity—the volume of output per manhour worked—is about 80 to 85 per cent of the U.S. level on average. Labour productivity is, however, an incomplete measure. There are other relevant factors of production which can be measured such as the amount or effective use of capital, the innovative capacity of the plant, the scale of the plant operations or the skill levels of managers. Together they constitute what is known as total factor productivity and affect the cost per unit of output. By this more complete measure Canada also has an approximately 20 per cent lower productivity level than the United States.

During the past decade the productivity gap between Canada and the United States has been narrowing slowly. A recent comparison by the Conference Board in Canada of goods' producing industries concluded that, between 1967 and 1974, output per manhour rose faster in Canada than in the United States. The gains in relative labour productivity performance were particularly strong in the Canadian durable goods industries, for example in the metal and wood products industries. It should be noted however that Canada is an efficient producer of some industrial products not susceptible of scale production, with rates of production comparable to

that attainable in the United States. Mr. Walter Ward, Chairman of Canadian General Electric, referring to "custom-built equipment" reported that

> "Our transformer plant in Guelph, Ontario, produces approximately one-third as many units per year as its associate in Pittsfield, Massachussetts, and, as near as we can measure, the productivity at Guelph, in some years, is very close to that at Pittsfield." (I, 38:8)*

Further, it should be noted that not all Canadian industry suffers from comparatively low rates of productivity. In steel, cement, or pulp, Canada does well by international comparisons.

But these bright spots must not be allowed to obscure the fact that much of Canadian manufacturing is not competitive with that in the United States. Most of the large Canadian companies which testified before the Committee showed significant divergence in productivity levels with comparable U.S. operations, often within their own companies. (See Table 3). These were firms generally considered to be outstanding and successful in Canadian terms.

Table 3

Productivity Comparisons*

Product	Measure	Canada as % of U.S.	Company & Committee Proceedings
Business forms	tons per 100 man hours in 1976	64.2%	Moore Corporation (II, 15:8)
Petrochemicals	volume/man year	89%	DuPont of Canada (II, 11:23)
Fibres	volume/man year	88%	DuPont of Canada (II, 11:23)
Steel	ton shipped per man hour	99%	Stelco (II, 8A:27)
Portable Habitable Structures	board ft/min.	90%(Calg) 85%(Mtl)	ATCO (II, 2:14)
Major electrical appliances	output/employee	85%	CGE (I, 38:7)
Custom-built power transformers	output/employee	100%	CGE (I, 38:8)
Appliance motors	physical output/employee	82.3%	CGE (I, 38:8)
Telecommunication equipment	output per individual	100%	Northern Telecom (II, 3:18)

*Most of the above figures are from companies with affiliated operations in the United States and Canada.

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* Footnotes referring to Committee proceedings indicate the issue and page number. As evidence was taken during both the first and second sessions of the 30th Parliament, the proceedings of the first session (1974-76) are identified by the prefix I while those of the second session (1976-77) are identified by the prefix II; for example, (I, 18:24) or (II, 18:24)

In discussing Canadian labour productivity one fact must be stressed. The productivity gap is not caused by Canadian workers being less energetic and hard working. Witnesses emphasized that the Canadian labour force was just as diligent as that of the United States. Mr. David Culver of Alcan, for example, asserted that "Canadian workers in the aluminum industry are very good workers, as good as can be found anywhere in the world." (I, 35:11) and Mr. A.V. Peters of Michelin stated that the quality of labour at the Nova Scotia plant was "a pleasant surprise" and its labour productivity compared to the best in the parent plant at Clermont-Ferrand, France and to that in their U.S. plant as well. (II, 24:12, 30). Other factors account for the generally lower productivity in Canada. Of these, the most important are short production runs and the persistently low level of research and development done by industry in Canada. But there are others related to financing costs, management skills and taxation disadvantages. Finally there are certain natural higher cost factors inherent in Canadian production and transportation which are due to the severe climate and the ribbon-like shape of the Canadian market which geography has imposed.

c) Higher Unit Labour Costs

The problem posed by the rapid growth in Canadian wage rates in terms of competition with the United States was succinctly expressed by Mr. Walter Ward of Canadian General Electric

> "The important fact is that Canada had, in effect reached and passed the parity point in manufacturing wages while it still was as much as 20 per cent away from reaching parity in productivity. In essence, the real problem that faces Canadian manufacturing today lies in this combination of factors." (II, 38:7)

The fact that the modest gains in Canadian productivity levels in the 1970s were far outstripped by increases in wage rates has meant a consistent increase in Canadian labour costs per unti of output relative to the United States. In the period 1970 to 1976, the cumulative increase in Canadian labour costs per unit of output amounted to 80.7 per cent as compared to 43.3 per cent in the United States.* With unit labour costs growing at such different rates in the two countries Canada's ability to compete in the U.S. market was significantly impaired.

Looking ahead, Canada is in a position to make productivity gains in the next several decades at a slightly faster rate than in the United States, if the right decisions are taken. The trend toward more liberalized trade will bring about some rationalization of the presently fragmented Canadian industry which should result in productivity gains. U.S. industry, which already has a relatively much higher degree of specialization, cannot expect to achieve the same level of improvements. But large production runs themselves are not usually sufficient to ensure that a product is competitive. A key ingredient to enhanced productivity is the development of new products, continuing and progressive improvement of existing products, as well as the

* Both percentages expressed in terms of U.S. dollars

implementation of new production processes and marketing techniques. The flow of innovative ideas in a firm depends largely on the research and development (R & D) being done. This report will discuss the problems and possibilities for effective rationalization and increased R & D in Canadian industry in Chapter IV.

Since the period during which the Committee heard its testimony, the depreciation of the Canadian dollar has largely compensated for the relative increase in unit labour costs in Canada relative to the United States, between 1970 and 1977. For the moment, with wage increases in the two countries roughly parallel and with strike activity in Canada at its lowest level since 1971, the competitive relationship which prevailed in 1970 has been largely restored.

Unfortunately, however, productivity increases at best will only support marginal adjustments year by year. Certain industries such as steel and auto assembly have productivity rates comparable to those in U.S. plants and these industries are the exceptions that can support real parity in wages. In general, Canadian productivity rates cannot support parity with the United States. If unit labour costs are to be competitive with U.S. industry, a substantial differential in the exchange rate of the dollar will be essential for many years. In the longer term, however, it would be preferable in industries with lower labour productivity than in the United States if increases in Canadian wage rates were restrained.

d) Comparative Taxation Levels

(i) *Corporate Taxation*

Taxes can have a major impact on industry's cost competitiveness.* The Committee received evidence documenting the tax disadvantage facing Canadian mining and forest industries compared to their American counterparts. However, Canadian corporate tax rates in general are a little lower than those in the United States. Combining federal and provincial levies, the rates vary between 46 and 51 per cent in Canada, whereas the comparable figure in the United States is about 50 per cent. For manufacturing and processing industries, the Canadian rates are substantially lower, running between 40 and 45 per cent. While Canadian treatment of losses is slightly less advantageous than that in the U.S., this is more than offset by the more favourable treatment accorded to intercorporate dividend payments.

In general, the United States provides stronger incentives to new investment through investment tax credit than does Canada. On the other hand, Canada permits very much faster write-offs for capital cost allowances than does the U.S. In Canada new manufacturing and processing equipment can be written off in two years, whereas in the U.S. many types of machinery have to be depreciated over ten to fifteen years for tax purposes.

Canadian producers, especially those who carry large inventories, are at a tax disadvantage relative to their American counterparts in periods of inflation, because inventory profits in Canada must be calculated on a "first-in-first out" (FIFO) basis

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* This section summarizes a more detailed analysis made by the Committee which is attached as Annex B.

while U.S. producers have the option—which most have taken—of calculating these profits on a "last-in-first-out" (LIFO) basis for tax purposes. In April 1977 the Canadian government responded partially to this problem by introducing a 3 per cent inventory valuation credit.

In the United States, the Domestic International Sales Corporation (DISC) provides a considerably reduced tax rate for profits earned on exports. However, the preponderance of testimony by Canadian industry witnesses indicated that this U.S. export subsidy tax scheme had not been a major competitive disadvantage for Canada.

(ii) *Resource Taxation*

In the resource field, companies in the United States have a clear tax advantage. Companies in Canada must pay heavy additional fees, taxes and royalties which leaves them in a disadvantageous position vis-à-vis their U.S. counterparts. The Department of Finance calculates that while the effective rate of tax on income for all taxes is six percentage points lower in Canada than in the U.S. for all industries, it is 12 and 24 percentage points higher in Canada for the mining and forestry industries respectively.

A major problem for the Canadian resource industries, and particularly the mining industry in recent years, relates to the jurisdictional disputes between the federal and provincial levels of government over the right to tax. Witnesses testified that this combined tax burden was seriously constraining the development of new mines in Canada. Mr. Alfred Powis of Noranda said that Canadian taxes in this area were more than double those in parts of the United States. He gave illustrations from his company's mines in British Columbia, Ontario and Nevada. Fortunately, this situation has begun to improve. British Columbia and Ontario have both taken steps in 1977 and 1978 to lighten the tax burden on the mining industry in their provinces. In April 1978 the Minister of Finance indicated he was reviewing taxation of the mineral industry in consultation with the provincial authorities. Nevertheless, the uncertainties and complexities of double taxation continue to have a serious effect on economic health in the Canadian resource sector.

In the Committee's opinion, it is intolerable that two of the most important components of the Canadian industrial spectrum, mining and forestry, should be shackled in this fashion. **The Committee recommends to both levels of government that they reach agreements as soon as possible to reduce the tax burden on the non-fuel mining and forestry industries in the various provinces.**

(iii) *Indirect Taxation*

One of the more important differences in the structure of Canadian and American taxes on business relates to taxes other than corporate income taxes, particularly the much heavier indirect taxes which burden Canadian industry. Mr. R.D. Brown of Price Waterhouse & Co. explained that these hidden taxes—sales taxes on equipment and supplies, capital taxes, business and franchise taxes—were applied to Canadian business whether they were profitable or not. The general manufacturing sales tax of 12 per cent had no equivalent south of the border. Mr.

Brown called these taxes inefficient and characterized their impact as "a front-end load on Canadian industry" (I, 28:6). In fact, the burden of these taxes more than offsets the benefits of the lower Canadian corporate tax rate described above.

The April 1978 budget appeared to recognize the burden by its offer to finance provincial retail sales tax reductions by 2 to 3 per cent, but this measure is only temporarily in effect and designed to provide an economic stimulus. A more permanent solution is important to improve Canadian competitiveness. Several possibilities have been suggested. The complete exemption from the federal manufacturing sales tax and from provincial sales taxes of a broad range of producers' goods would certainly alleviate, though not eliminate this problem. This method would cause a minimum amount of administrative problems under existing tax structures, but could involve a significant revenue loss. A second method would be to rebate to producers the sales tax which has been levied on inputs which they purchase. While this solution is administratively more difficult than the first, it would probably provide the maximum of benefit to producers with a minimum of loss of revenue. The suggestion of several witnesses that the sales tax burden could be eliminated by switching to a value added tax (VAT), similar to that used by European countries, to assist manufacturers does not appear to be readily applicable to Canada. The main difficulty would be that the sales tax field is shared between federal and provincial jurisdictions. However, since proposals recently advanced by the Minister of Finance for the replacement of the federal manufacturing sales tax with a wholesale tax are to be re-examined, the Committee recommends that the above proposals, or other methods designed to reduce this "front-end load" tax burden on producers, be given urgent consideration.

(iv) *Personal Income Taxes and Social Security Tax Levels*

The Committee heard testimony from numerous Canadian business witnesses relating how difficult it is for their companies to bring young executives to Canada because of the comparatively much harsher tax régime. In fact, the average Canadian personal income tax burden is not much higher than the U.S. and there is a wide variation in tax levels across states and provinces which makes comparison difficult. Nevertheless, as of 1977, an employee earning roughly $20,000 or over faced higher taxes in Canada than in almost all states in the U.S. and if this taxpayer were married and the sole earner in the family, he was quite severely disadvantaged relative to a U.S. counterpart. The typical young executive earning about $30,000 would fall into this category. The tax differential could increase if the executive moved from a low tax state to a high tax province. While a move from the high tax state of New York to the low tax province of Alberta would result in a saving of almost $1,000 in income and social security taxes, a move from a low tax state such as Texas to a high tax province such as Saskatchewan could result in additional taxes of about $4,000. Quebec would be even more disadvantageous. The "brain drain" from Canada to the United States is naturally influenced by this situation.

However, average tax rates do not tell the whole story, and transfer payments may go a long way to offset higher personal income tax burdens in Canada. Payments received via family allowances and hospital and medical insurance have no

U.S. counterpart. Moreover, the combined old age security/Canada Pension Plan benefits in Canada are likely to be higher upon retirement than U.S. social security payments. Most of these benefits would, however, be of little or no interest to a U.S. executive working only a few years in Canada and are not of prime consideration to many productive and entreprenurially-minded Canadians.

(v) *Taxation and Uncertainties in the Investment Climate*

One other factor of Canadian taxation which bothered Canadian industry related to the business uncertainty created by the almost continuous revisions in the tax system. Not only does business find it expensive to cope with the administrative difficulties caused by the rapidity of tax changes, but more importantly, it loses its basis for making long term investment decisions.

Whether this situation is much worse than pertains in the United States is difficult for the Committee to judge. However, it is important that governments, both federal and provincial, recognize the handicap effect on Canadian business of constant unpredictability in corporate taxation fields.

e) Exchange Rate

The decline in Canadian competitiveness in the U.S. market in the mid-1970s was attributed by a number of witnesses to the over-valued Canadian dollar which reached as high as $l.03 in terms of the U.S. dollar by mid-1976. Both resource and manufactured goods exports were hampered by this situation while the import of manufactures was stimulated.

Since the time the testimony was received, the value of the Canadian dollar has declined to a level that falls within the .85 cent to .95 cent (U.S.) range which most witnesses in late 1976 considered as more "appropriate", considering the existing differences in costs and productivity in the two countries. Canadian unit labour costs had risen 52 per cent since 1970 compared to 35 per cent over the same period in the U.S.

In 1977 the Canadian dollar declined during most of the year, falling below .90 cents in terms of the U.S. dollar by late October. An examination of trade figures for the fourth quarter of 1977 reveals the important impact which a realistically valued dollar can have on trade patterns. For this period the volume of imports was down by 1.8 per cent from the corresponding quarter a year earlier whereas exports were up 12.2 per cent. Imports of end products declined by 2.5 per cent in volume terms from a year earlier and exports in this category increased by 15.7 per cent. Inflation, however, meant that the dollar deficit in end products was not reduced, while for the same reason improvements in exports of resource commodities were reflected in the larger dollar surplus in this category.

Analysts are inclined to attribute this welcome trend in fourth quarter figures to the dollar's devaluation in 1977. It is however, difficult to be sure how much is due to the pick-up of the U.S. economy, which has shown greater strength than the Canadian economy. In any case, as Mr. Carl Beigie, Executive Director of the C.D.

Howe Research Institute, told the Committee at a time when the dollar was woefully overvalued yet sustained by heavy external borrowing

> "the exchange rate as a tool for adjusting to what has happened to wage and productivity trends between the two countries is a very blunt instrument." (I, 29:11)

Blunt it may be, but the devaluation of the Canadian dollar has provided the essential corrective element to compensate for competitive weakness. Unfortunately, while providing essential relief, it does nothing to correct the underlying structural problems which bedevil Canadian production.

f) Relative Financing Costs

A focus of concern for many industries was the financing of capital formation. By far the most important source of new financing for the private sector is within companies themselves. This source has been growing increasingly inadequate—both because of depressed profit levels and the inflated costs of new plant and equipment. From 1971 to 1973, 75 per cent of funds for financing new or replacement investment were generated from internal company sources whereas for the years 1974 to 1976, only 66 per cent of funds were so generated. Business representatives before the Committee compared the situation in Canada unfavourably with the situation in the United States and blamed a lack of governmental and public understanding of the role of profits in business.

In addition, it was observed that lower interest rates in the United States make capital borrowings easier for firms seeking to expand or improve. Nor has there been the same availability of capital for borrowing in Canada as is generally the case in the United States, the Committee was told.

In the mid-1970s the differential between Canadian and U.S. interest rates widened substantially. The premia of rates from 1972 to 1976 on Canadian industrial bonds over U.S. corporate bond rates averaged about 130 basis points. While the difference narrowed somewhat in 1977 it is expected that Canada's heavy capital requirements during the next few years will keep the Canadian rate higher for some time to come.

g) Higher Machinery and Equipment Costs

Another area of higher capital costs in Canada relative to the United States was the higher cost for equipment and machinery. Canada imports a very high proportion of industrial equipment; in 1976 over $2½ billion from the United States alone. Evidence was presented to the Committee showing that Canadian forestry producers paid an average of 15.5 per cent more for machinery and equipment than their U.S. counterparts. Averaging all sectors, a 1976 study estimated prices for machinery and equipment could be 25 per cent higher in Canada than in the United States. U.S. producers can easily surmount the tariff and still compete with Canadian producers. While lower import tariffs might help reduce slightly the costs of machinery and equipment, this is a cost which Canadian industry will have to continue to absorb.

h) The Natural Disadvantages of Climate and Geography

Some costs can be attributed to the climate and geography of Canada and represent an inescapable cost handicap which Canadian business must bear in competing with U.S. business in Canada, in the United States, or abroad.

The colder climate has meant higher costs for Canadian industry. Insulation, deep foundations and other cold weather building specifications add costs to the construction of plants and warehouses. Heating costs are higher, as is construction in the winter. The Canadian climate is also an inhibiting factor for forest growth, a cost factor becoming particularly evident to the forest industry in competition with companies harvesting the much faster growing trees of the south-eastern United States.

Climate and geography combine to make access to resources more difficult and costly than in the United States. Resource companies in remote areas are frequently required even to set up town-sites and provide municipal services.

Because of the geographic stretch of Canada, Canadian manufacturing companies are often faced with high transportation costs in order to get their goods to market. The sparse population of 23 million, stretching in a narrow ribbon across a continent over 5,000 miles wide, represents a badly structured market on which to build a domestic market base. U.S. plants can usually reach the necessary concentration of markets much more readily. Business witnesses also observed that, because of the distances and transportation costs involved, they were obliged to carry between 50 to 60 per cent more inventory than in a comparable U.S. plant.

2. Causes of Relocation and Disinvestment

As referred to in the previous chapter, there has been a significant movement by many Canadian companies to set up plants in the United States or to expand their U.S. operations rather than those in Canada. Simultaneously U.S. companies are cutting back on reinvestment in Canada and are repatriating profits. For the first time in 1977, U.S. parent companies took more funds out of Canada than they invested in Canada, including reinvestment.

Industry witnesses gave a variety of reasons behind each decision. Businessmen explained that they sought the lower wage rates and the higher productivity rates in the United States. They mentioned:

- the lower capital costs in the United States for plant and equipment;
- the greater availability and lower costs of financing;
- the more favourable tax rates and lower transportation costs;
- the availability of the export incentive scheme DISC;
- the ready availability of highly developed cores of research and development (R & D);
- a better availability of trained managerial personnel;
- a more favourable industrial relations climate in the U.S. with labour unions less politically involved; and

- the availability of non-unionized labour in some southern U.S. states.

During 1975 and 1976 the high exchange rate of the Canadian dollar was seen as a stimulus to relocate in the United States.

In discussing the investment drain and trends to relocate in the United States, many witnesses spoke critically of the unfavourable business environment in Canada as compared to that south of the border. Canadian businessmen referred repeatedly to the widespread misunderstanding in Canada of the importance of profits. For example, both Mr. Ian Barclay of B.C. Forest Products and Mr. Walter Ward of Canadian General Electric stressed that profits must have a realistic relationship to adequate return on equity investment. Furthermore, profits were needed to maintain or expand plants and to replace inventory, which in periods of inflation meant at inflated figures. Mr. R. W. Chorlton of Wajax was more blunt.

> "We have permitted the development of a concept whereby profit has become a dirty word, and profitable corporations are believed in some mysterious way to siphon off the wealth of society for their own nefarious ends. Nothing could be further from the truth. Profits generated by Canadian corporations are the life blood of our economy." (II, 9:22)

Dissatisfaction and uneasiness were expressed over the degree of government intervention in the Canadian market place. This was coupled with examples of the difficulties posed for industry by unpredictable government policies. Industrial undertakings requiring long term financial lead times were being restricted, witnesses said, by uncertainties of government policy. Mr. W. A. Darby, General Accountant, Taxation, of Stelco spoke of the difficulties which companies could encounter in this regard.

> "Any incentives that are adopted should be put in place for a long-term period. You cannot put your foot on the capital spending accelerator and then put on the brake. You must have time for advance planning. You cannot react quickly. It has to become an integral part of the Canadian tax structure so that when we make our long-range plans, we have a reasonable idea of what our return on investment is going to be." (II, 8:58)

Mr. Carl Beigie of the C.D. Howe Research Institute drew the distinction between "the fundamental difference in apparent philosophy" between the United States and Canadian governments. The Canadian approach, he said, has been "to increase regulation, to increase the use of marketing boards, to increase government intervention, to increase controls on exports." (I, 29:13) Businessmen and labour representatives reiterated this theme to the Committee, both groups frequently referring to the AIB's controls as an example. There was, however, a recognition that controls had conferred certain benefits as well and may have been necessary.

A number of business witnesses complained about the unproductive industrial relations atmosphere in Canada as compared to the United States, citing the fact that the labour unions in Canada were more political and less business-oriented than their U.S. counterparts.

The crisis of confidence in the Canadian business environment appeared to afflict U.S. investors and businessmen as well as Canadian. Mr. William Eberle, the former U.S. Trade Negotiator to the Tokyo Round of the multilateral trade negotiations and now a businessman, explained to the Committee the perceptions and concerns current in the United States.

"We in the United States are, first and foremost, worried . . . about the attitude toward investment in Canada and this is brought out first of all by your FIRA, wage and price controls, by the rate of inflation. It is a concern that is hard to put one's finger on, but the question which pervades most board rooms in the United States is whether this is the kind of country in which to place investment. There is concern as to whether or not long term profits are going to be there; there is concern as to the future of the private enterprise system in Canada." (II, 17:11)

Recognition by the U.S. business community and economic analysts that the principal objectives of the Foreign Investment Review Act (FIRA) are not to block investment, as much as to gain better terms for Canada, has been slow in coming. However, the U.S. Administration has stated that it does not consider FIRA to be a "serious obstacle" to most foreign direct investment in Canada.*

While Canada has long been regarded in the United States as a reliable trading partner, a number of developments in the 1970s may have caused a reassessment of this attitude and may be responsible in part for the disinvestment trends by U.S. companies. Such decisions as the 1973 phase-out of Canadian oil exports for example was a surprise blow to U.S. industry. Even though there is now a wider U.S. understanding of the reasons for the change, the initial reaction to the "blue-eyed Arabs of the North" included outraged demands for retaliation. Mr. Eberle characterized this as "the Canadian shock to the United States." (II, 17:29)

The nationalization by the Saskatchewan government of a part of the potash industry produced a strong negative reaction from the United States. The United States is heavily dependent upon Saskatchewan as a source of potash. Almost 70 per cent of U.S. potash needs came from Canada in 1974. In an aide-mémoire on the issue to the Canadian federal government, the United States government spoke of "the major potential for damage to U.S. interests and to U.S.-Canadian relations inherent in this action."** A number of U.S. political figures expressed concern over the security of their import supply. Even though the Saskatchewan government made it clear it wished to expand production (and presumably sales), some of the U.S. customers tended to interpret Saskatchewan's action as an attempt to increase revenues by restricting supplies and increasing prices. In the opinion of Mr. Alfred Powis, President of Noranda, the Saskatchewan government's policy has resulted in U.S. attempts to develop alternative sources of supply of potash in third countries such as the Soviet Union. However, the 1977 decision of U.S. producers to develop potash deposits in New Brunswick suggests that U.S. attitudes may be relaxing.

The recently announced intention of the Quebec government to take over a U.S.-owned asbestos company in Quebec has produced a similar uneasy reaction in the United States, although it may have been less unexpected. The 1976 election platform of the Parti Québecois had called for nationalization of this industry, which accounts for 80 per cent of Canadian production and 50 per cent of the free world supply. Since the election, the policy emphasis of the Quebec government has been to seek to increase the amount of processing of this product within the province.

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* U.S. Embassy, Annual Review of the Canadian Economy 1977

** Aide-mémoire, U.S. Embassy, Ottawa, December 9, 1975

There is no doubt that the election of the Parti Quebecois government in Quebec has had an unsettling impact on the U.S. business and investment community's perception of Canada. The concept of Canada as a cohesive and unified country has suffered a serious blow in Americans' minds. Doubts as to the reliability of Canada as a resource supplier have been sown by this Quebec political development as well as by provincial expropriations of U.S. resource companies. Certainly there is enough concern in Washington as to the extent of provincial powers over resources that some press reports have suggested that the United States seek to develop direct relations with the provinces rather than dealing through Ottawa.

An important and somewhat surprising stimulus to the expansion and relocation of Canadian companies in the United States, as well as to the reduced investment by U.S. subsidiaries in Canada, is the prospect of reduced tariffs resulting from the current GATT trade talks. It was argued that, for Canadian companies, any tariff liberalization on top of the other competitive disadvantages of producing in Canada, would make it more attractive to produce in the United States. Mr. R. W. Chorlton of Wajax commented,

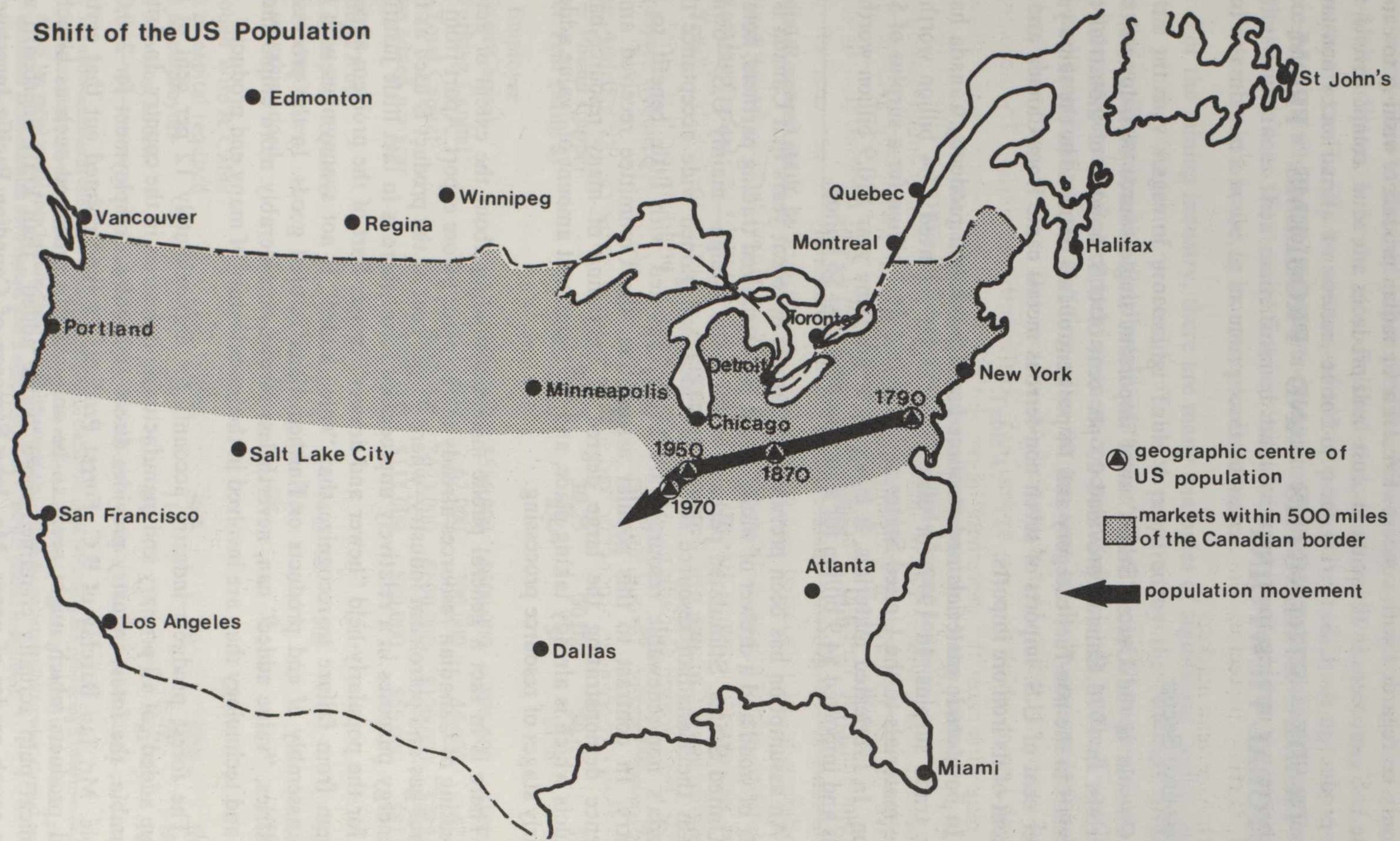
> "Now because of the rapid escalation of Canadian wage rates we are studying. . . . our manufacturing at our Seattle plant. Preliminary indications are that because of lower component costs, lower wage rates and a somewhat larger domestic market, we would derive corporate economic benefit from closing down in Canada and developing our Seattle unit. Any reduction in Canadian tariff rates would, of course, increase these benefits." (II, 9:21)

U.S. multinationals, influenced concurrently by the more fundamental change taking place in the location of standard technology industries on a global scale, also appear to be considering the reduction of production facilities in Canada. According to a 1978 survey by the U.S. Department of Commerce which forecasts planned capital expenditure by U.S.-controlled companies in Canada, such expenditures will rise by only 1 per cent as compared to 5 per cent in 1977 and 10 per cent in 1976.

The attitude toward tariff liberalization by both Canadian companies and U.S. subsidiaries in Canada appears to be almost entirely defensive. Preoccupied with their vulnerability if the Canadian tariff were lowered, producers in Canada expressed little if any interest in the expanded opportunity of exporting to the U.S. market when U.S. tariffs were simultaneously lowered. Part of the explanation, at least for Canadian-controlled companies, may lie in the presumption that non-tariff barriers such as import quotas and U.S. procurement practices represent obstacles to exports from Canada which would nullify the effect of a reduction in the U.S. tariff. (As far as U.S. subsidiaries are concerned, many are constrained by the parent corporation from selling in the United States in any case, so their indifference to the U.S. market opportunities is not unexpected.) A number of witnesses whose firms were expanding into the United States were quite explicit that U.S. federal and state procurement policies constituted barriers to market penetration which could only be effectively circumvented by establishing U.S. production centres. Some witnesses spoke of the difficulties posed by the U.S. customs administration, while others feared the imposition of U.S. import quotas. In short, a whole range of non-tariff measures were seen to loom large in restricting market penetration in the United States.

The implications of such a situation for the future of Canadian manufacturing can only be regarded with concern. Even if a Canadian producer, wishing to export to the U.S., succeeds in reducing his costs and produces a product competitive with a U.S. product in the U.S. market, he could be restricted in that market by non-tariff measures. This at least appears to be the view of the Canadian exporting companies which are minimizing their risks by locating production facilities within the U.S. itself, thereby protecting the access of their products to 90 per cent of the total North American market.

Finally, another factor in the relocation and expansion in the U.S. is the steady and continuing shift of the U.S. population from the east and north towards the south and west of the United States; that is, farther and farther away from the production centres of the Canadian manufacturing industry. This problem was raised by the Canadian Manufacturers' Association and in the Committee's opinion is a valid point which does not appear to be sufficiently recognized. The accompanying map illustrates the movement of population during the past two hundred years in the United States, a movement which actually understates the shift of industry and of purchasing power. The population of the south and west is younger and tends to have higher patterns of consumption. The economic life of the area is more vigorous than the national average. Industry is newer and concentrated in fields which tend to be growing faster. In 1975, approximately 80 per cent of total Canadian sales of fabricated and end products to the United States were made to states lying within approximately 500 miles of the Canadian border. As purchasing power and industry moves toward the south-west, selling to the U.S. market and serving it from Canada will become increasingly difficult and costly. It is little wonder that many Canadian companies anxious to profit from this large and fast-growing market throughout the south and west of the United States, have established or expanded production and service facilities across the border.


Shift of the US Population
Edmonton
Winnipeg
Regina
Vancouver
Portland
Minneapolis
Salt Lake City
San Francisco
Los Angeles
Dallas
Chicago
Detroit
Toronto
Quebec
Montreal
Halifax
St John's
New York
Atlanta
Miami
1790
1870
1950
1970
geographic centre of US population
markets within 500 miles of the Canadian border
population movement

IV TRADE STRENGTHS AND PROBLEMS FROM A SECTORAL VIEWPOINT

1. Resource Sector

Canada is the United States' most important single source of industrial raw materials. In 1976 Canada provided 23 per cent of U.S. imports of industrial raw materials in the non-fuel category and 14 per cent of fuel imports. In the same year, 34 per cent of U.S. imports of seven non-ferrous metals came from Canada and 64 per cent of its iron ore imports.

In both crude materials and resource-based fabricated products, Canada has a large trade surplus. In 1977 for example, Canada exported $5.4 billion worth of crude materials to the United States and imported $1.7 billion for a surplus of $3.6 billion. In fabricated materials, it exported in the same year $10.9 billion worth of goods and imported $4.9 billion for a surplus of almost $6 billion.

An assumption has been prevalent in Canada in recent years that Canada is "a hewer of wood and a drawer of water" for its industrialized trading partners, notably the United States. Stimulated perhaps by the large foreign—mainly U.S.—ownership in the Canadian resource sector, the idea had gained wide acceptance that Canada's non-renewable resources are being exploited with little benefit to the country. In contrast to this popular assumption, the Committee received ample evidence demonstrating the large degree of upgrading of many resource-based products which is already taking place, and the significant amount of "value added" in early stages of resource processing.

There is in fact a general public misunderstanding about the extent of actual processing of Canadian resources already taking place before export. Apart from the natural gas and petroleum industry, where 95 per cent of the product is used as fuel for energy purposes in a relatively unprocessed form, there is in fact little justification for the popularly-held "hewer and drawer" image. Part of the problem appears to stem from failure to recognize that "value added" is not synonymous with the final assembly of end products or finished manufactured goods. In the processing industries, "value added" can, nevertheless involve considerably more employment, skill and technology than are involved in the manufacture of many end products.

The forest products industry accounts for approximately 12 per cent of the "value added" of all primary and manufacturing industries in the country. In British Columbia, the forest industry provides direct and indirect employment for 250,000 people. Mr. Ian Barclay of B.C. Forest Products Limited pointed out that certain wood products which might seem to be only slightly processed such as bleached chemical pulp actually contained more "value added" than kraft linerboard and some rough grades of paper. Mr. John Stenason of Canadian Pacific Investments

(CPI) estimated that kraft pulp represents at least 80 per cent of the processing from basic wood fibre to finished paper product. Newsprint, a major Canadian export to the United States, is in the most finished state possible for export since American newspapers can hardly be written, edited or printed in Canada. A cut and dressed piece of 2" x 4" lumber represents considerably more "value added" in terms of capital and labour than many finished manufactured goods and is, except for the final assembly in a house, in its most processed state.

For the mining industry, there are many examples of significant "value added" in the primary stages of processing. Table 4 prepared by the Noranda group of companies, illustrates the distribution of "value added", capital requirements and employment generated as copper is mined, concentrated, smelted, refined, made into rod and transformed into building wire. 60 per cent of the "value added" occurs

Table 4

Capital Required, Direct Employment Created and Value Added at Different Levels of an Integrated Copper Industry

	Mining & Conc.	Smelt. & Refining	Rod Mill	Wire & Cable	Total
Capital Required (Mill. $)					
Fixed Assets	$300	$250	$15	$190	$755
Working Capital	20	30	15	110	175
Total	$320	$280	$30	$300	$930
Employees Required	1,200	450	50	2,500	4,200
Value Added					
Per Pound Copper	$0.75	$0.25	$0.02	$0.69	$1.71
Per Year (Mill. $)	$150	$50	$4	$138	$342
Per Employee					
Fixed Capital	$250,000	$556,000	$300,000	$76,000	$180,000
Working Capital	17,000	67,000	300,000	44,000	42,000
Total Capital	$267,000	$623,000	$600,000	$120,000	$222,000
Value added per year	$125,000	$111,000	$80,000	$56,000	$81,000
Through Rod					
% of capital required	51%	44%	5%	—	100%
% of employees	71	26	3	—	100
% of value added	74	24	2	—	100
Through Wire & Cable					
% of capital required	35%	30%	3%	32%	100%
% of employees	29	11	1	59	100
% of value added	44	15	1	40	100

Note: The above assumes development of two typical British Columbia open pit mines each producing 50,000 tons of copper in concentrate per year, integrated with a smelter plus refinery capable of producing 100,000 tons of metal per year. All of the metal would then be rolled into rod which would then all be drawn into building wire. Capital costs are estimated in unescalated 1976 dollars and a copper price of $1.00 per pound is assumed.

Source: Estimates by Noranda Group companies.

before the rod is drawn into wire. Similarly, Mr. Stenason of CPI pointed out that over 60 per cent of the processing of lead and zinc is achieved at the concentrate stage. He told the Committee that, for lead and zinc, 80 per cent of his company's production was fully processed or significantly processed in Canada, while all of its production of forest products, including pulp and paper, was Canadian processed, either wholly or largely. Mr. Alfred Powis of Noranda gave the Committee some overall Canadian figures which showed that in 1974, 80 per cent of Canadian copper exports to the United States had been transformed to the metal stage, 59 per cent of zinc exports and 53 per cent of lead.*

Aluminum undergoes extensive upgrading. Sometimes mistakenly thought of as a Canadian resource, it is a product made from mainly imported raw products. To these raw materials, Canadian aluminum producers apply capital, labour and energy in a labour-intensive upgrading process. Mr. David Culver of the Aluminum Company of Canada gave the Committee an example of the contrasting amounts of "value added" at two stages, the more intensive amount being in the earlier stage.

> "If we then take the pound of aluminum ingot and roll it into a pound of sheet, the popular concept is that we have added a lot of value and provided a lot of jobs. Well, we have just built a new, very modern rolling mill in Kingston, Ontario, which can roll 150,000 tons of aluminum sheet per year. It provides 165 jobs. But back in the Saguenay, there are going to be 2,250 men working in the chemical plants and smelters to produce that 150,000 tons of ingot for the rolling mill in Kingston." (I, 35:12)

This works out to be approximately 15 times the number of jobs in the creation of a ton of aluminum than to roll it into aluminum sheet, a later stage of processing.

Another major processing industry, the Canadian steel industry, has developed into a modern, efficient and competitive force on the basis of indigenous iron ore and imported coal. While not a major export industry, it now supplies 90 per cent of the Canadian domestic market, reinforcing the fact that in such industries, import substitution is as important as exporting. Some fabricated iron and steel products have made significant inroads into the U.S. market in recent years. While large volumes of iron ore are shipped to the United States in raw or pelletized form, U.S. iron ore and coking coal are also shipped into Canada to provide, most economically, the raw materials basic for some companies' steel manufacturing. This bilateral exchange of iron ore is mainly a matter of transportation economics.

In the petroleum and natural gas sector, Canada is now embarking on upgrading through a number of world-scale petrochemical plants of which the two largest are ethylene plants, one in Sarnia, Ontario and the other in Red Deer, Alberta, each with a capacity well in excess of 1 billion pounds a year. According to the Canadian Chemical Producers Association, the total "value added" for the oil and gas used by the petrochemical industry for feed-stock in Canadian manufacturing, although only 5 per cent in volume, is equal to the "value added" for the whole of the oil and gas used as fuel.

Nor can the Canadian resource sector be considered merely as an unsophisticated extractor and processor from a technological point of view. Contrary to popular

* Although he made the point that the lead and zinc figures suffered from the distorting effects of a strike.

belief, the amount of high technology and skill levels is often superior to that employed in the mass production processes of secondary manufacturing. Moreover, these processes have frequently had important export spin-off benefits. As Mr. Tom Burns of Industry, Trade and Commerce said

> "Even the so-called crude materials are generally the end result of sophisticated production methods. Agriculture, mining and forestry, which are important primary industries in Canada, have achieved their high degree of efficiency largely because of very substantial investments of capital, a wide use of science and technology and a skilled and experienced labour force . . . For example, because of the nature of our mineral resources, Canada has been very successful in developing geophysical instrumentation, advanced techniques of topographical mapping, as well as automated cartographical techniques, all of which have entered into our export trade." (I, 22:8)

The resource sector makes an important contribution to regional development and employment, often in remote areas. Mr. Culver pointed out that Alcan had approximately 20,000 people working in Canada, "in areas where alternative employment was not plentiful." He estimated that over 10,000 Canadian jobs depend upon the U.S. aluminum market alone (I, 35:6). The Canadian forest industries support nearly one million jobs directly or indirectly. They are of major importance to rural Canada; many communities have no other industry.

These positive contributions of the resource industry to the achievement of a balanced national development have not been fully recognized in recent years by the federal and many provincial governments. Not only does it contribute in a major way to the Canadian balance of payments, but there is a very significant degree of "value added" involved in resource processing and there are important high technology and regional benefits derived from this sector. The question is how much additional upgrading and processing of Canadian resource-based exports to the United States can be realistically expected?

a) U.S. Tariff Protection on Fabricated Products

The U.S. tariff presents problems to Canadian resource processors exporting to the United States. Like the Canadian tariff and that of other industrialized trading partners, the U.S. tariff generally rises with the degree of processing of the imported goods. It is only fair to point out, however, that access to U.S. markets for such products is considerably easier than to either Japan or the European Community.

Since the United States is itself a major producer of most natural resource products it is not surprising that it seeks some protection for its own processing industries. It is the world's largest producer of mining products and a substantial net exporter of some of them. This is the case for many copper products, for molybdenum and for zinc alloys except for those products related to the automotive industry. Mr. Alfred Powis of Noranda explained the U.S. tariff impact on Noranda's operation.

> "We cannot get into the U.S. market from Canada in those copper products because of the tariff structure. Therefore if we really want to operate in the U.S. market, we have to locate our plants there". (I, 36:12)

Mr. John Stenason of Canadian Pacific Investments Limited said that the stiff U.S. tariff against very high purity metals used in electronic manufacturing is the reason why their subsidiary, Cominco, set up a processing plant in Spokane, Washington, and shipped Canadian raw materials there for processing.

Officials gave the Committee an example of tariff impact based on 1971 figures. Canada exported $285 million worth of unwrought nickel to the United States with no duty but semi-manufactured nickel attracted a nominal duty of 8.8 per cent and imports of these products dropped to $2.6 million over an average weighted tariff of 2½ per cent*. Canadian exports of unwrought copper facing a weighted average tariff of 1.7 per cent were $133 million. Semi-manufactured copper goods faced an average weighted tariff of 3.1 per cent and exports amounted to $41 million.

The impact of the escalating U.S. tariff can also be seen in exports of the forest products industry. While raw lumber trades freely, a U.S. tariff is imposed as soon as the board is stained or sanded and it escalates at a rate which depends on whether it is made into veneer or plywood, prepared for flooring, doors or containers or processed in other ways. The average U.S. tariff for wood-based panels is 16 per cent but it reaches as high as 20 per cent for Douglas fir plywood. Some tariffs appear illogical. A U.S. tariff of 2.5 per cent on a dowel for example, jumps to 16.66 per cent if the dowel has a hole in its end. Pulp, paper waste, paper and paperboard face no tariff or very low U.S. tariffs, and Canada's exports in these items totalled $1½ billion in 1971. But pulp and paper manufactured exports are subject to tariffs around 7 per cent and Canada exported only $11 million of these products. While many of the U.S. tariffs against resource based goods are numerically low, i.e., below 5 per cent, they can be effective in blocking Canadian exports.

The effective rate of protection afforded to the U.S. processors' "value added" by these tariffs is often two or three times as great as the nominal rates would seem to imply. This is especially so when the nominal tariff protecting the processed product is higher than the tariff on inputs. For example, if the tariff on fine papers entering the United States is 6.2 per cent and the tariff on the principal input, pulp, is 0 per cent, the rate of protection of the "value added" in the fine papers will be greater than 6.2 per cent; how much greater will depend on the relative importance of pulp cost to the total cost of producing fine paper.

Conscious of these barriers against resource-based processed goods, Canada has attempted to focus attention on resource-based tariffs in the current GATT negotiations. Mr. Tom Burns of the Department of Industry, Trade and Commerce explained that the government's objective was to press for better access

> "... so that there is an opportunity for Canadian producers to look at a market that is larger than the Canadian market for these downstream products, and thereby remove one of the important inhibitions against establishing in Canada the scales of production which would make us competitive internationally in downstream products." (I. 22:25)

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* An average weighted tariff is a level reflecting the tariff average of items within a category, weighted by the volume imports entering the United States.

Canada's tactic to attain its objective has been to promote sectoral negotiations, that is to put the products of an entire industry on the negotiating table from the crude to the processed stage of production. By this approach, Canada hoped to reduce all tariffs or non-tariff measures now in place against a particular product at all the various stages of processing or manufacture. Canada specifically proposed negotiations in non-ferrous metals and forest products and government negotiators have used copper as a model for supporting their proposals. The United States gave cautious support to the sectoral approach and even proposed sectoral negotiation in steel, but by early 1978 other important GATT participants were responding negatively to this approach and it appears to have lost its chance of being used as a framework for negotiating tariffs.

The GATT negotiators had, by early 1978, agreed to make cuts along the lines suggested by Switzerland. The Swiss formula calls for a 40 per cent average cut with high tariffs being cut more deeply than low tariffs. This immediately presents Canada with a problem vis-à-vis the United States and its other major trading partners, because an estimated 90 per cent of Canada's dutiable exports to these partners encounter tariffs which are low but nonetheless effective in frustrating Canadian efforts to further process many raw materials before export. Such tariffs will receive comparatively smaller cuts. On the other hand, Canadian tariffs on manufactured goods, of which it already imports more than the three main industrial partners combined, are relatively higher than similar tariffs of other industrialized countries. These tariffs on manufactured goods will receive more drastic reductions leaving Canada more vulnerable to imports.

With the resource industries very much in mind, Canada has taken the position of linking its willingness to make tariff cuts along the lines of the Swiss formula to the progress which the negotiations make in two other areas, namely

> "to the degree of success in eliminating, reducing and bringing under control certain non-tariff measures and on the willingness of the other participants to meet Canada's objective of a greater liberalization of tariff and non-tariff barriers in the key resource-based sectors of Canada's export trade (non-ferrous metals and forest products)".

This linkage will presumably permit Canada to argue that if it does not receive commensurate cuts on a weighted average for its resource-based exports it would be able to make lower-than-formula cuts on its own higher-than-average tariffs or obtain an increased number of exemptions from those lists. The outcome of the GATT negotiations is therefore, vitally important to increased Canadian processing for export.

A more liberal access to the U.S. market for resource-based products is desirable. **In the Committee's opinion therefore the reduction or elimination of these escalating tariff barriers must be a prime Canadian objective at the GATT negotiations.**

However, tariffs in the United States and elsewhere are not the only constraint to increased processing. Even if Canada achieved all its objectives at Geneva with respect to better tariff access for resource-based products, it is not at all clear how much more resource processing and upgrading in Canada would result. Canadian businessmen cited other constraints.

One most frequently cited was market proximity. Mr. David Culver said Alcan had not only aluminum sheet mills in the United States but specialized mills for the building products trade and a whole series of service centres, mobile home centres and small staging points. These were located near the local manufacturer so that Alcan could supply him with his more specialized requirements. The company also had several American plants which manufactured electrical bare and covered wire and cable from imported Canadian-made aluminum rod or wire bars. Mr. Culver doubted that a significant change would result in this pattern of production, even if the U.S. tariff were eliminated.

> "I would hate to see us deceive ourselves into feeling that if we paid a very high price in some way in order to achieve, let's say, total free trade in the products we are talking about, both ways, that things are suddenly going to change, or even that over time there would be a tremendous change in the location of manufacturing facilities. The reason I say that is that basically the further down the line one goes, the more it is a local service business". (I, 35:18)

Mr. Powis of Noranda confirmed that the higher the level of processing, the closer to the market the production facility needed to be. He commented on the reasons why his company's very large aluminum products plant in Cleveland was not built in Canada. It was even a mistake to have built in Cleveland, he said.

> "We should have a number of smaller plants closer to the market. The products tend to be tailor-made for the particular market you are operating in. You need fast delivery, otherwise your inventories get out of hand. In a great many cases our warehouses are just too far away from that Cleveland plant and we are now considering the possibility of breaking it up into a number of smaller units". (I, 36:23)

For the lead and zinc exports, Mr. Stenason of Canadian Pacific Investments emphasized that they must be closely geared to the needs of the existing market. He also made the point that if Canada did not want to supply concentrates to use in existing foreign smelters or refineries, he was confident there were other foreign competitors who would be happy to do so.

In the forest products industry, Mr. Stenason pointed out that the manufacture of fine paper was also market oriented. However, the advantages of proximity to market do not prevent competitive inroads from more distant producers. As Canada's cost competitiveness has decreased, when strikes and higher Canadian costs hit the Canadian industry in 1975 and 1976, fine paper imports from the United States took a greater share of the Canadian market despite a sizeable Canadian tariff and the acknowledged benefit of local production facilities.

The close market-orientation of another type of paper production was most striking. Moore Corporation is a Canadian-owned firm controlling 28 per cent of the U.S. business-form market, as well as 40 per cent of the Canadian. Mr. David Barr, Chairman of the company, testified that because fast service was competitively important, the company had located its manufacturing units strategically throughout the United States and Canada, each serving a limited geographic region. For sales to large companies such as Ford, Sears Roebuck and General Motors, Moore Corporation even has its own personnel working on the customers' premises on a full-time basis. For this reason, Mr. Barr thought that it was unlikely that reduction of the high tariff (20 per cent) imposed by both countries on business forms would affect the present locations of their manufacturing plants. The need to be close to a

regional market was, however, reinforced by two important non-tariff barriers—government purchasing and country-of-origin labelling.

Another constraint, at least at present, is the relatively high capital cost disadvantages of newly constructed Canadian facilities. Mr. John Stenason warned that any new Canadian smelting or refining plants built at current high costs and designed to penetrate export markets, including the U.S. market, would have a very difficult time competing with the products of existing low-cost plants in those countries.

In respect to the increased processing of Quebec asbestos a 1978 industry report pointed out that the market for traditional asbestos products was being rapidly overtaken by new asbestos based products or by non-asbestos substitutes. Rather than expanding processing in Quebec, the challenge to the industry will be to develop new products and processes in order to maintain and expand its market.

In addition, non-tariff measures such as quotas can be instrumental in barring exports of resources and resource products to the United States. Mr. Alfred Powis told the Committee that Canadian zinc and lead exporters fight a continual battle against the attempts of American industry to have quotas on imports. In December 1977 an application by U.S. zinc producers sought an increase of the tariff from 0.7 cents a pound to 7 cents a pound for imports in excess of a base quota. In January 1978, the U.S. government was being petitioned by copper producers to increase the tariffs or impose quotas on refined copper. Even if U.S. tariffs were lowered on fabricated materials as a result of an agreement in GATT, significant increases in exports might be blocked by a variety of constraints, unless special access to the U.S. market was gained through a free trade agreement.

The goal of better U.S. access for upgraded products, is particularly important at this time for the Canadian petrochemical industry. The two new petrochemical plants scheduled to come into operation by 1980 will produce such products as ethylene, propylene and polyvinyl chloride. They will have enormous excess capacity. Only about half of the ethylene can be absorbed into plastic production on the domestic market through import substitution. The remainder must be exported to make the plants viable. The United States has already voiced an interest in improving access for these products provided additional Canadian gas supplies were made available. However, the Arab countries are also interested in upgrading their petroleum resources and the same *quid pro quo* vis-à-vis the United States will be available to them in this respect. The U.S. petrochemical industry itself will be seeking more not less protection and the competition from the established lower-cost Gulf coast producers will be very difficult for the Canadian industry which has construction costs of up to 20 per cent higher. The prospects for Canada are not particularly bright unless Canada entered a special arrangement with the United States.

A number of problems are facing many of Canada's resource industries. In the mining sector, world demand is unstable. Under-developed countries rich in resources have been undermining commodity prices by sustaining production regardless of cost and demand in order to maintain employment and earn foreign currency. Inventories are high, prices are generally low. Several Canadian ore bodies are of low

grade and have been brought into production through mining expertise and high capital investment, whereas many new ore bodies in third world countries are more competitive than Canadian bodies. Challenges of another sort in the form of seabed nodules face domestic producers of metals.

The forest industry, particularly in Eastern Canada, is suffering serious difficulties due to new competition from the fast-growing trees of the southern United States. These well-planned, carefully managed, planted forests are easily accessible and readily harvested by efficient mechanical means. They are not constrained by the more rigorous climatic conditions or the rough terrain of Quebec. New Brunswick and British Columbia. Technological advances have reduced the competitive advantage of Canadian softwoods for pulp by devising new methods of pulp and paper production from hardwoods.

Despite its present and future problems, the Canadian resource sector remains the backbone of the economy and of its export trade. Without its foreign earnings, not least in the United States, Mr. Carl Beigie of the C.D. Howe Institute considered that

> "even though we want to be less dependent on resource industries, what has been happening in the wage field suggests to me that in order to pay for our needs in external markets, we are going to have to be probably at least as dependent on resources for as far into the future as I can see". (I, 29:17)

It is essential for Canada to retain a vigorous and healthy export sector. For reasons discussed in another section of this report, the Committee doubts that Canadian secondary manufacturing can, in the foreseeable future, become a strong export performer, except in a few selected indigenous high technology areas. However, in many fields of resource development, Canada is known as a world leader. In mining, sophisticated technological equipment and techniques have been developed in Canada. In most cases there is no problem of Canada running out of resources. Except in the fossil fuel sector, Canada's resources are renewable or in adequate supply for generations to come. Despite certain built-in Canadian disadvantages resulting from climate and the remote location of many of the raw materials, Canada continues to have important assets, a skilled labour force, long years of experience and some sources of inexpensive energy. Rather, Canada's difficulties derive from a recent sharp increase in unit costs of production, which the depreciation of the Canadian dollar has done something to reverse, and a variety of barriers limiting access to foreign markets.

In regard to improved competitiveness the Committee has already indicated its concern over the onerous impact of double taxation in the resource field and recommended that governments at both levels eliminate this burden as quickly as possible.* Here as elsewhere there has been far too little recognition of the capital required for investment and expansion purposes, and until recently, little understanding of the need for after-tax profits for expansion. On the resource industry's part, with few exceptions, there has been little governmental recognition of the need to increase their R & D so as to improve their technological capacity and develop new processes which will also improve their competitiveness.

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* see above, Resource Taxation p. 22

Mr. David Culver had a wise word to say about competitiveness and value added in Canada's resource sector. he stressed the importance of adding value *efficiently*. Otherwise, he said, it would be better to concentrate on developing efficiently the resources Canada had been blessed with.

> "Rather than talking about seeking value added, I think we should start by saying that we seek value efficiently added and make sure we go after the conditions which will permit the efficiency. Then I am sure we are getting a net gain. Otherwise, we run this risk of frittering away some of our advantages by striving to add value when we cannot add value as well as somebody else can." (I, 35:16)

In addition, **efforts must be made by both industry and government to increase public understanding of the value of the resource sector to the national economy.** A commendable and responsible beginning to this campaign has been initiated by the pulp and paper industry, and this may stimulate comparable efforts in other resource industries.

b) Two Areas for Examination

In its discussion of the Canadian resource and manufacturing industries, the Committee identified two areas for which important basic data were not available. Before intelligent economic decisions can be made, the relevant facts, figures and costs must be publicly and clearly at hand. The Committee concluded that there were requirements for:

a) a study to determine the relative costs and contribution to the economy made by the resource-based industry as compared to secondary manufacturing

b) a review of Canadian statistical classifications.

(i) *The Relative Costs and "Value-added" Contributions of the Resource and Secondary Manufacturing Sectors*

In the face of rising energy costs, increasing capital costs, and hard-to-measure environmental and social costs, Canadians are asking what are the relative benefits of increased emphasis on resource upgrading as compared to a more rapid development of import-competing and export-oriented secondary industries. As long as there is competition for scarce energy or financing, the encouragement of one sector usually means the discouraging of another. The federal government has, under the Export-Import Act, broad discretionary powers to use export controls in order to promote further processing. Should such controls be used and, if so, under what conditions? Before pursuing such policies, it is essential to have all the facts.

The Committee recommends a major study which would analyse and compare the effect on Canadians and the Canadian economy of the relative "value-added" contribution made by resource-based industry as compared to secondary manufacturing. Such a study should be undertaken by one of Canada's leading research institutions. The inquiry might explore: the amount and nature of employment to be generated in each sector including skill levels, pay levels, the comparative regional and urban-rural incidence of activity, whether directly or indirectly generated; the comparative net tax effects; the relative technological sophistication of both sectors' activities; the relative dependency on foreign capital, equipment, technology and

management, and the relative impact on the renewable and non-renewable resource base.

(ii) *Problems in Statistical Classifications*

There appears to be a shortcoming, even a distortion, in the statistical data available in respect to Canadian manufactured goods. It is understood that the data are classified according to international breakdowns, but do these classifications suit the Canadian economy? The artificial separation of "fabricated" or "processed" goods such as lumber or newsprint from the rest of the "manufactured" products or "end products" distorts the amount of manufacturing done in Canada and the actual imbalance of trade in manufactured goods. This report has indicated that many products such as newsprint or lumber are already taken to their final points of manufacture before being exported. There has been an unfortunate and misleading tendency to equate the end products category of manufactured goods with "high technology" and the fabricated group with "low technology". However, witnesses emphasized that there is more high technology involved in producing pulp and paper than in building a television set. The unfortunate result has been that the huge imbalance in end product trade has been generally misinterpreted as showing Canada has little high technology manufacturing.

Officials from Industry, Trade and Commerce before the Committee acknowledged that both fabricated materials and end products were manufactured goods and stated a preference for classifying them together. They pointed out that in the United States' commodities statistics, various items which under the Canadian system would be segregated were grouped together under the heading of manufactured goods.

The Committee recommends that Statistics Canada examine this problem of classification.

2. The Manufacturing Sector

The Canadian Manufacturers Association told the Committee that Canada has a deficit in manufactured products with every country with which it trades and in every major commodity grouping. Canada also takes a higher proportion of its imports in manufactured form than other major countries—74 per cent as compared to 60 per cent for the United States and 32 per cent for the European Community. This situation is reflected in employment figures. And the situation is deteriorating. Mr. Walter Ward of Canadian General Electric reported that the proportion of the Canadian workforce engaged in manufacturing declined from 24 per cent in 1960 to 22.5 per cent in 1973, a decline not paralleled in other industrial trading countries during the same period.

According to figures produced by the Science Council, Canada has fallen behind other industrialized countries in its rate of industrialization. Whereas in 1955 Canada was second only to the United States in terms of the production of manufactured goods per capita, by 1974 it had been overtaken by six other industrialized countries; Sweden, France, Japan, Finland, Australia, and West

Germany. Others including Norway, Belgium, Denmark, Austria and Italy have come from far behind and almost overtaken Canada. In terms of the value of finished manufactured goods as a per cent of total exports, Canada's earlier place near the lead has been retained only because of the tremendous spurt of exports achieved as a result of the Automotive Agreement of 1965. If trade arising from the Automotive Agreement is excluded however, Canada made scant progress in its finished manufactured exports—an increase in two decades of only 3 per cent compared to Denmark's 11.3 per cent, France's 5.5 per cent, Mexico's 16.8 per cent and Sweden's 10.8 per cent. Mr. John Shepherd, Executive Director of the Science Council said that Canada could almost be considered to be "de-industrializing as a country", and a recent Science Council report referred to the sixties as "a period of serious decay in Canadian manufacturing".* This unsettling conclusion is more disturbing when it is recalled that the "golden" sixties are generally assumed to have been a very successful period of Canadian industrialization. It is now apparent that the Auto Pact-induced exports concealed an otherwise generally weak performance.

The United States is Canada's main market for manufactured goods and Canada is the largest market for U.S. manufacturers. In 1975, 70 per cent of Canada's imports from the United States were classed as end products, although the portion falls to 38 per cent if automotive products imports are excluded. 39 per cent of Canadian exports to the United States are end products, but this declines to 11 per cent if exports of automotive products are excluded. While the last figure is relatively low, the United States is, nevertheless, by far the best market for Canadian manufactured goods. Moreover, as has been noted previously, there is much more manufacturing in the exports of fabricated materials from Canada to the United States than is generally realized and than is reflected in the statistical classification.

Canadian exports in dollar terms have been growing in all categories, reflecting in part the recent high rates of inflation. However, as chart 4 demonstrates, in 1977 Canada's export of end products (other than automotive products) actually declined, even though the U.S. economy was performing well. The erosion of the U.S. market for Canadian manufactures has occurred at a time when U.S. goods have been increasing their penetration of the Canadian market. In the important machinery industry sector, for example, a recent government study found that between 1970 and 1975 the percentage of the Canadian market supplied by domestic production fell from 46.9 per cent to 37.7 per cent. Excluding automotive trade, the bilateral imbalance in end products with the United States has grown sharply: from $4.4 billion in 1975, to $7.7 billion in both 1976 and 1977. The trends are unmistakeably unfavourable and require a fundamental reassessment of the role of manufacturing in Canada.

a) Structural Problems in the Manufacturing Sector

A phenomenon of the post-war world has been the development of highly efficient large-scale units of production with a considerable emphasis on product specialization. The trend has been assisted by increasingly efficient, low-cost trans-

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* *Uncertain Prospects,* Canadian Manufacturing Industry, 1971-1977, p. 3

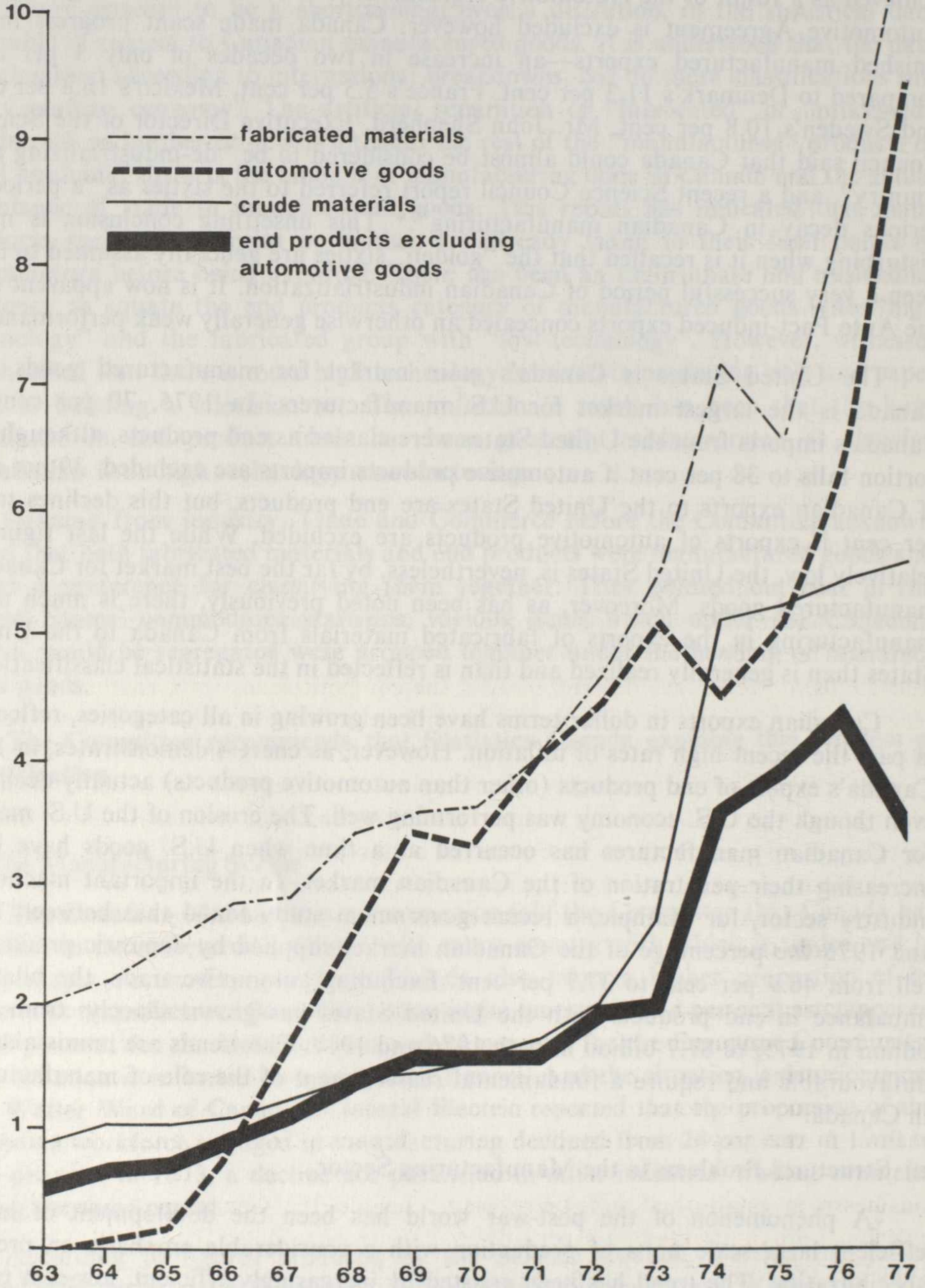
Chart 4
Canadian Exports to United States 1963–77, ($ billion)
fabricated materials
automotive goods
crude materials
end products excluding automotive goods
10
9
8
7
6
5
4
3
2
1
63
64
65
66
67
68
69
70
71
72
73
74
75
76
77
Source: Statistics Canada

portation although this will now be constrained as fuel costs rise. Both these developments favour countries with large domestic market bases.

Canada is severely disadvantaged by the size and shape of its domestic market—a mere ribbon of 23 million people strung out the width of the continent. It has with Australia the dubious distinction of being one of two industrialized countries without free access to a market of at least 100 million persons. However, because of geographical proximity to the United States, Canadian tastes and expectations, to a far greater degree than those of Australia, have been influenced by the U.S. market. While called upon to produce the same wide range of product choices, Canadian industry has been unable to achieve the economies of scale necessary for efficient production of many items at competitive costs. Sophisticated automated production equipment cannot keep unit costs down if the machines must be stopped and readjusted frequently for product differentiations such as colour, size and pattern.

For several decades, Canadian tariff protection has allowed its small scale and high cost manufacturing to remain relatively unchallenged. Mr. Carl Beigie commented,

> "I do not know of any other country as small, in terms of its domestic market, as Canada that has such pretensions about being able to duplicate the industrial structure of the much larger economies. We produce virtually everything in this country and we do not seem to be able to decide whether we want to specialize on the one hand, or protect, on the other." (I, 29:21)

Tariff protection combined with lack of access to a large market has meant that those Canadian manufacturers producing mainly for the domestic market have remained relatively unchallenged with their small scale high cost operations. In the mid-1970s, however, the deterioration in the competitiveness of Canadian manufactured products combined with post-war tariff reductions reduced the effectiveness of the tariff wall to the point where many U.S. imports penetrated the Canadian market easily. Canada is not only exporting less manufactured end products, but it is buying much more from the United States so that the bilateral deficit in this category is now reaching an enormous $8 billion annually. Small plants devoted to the domestic market are in difficulty even with the existing tariff and are totally unprepared for the sizeable tariff reductions which may be agreed to at the Geneva GATT trade talks.

The weaknesses resulting from small scale production and lack of specialization have been compounded by the high degree of foreign ownership of the Canadian manufacturing sector. Inadvertently and somewhat paradoxically, the tariff, originally designed to protect Canadian industry from U.S. incursions, has been instrumental in the growth and establishment of branch plants in Canada. Eager to sell their products in Canada and to benefit from the British Preferential Tariff, U.S. businessmen established subsidiary plants behind the Canadian tariff wall. Geographical proximity made it especially easy for them to do so. The result is that more than 50 per cent of Canadian manufacturing, including many key industries, is foreign, mainly U.S. controlled.

It is in the secondary manufacturing sector, as distinct from the resource sector, that foreign ownership has resulted in the fragmenting of the Canadian industrial

structure. The establishment of "miniature replicas" of the parent corporations has been the usual pattern; subsidiary companies designed to produce a similar range of products as the parent but often for the small Canadian market only. There are some exceptions where subsidiaries have been set up as part of a total North American production pattern and allocated specialized producer lines to produce for larger specified markets. These have unfortunately tended to be the exception rather than the rule.

Many branch plants operate under some constraints in exporting. A survey done by the Department of Industry, Trade and Commerce of 800 American manufacturing subsidiaries in Canada found that 58 per cent operated under some form of export restriction and of these 33 per cent were excluded from the U.S. market.* However, aggregate figures show that foreign-controlled firms in Canada do about as well as Canadian-controlled firms in exporting, particularly if the automotive industry is included. One is left to speculate what might have been their export performance if more of the firms had been rationalized on a North American basis or if they had not been constrained by market allocations.

In respect to imports, existing statistics reveal that foreign-owned firms are more import-oriented than Canadian firms and that an increasingly large proportion of total Canadian imports are in the form of inter-affiliate transactions. It is not surprising that American subsidiaries would import significant quantities of machinery and components from affiliates or their established sources. Cost, availability and familiarity combined with specialized technical factors probably influence such choices. Yet rigid or familiar patterns of inter-affiliate procurement can make it almost impossible for a Canadian producer seeking to enter the market. And this is so even if his product is competitively priced. Professor Ray Vernon of Harvard University told the Committee that because multinationals usually had a global strategy, they were more impervious to price competition. According to several witnesses, this has had a frustrating effect on the development of indigenous Canadian firms.

The necessary domestic rationalization of the Canadian manufacturing sector through mergers or joint ventures may be inhibited because so many firms are subsidiaries. The fear of extra-territorial application of U.S. anti-trust laws on their Canadian plants may cause U.S. parent corporations to be wary of allowing structural amalgamations of their subsidiaries although this may be perfectly legal or even encouraged in Canada. In discussing the negative effect of foreign ownership on Canadian managerial capacities and development, several witnesses expressed concern that Canadian management personnel working in subsidiary firms are likely to be limited in their decision-making responsibilities and may not be developing the skills for innovation and risk-taking. Mr. R. W. Chorlton of Wajax commented that capital management and market strategy expertise is frequently situated outside of Canada, that excutive direction of the "Canadian satellites" is integrated with the U.S. parent management pool and that the subsidiaries in Canada have

> "... skeleton management groups led by a young aggressive manager on his way to the 'big job' south of the border, or by an older man who is close to retirement." (II, 9:20)

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* *Foreign Direct Investment in Canada:* Industry, Trade & Commerce, 1972, p. 163

Testimony indicated that foreign ownership was also a factor in restricting the amount of R & D done in the Canadian manufacturing sector. A number of witnesses emphasized the low R & D expenditures by foreign-owned firms in Canada have tended to impede Canadian innovation and the development of distinctive marketable export products.

b) New Challenges

A recent challenge to the domestically-oriented Canadian manufacturing industry is the growth of new low-cost manufacturing centres in developing areas such as Taiwan, Korea, Brazil and Hong Kong, the "new Japans" as they are called. Low cost standard technology items are being efficiently manufactured by very low-wage workers in these countries at costs which can absorb the Canadian tariff and compete easily on North American markets. Dr. André Raynauld, Chairman of the Economic Council of Canada explained to the Committee that while the import challenge was already serious from the United States, Japan and the European Community, it would become much more severe from these low cost countries. The unmistakeable trends are for a continued and intensified erosion of the domestic market by these standard-technology import products. Multinationals will find it in their interest to produce standard technology items in low-wage cost countries instead of in Canada. Mr. John Shepherd summarized the problem when he stated that "Canada is being whipsawed between low technology countries with low labour [costs], and advanced high technology countries with a better competitive edge in design and development". (II, 18:9)

As has already been mentioned, an even greater challenge, potentially, will face Canadian producers if the GATT multilateral trade negotiations succed in lowering tariffs on manufactured goods by 30 to 40 per cent. The challenge here will be to meet the cheaper imports on the Canadian market with competitively priced products and at the same time to take advantage of the easier access to the U.S. market to increase Canadian exports. It was evident from the testimony that few Canadian manufacturers felt they were prepared for the intensified competition.

c) Areas of Specialization

Canadian industry is being outpriced in its attempts to produce a wide range of low or standard technology items for its small market. While it is not difficult to reach the conclusion that Canada should no longer try to participate in many of these areas, it is more difficult to pin-point which areas of secondary manufacturing Canada might specialize in. Most prescriptions advocate finding particular areas of high technology in which Canada could have an advantage. According to Mr. John Shepherd of the Science Council, studies in the United States have shown that technologically intensive industries grew 45 per cent faster, their employment 88 per cent faster and their productivity 38 per cent faster than low-technology based industries.

The Economic Council considers that Canada's "comparative advantage" will lie in "knowledge-intensive" activities by which Dr. André Raynauld meant undertakings requiring a fairly sophisticated level of training and skill in the labour force.

"Because our labour costs in particular are bound to be far higher than those in low wage countries, we must focus on areas of production where our more highly trained workers can help to achieve results not available in less developed economies". (I, 18:6)

In many cases, the "knowledge-intensive" activity to the exported would involve the output of intangibles rather than goods and he gave as an example a research project which Canada would conduct for a particular project in an advanced country with the subsequent production of the item being carried out in a low-wage country.

While this emphasis is for the long term and with world export markets in mind, witnesses drew attention to other possible areas of specialization which related more closely to indigenous elements in the Canadian scene springing from geography, distance, climate, or natural resources. There are still other areas where restructuring, rationalizing and perhaps concerted public procurement policies could ensure a solid domestic base, reduce the level of imports and possibly lead to some exporting.

Mr. Shepherd pointed out that there was an "industrial vacuum" in the field of renewable energies—such as solar energy, wind energy and biomass—which could be seized upon to build competitive Canadian corporations. In addition, cold ocean engineering, the defence of Canada's maritime limits and its Arctic sovereignty, the transport of resources from the North, mining machinery, electronics and project management systems, communications and transportation requirements were suggested as areas of specialization by this witness. Professor Abraham Rotstein of the University of Toronto emphasized the need "to dovetail our manufacturing capacity to a greater utilization of our resource base" and suggested the petrochemical field and other products related to Canadian resources for which Canada is at present a net importer as well as communications technology and marine technology. (II, 20:8,9)

The link between specialization and Canada's natural resources and indigenous elements was repeated in the testimony of manufacturers themselves. Mr. Walter Ward of Canadian General Electric pointed out that even with the necessary improvements in the factors affecting Canada's competitive position and a sound domestic market base, no single Canadian plant in the appliance industry could match the production costs of a single U.S. plant at present. He gave an excellent example, however, of how a Canadian company can specialize in areas where there is no disadvantage from small scale production.

"... the things we can export and the things we can really do a job on tend to fall into categories where Canada has some indigenous advantage ... Canada is a country of vast distances, with one of the highest uses of electricity per capita in the world, with large power blocks, such as the big provincial utilities. (Ontario and Quebec Hydro are amongst the biggest in the world.) This provides, in effect, an outdoor laboratory for the development of certain kinds of equipment such as DC transmission equipment for electrical transmission of large blocks of power ... We are active in the international market in this area, such as in large air blast circuit breakers for large transmission systems; and similarly with hydro power generation ... We have sold these very large generators for the Grand Coulee project in the United States. We have recently sold power circuit breakers to TVA, a large public utility in the United States ...

The second thrust we have in also a strength of a multinational subsidiary. We have some areas of technological excellence in Canada. For example, a couple of years ago we came to an agreement with General Electric that we would take responsibility for the development and supply of large air blast circuit breakers. This is because we had developed the technology in Canada; and we have big systems in Canada, in effect, a natural laboratory in the country.

General Electric is selling this product on our behalf in the United States, and we are selling it overseas where we can.

We have a joint arrangement on high voltage DC equipment, where we are doing the same thing. Likewise, we have an advantage in hydro-electric generators, where we have had a long history of very competitive technology . . . where we have moved into joint venture arrangements with some General Electric affiliates in other countries. For instance, in Brazil, where General Electric has manufacturing plants, we work with them to produce the sufficient local content to satisfy the requirements of the Brazilian government. We in Canada provide other components along with the necessary technology. We maintain our presence that way in markets that otherwise would be closed to us because of what are in effect non-tariff barriers." (I, 38:13)

This CGE example combines a number of important ingredients for successful specialization in Canada:

—products with a specialized market rather than a mass consumer market

—a joint venture or joint arrangement with an affiliated company

—the utilization of existing marketing facilities of the multinational company

—the relationship to indigenous Canadian conditions such as the geography requiring long distance transmission lines and the availability of hydro-electric power

Machinery for the natural resources industries was the area for specialization emphasized by Mr. R. W. Chorlton, a machinery manufacturer. Canada already has a capability in some forest and mining machinery products. There appear to be favourable circumstances at the moment particularly in Western Canada and the Arctic which will require advanced and sophisticated machinery and techniques both for operational and transportation needs.

Although the overall picture remains somewhat bleak, there are isolated and impressive success stories where Canadian firms have improved their competitive position, enlarged their share of the domestic market and increased their exports. Unfortunately, there is no simple prescription for success. But the achievements of some Canadian companies must be regarded as proof that there is no fundamental reason why Canadian manufacturing industry cannot succeed in international competitive terms in specialized high technology areas.

d) Possible Policy Responses to the Problem

Until now, the response of Canadian federal and provincial governments to the deteriorating situation in the secondary manufacturing sector has been to rely increasingly on intervention in the form of subsidies, import quotas, regional developments grants, marketing boards, etc., in effect, protectionist devices. But as Mr. Carl Beigie pointed out, there have been heavy costs to such government intervention in terms of efficiency and production which inevitably lead to increased demands for more support and intervention. The alternative to government intervention, he said, is to rely on market forces which can be a far more efficient allocative system for growth and expansion than the decisions of government can ever be. In the face of the present difficulties, Mr. Beigie summed up the situation as follows:

"I see the question of allowing international market forces to have a bigger role in determining the evolution of the Canadian economy as the only real option to an increasing proliferation of interventionist policies by government in response to demands of the Canadian people". (I, 29:19)

Mr. Beigie has raised a major question: whether Canadian industry should have more government support programs or be exposed to increased international competition through the lowering or eliminating of tariff barriers? Mr. Beigie's preference is clear: external competition is needed to force Canadian industry to rationalize and specialize. But another witness, Mr. John Shepherd of the Science Council asserted that tariff reduction, at this time, "effectively ensures disaster by introducing the patient to a cure he cannot survive". (II, 18:11). He favoured instead a series of government programs designed to encourage the rationalization of industry, to promote R & D efforts through offering increased incentives, and to stimulate promising products through coordinated government procurement policies. These and other techniques to strengthen Canadian industry were discussed and reviewed by the Committee with its various witnesses. They are examined with an assessment of the benefits which might be derived from each one.

(i) *The Possibilities for Rationalization*

There was no lack of acknowledgement by industry witnesses of the weaknesses and problems of secondary manufacturing in Canada. Witness after witness explained the higher costs of making a large variety of products in small scale Canadian plants and even more of short production runs compared to the efficiencies of the American large scale plants and long production runs. Mr. Ian Barclay, Chairman of British Columbia Forest Products Limited said that in plywood production there were

> "... any one of five firms in the United States who can themselves produce about half the Canadian market requirement and with large economy of scale you can certainly bring your costs down." (II, 6:26)

Mr. Franklin McCarthy, President of Du Pont explained that

> "For the large majority of Du Pont of Canada products, particularly in man-made fibers and plastic resins, plant scale is perhaps the single most important determinant of efficient low-cost and hence international competitiveness." (II, 11:47)

Nor did Canadian producers consider that the idea of consortia of firms for the purpose of *export only* as permitted under existing competition policy had improved the situation. Mr. Ian Rush, President of Polysar stated

> "We must have the base-load of a domestic market before we can think of exporting ... The domestic producer must be competitive. When there are numbers of firms each with plants, none of these plants are competitive. Even if they were to get together for export purposes, it would not have a significant effect in helping their cost position." (II, 11:40,41)

Export consortia have been little used, partly because they do not, by themselves, reduce costs and partly because of the difficulties of defining the rights of the parties to enter or withdraw from such agreements and the detailed arrangements for coverage, duration, and shares.

Industry representatives reiterated the prior importance of a healthy base in the domestic market as a spring board for exporting. Northern Telecom, for instance, told the Committee that its strong position in the Canadian electronic equipment market made it possible for it to compete successfully in the highly competitive U.S. electronic market.

The fragmented structure of Canadian production is a difficult situation to rectify. While no one disputes the need for domestic rationalization of manufacturing in Canada in order to achieve more efficient, low cost production, there was no consensus on how to do this nor indeed whether it could be done. The most effective approach, if it were possible, would be to leave the process to the action of natural market forces. Du Pont has, by its own volition, reduced the number of lines of nylon products made in Canada by more than half since 1969. But such an approach in an industry where economies of scale await realization will only lead to lower costs if the domestic market is large enough to absorb the increased production or if an export market can be developed. In fact, as costs of production relative to the United States have increased in recent years in Canada, the tendency has been for some Canadian production to be displaced by imports so that the market for domestic production actually contracted in some fields. In the overall, the evidence suggests that natural forces cannot be counted on to produce domestic rationalization in Canadian secondary manufacturing sufficient to achieve in the short term increased productivity and lower unit costs. Some other methods are needed.

One device which has been suggested is duty remissions to encourage rationalization. Some years ago Du Pont offered to cut down the number of nylon products it made in Canada and increase the volume of production of the remaining lines if it could obtain import licences to bring complimentary lines in tariff-free from its U.S. parent company.* While this proposal was rejected, several comparable remission suggestions have in recent years been approved by the government. The Committee reviews the potential of this approach below** and recommends its wider application in the machinery field. Nevertheless, it must be acknowledged that this approach is not capable of general application and that, depending on relative levels of tariffs, it may even have a distorting effect on trade. It can bring short term benefits and promote some rationalization, but it cannot resolve the problem in the long term.

Instead of total structural mergers of two or more companies, Professor Lawrence Skeoch promoted rationalization through joint ventures, partial or quasi-mergers, specialization agreements and joint marketing arrangements. He told the Committee that these approaches were more flexible than total mergers which he described as

> "... an omelet which you cannot unscramble because you have destroyed the organization, and it seems to me that the internal organization ... is just as important to a firm as the possession of patents perhaps." (II, 16:16)

The incidence of these partial mergers has increased much more rapidly in Europe and the United States in recent years than total mergers. With this technique, he suggested Canadian firms could produce a product with some firm in the United States or elsewhere in the same way European automobile manufacturers have combined to produce the V-6 engine. These techniques could facilitate the borrowing of the most advanced technology and such arrangements with U.S. firms could also help ensure access to U.S. markets. Professor Skeoch commented that the quasi-merger is "a technique of getting some of the advantages of economies of scale

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* Caroline Pestieau: *The Canadian Textile Policy: A Sectoral Trade Adjustment Strategy*, p. 70

** See p. 64

and of getting into export markets without just having to make a head-on assault on those markets". This partial form of rationalization has apparently been used very little by Canadian industry up until now. The hesitation of industry may be explained by industry's fear of being judged in restraint of trade under the existing legislation (although such arrangements are theoretically possible).

On the basis of its brief look* at competition policy from the point of view of essential improvements in Canadian productivity and competitiveness, the Committee considers that the essential point to understand is that the interests of the Canadian consumer can be protected by import competition as well as by internal anti-combines legislation. As Mr. Ian Rush of Polysar pointed out, while his firm had a virtual monopoly in the Canadian market for synthetic rubber products, there was no lack of competition from imports. When the level of import competition has increased so greatly and will progressively increase with further trade liberalization, it is no longer appropriate or necessary to assess the degree of competition which exists solely in terms of the number of domestic producers.

Nor should new Canadian legislation be modelled on U.S. anti-combine laws. Profesor Lawrence Skeoch made the point that anti-trust action in the United States does not prevent U.S. corporations from remaining large and strong producers. The Canadian situation is entirely different. The difference is one of size. Fifteen per cent of the U.S. market—the target figure which the most ardent American authorities consider U.S. companies should not exceed—represents 1½ times the entire Canadian market. Canada needs strong corporations with a large share of the domestic market to compete abroad. The Committee is disturbed that a Canadian controlled company like Northern Telecom which is succeeding in the strongly competitive, high technology market in the United States and elsewhere should be faced with the prospect of being divested from its important affiliate, Bell Canada. A more promising development which recognized the need for rationalization in the Canadian manufacturing sector is the decision of two companies, CGE and GSW, to join in forming a single company, CAMCO, to make household appliances. The government appears to have supported and endorsed this joint venture.

To summarize, alteration to the Competition Act could provide some stimulus and assistance to the much needed domestic rationalization. **The Committee recommends the modification of Canadian competition policy to provide a conducive climate for rationalization of Canadian manufacturing production.**

It must be recognized however that the prospects for domestic rationalization, even under a modified competition policy, will be inhibited by the high degree of foreign ownership in the manufacturing sector. Subsidiaries of U.S. companies would be wary of undertaking mergers or co-operative arrangements in Canada which might place parent firms in the United States in danger of anti-trust action. Even though recent changes in Canadian law have expressly excluded subsidiaries from the effect of U.S. anti-trust law in Canada, many U.S. subsidiaries have shown a reluctance to rationalize. This probably stems not only from uncertainty about the actual protection offered by the Canadian law, but also from a natural reluctance by

* Another Senate Committee, the Standing Senate Committee on Banking, Trade and Commerce is undertaking a more lengthy study of the proposed competition legislation.

competitors to join forces. The same inhibitions can be expected to deter U.S. subsidiaries in Canada from agreeing to joint ventures or other forms of collaboration with major foreign competitors. Additional inducements will be needed.

It has been suggested that the government itself should take an active part in bringing about mergers of Canadian companies, in effect, forcing rationalization in certain selected and promising areas. The Committee is doubtful if this would work. The initiatives and with them the responsibility must come from the private sector with the government's assistance limited to modifying the environment through legislation and by offering other supportive measures. If the government itself were to take the merger decisions, the economic rationale for the choices would risk being distorted by other concerns such as regional development which the government legitimately would have. Moreover, in industries with a high degree of foreign ownership, forcing subsidiaries to merge contrary to parent corporations inclinations might prove very difficult. While the Committee does not agree with "forced" rationalization, it sees benefit in a program of inducements such as special R & D support for firms in selected, potentially viable, areas which decided to merge.

It has also been suggested that unilateral free trade would be an effective way of spurring domestic rationalization in Canada. The pressure of cheaper imports would force companies to reorganize into more efficient large scale producing units to survive. However, it is doubtful whether the rationalized firms' share of the domestic market, particularly if it were eroded by imports, would provide a sufficiently large market to achieve the desired scale production. Exports would normally be essential, yet unilateral free trade would offer no improvement in access to the United States or other markets. Moreover, in such a situation many U.S. multinationals might choose to phase out their subsidiary operations in Canada and supply the Canadian market from south of the border locations. Another problem is posed by the uncertainty of demand by Canadian consumers. Would they choose the Canadian product in the face of a wide variety of imported products? If not, the objective of a large Canadian market base would be unachievable. The unilateral free trade approach does not appear to offer the solution.

Finally there is the question as to what effect bilateral free trade with the United States would have on rationalization. Clearly with no tariff protection, Canadian manufacturers would feel the pinch from lower cost free access imports. In effect they would be stimulated to merge in order to survive.

The fragmented structure of Canadian industry requires restructuring and reorganization, in particular a rationalization which will result in longer efficient production runs in key import-competing and exporting industries. The situation will become particularly urgent in the event of a GATT agreement on the multilateral lowering of tariffs. Government competition policy should provide a conducive climate for increased rationalization. **The government should encourage rationalization to the point of offering inducements but should not force mergers.**

(ii) *The Need for More R & D*

Improvement in Canadian industrial performance requires the continuous introduction and successful implementation of new production and marketing techniques.

The flow of new ideas capable of affecting productivity and improving domestic sales and exports depends in part on the research and development (R & D) activities of the firm, as well as that of supplying firms.

By international standards the performance of Canadian industry in developing a vital indigenous technical competence is poor. In 1970 the Senate Special Committee on Science Policy reported on Canada's unimpressive innovative record in industry. In an international comparison of ten countries for location of 100 significant innovations since 1945, for monetary receipts for patents, for number of patents taken out in foreign countries (year with comparable data was 1963), and export performance in research-intensive product groups, Canada ranked between eighth and tenth. By 1977, this same Committee found that no significant improvement had taken place and the Canadian technological gap for industrial innovation appeared to be widening.

As a nation, Canada spends about one half the proportion spent by other industrialized countries on R & D. Furthermore, its spending on R & D is declining in relative terms; from 1.29 per cent of its Gross Domestic Product (GDP) in 1967, Canadian R & D expenditures declined by 1975 to 1.1 per cent and by 1977 to .92 per cent. By comparison, the United States spent 2.3 per cent in 1975 of its much larger GDP.

The record for patents filed by Canadians is also revealing. In 1974, Canadian nationals and residents filed only 5.7 per cent of the total patents filed in Canada. This percentage is very low compared with 73.1 per cent for Japan, 69.5 per cent for the United States, 38.1 per cent for France and 23.5 per cent for the United Kingdom. Of the approximately 20,000 patents granted annually in Canada, 95 per cent are granted to foreigners, of which three-quarters are Americans.

In view of these statistics, it is not surprising that Canadian high technology industries have failed—with some notable exceptions—to keep pace with those in other industrialized countries. The fact is reflected in Canada's export performance in high technology fields. A recent study of 19 Canadian higher technology industries revealed that between 1970 and 1975 the balance of trade had deteriorated very significantly in 18 of the 19 examined. This group comprised a fairly broad spectrum of industries including chemicals, fibres, machinery, and communications equipment. The only industry showing a favourable balance in this period was petroleum. Yet it is the advanced high technology industries which hold the most potential promise.

The Canadian Manufacturers Association pointed with concern to the continuing decline in the ratio of Canadian industrial R & D to GDP and testimony from individual Canadian industrial representatives also showed a recognition of the need for innovation and increased R & D. Despite this awareness, the actual part played by Canadian industry in the overall industrial research in Canada is dismaying. In many industrialized countries, industry performs about 60 per cent of the total national research effort. In Canada, industry accounts for only one-third of such expenditures and even this is declining. Whereas 1.2 per cent of sales was spent by industry on R & D in 1967, the figure dropped to 0.7 in 1975.

The lack of R & D in Canada is related at least in part to the multitude of small manufacturing plants protected behind the tariff wall. Mr. John Shepherd referred to the fact that there were over 31,000 such small manufacturing plants in Canada with an average of 11 employees. Of these fewer than 5 per cent can afford to do R & D and only 3 per cent really do it. Only 367 companies in Canada have more than six qualified engineers or scientists on their staffs while the average number is two.

Foreign ownership and the branch plant structure of much of the Canadian manufacturing sector were cited as a contributing factor to the poor Canadian record for industrial R & D. In the automotive industry for example, a 1977 government study underlined the minimal amount of R & D done in Canada by the "Big Four" car companies while the Canadian subsidiaries have paid out over $230 million annually in the past six years to the parent companies for this purpose.

Some subsidiaries of foreign-owned multinationals are, however, doing considerable research in Canada. Mr. Walter Ward of Canadian General Electric said that his company had between 800 and 900 scientists and engineers working in development, research and design. In 1974, this company spent about $12 million on R & D, and $101 million over a 10 year period. Although this firm imports much more technology than it exports, Mr. Ward said it was a "two-way street" with the export part growing. However, the location of the head office of multinational companies is not decisive in deciding the location of R & D. Some Canadians-owned multinationals such as Massey Ferguson do a large part of their R & D in the United States and others such as Moore Corporation do all of their R & D there.

What can be said is that firms which have substantial R & D programs in Canada have also experienced success in their exports. Northern Telecom and its affiliated Bell Northern Labs spent $100 million in 1976 on R & D or 7 per cent of sales. Alcan and Polysar both reported large research programs, in the latter instance amounting to 2.5 per cent of sales. One small Canadian firm, Dominion Road Machinery, made a surprising R & D expenditure with excellent results. Mr. Bruce Sully said his relatively small company which has sales of $50 million, spent more than $2.5 million over a six-year period researching and developing an improved road grader which subsequently became a major export success in competition with the product of giant U.S. companies. These are positive examples of what can be achieved, but the overall Canadian R & D performance is lagging badly.

Incentives for Industrial R & D

The lack of industrial R & D in Canada is not an easy situation to turn around. Governments have tried a variety of incentives over a considerable period. For almost 40 years firms have been entitled to write off 100 per cent of R & D expenditures. In 1962 companies were permitted to deduct a further 50 per cent of R & D expenditure from their income for tax purposes; current expenditure was limited to additions beyond the 1961 level of spending, but capital expenditure was not limited. In 1967 this program was dropped because it was judged to provide insufficient

control and was replaced with government support grants such as IRDIA (Industrial Research and Development Incentives Act) and PAIT (Program for the Advancement of Industrial Technology). But all these incentives were to no avail. As the record indicates, the situation has steadily deteriorated. And it became evident that IRDIA grants were being used to a large extent by companies already active in R & D. For example, between 1970 and 1975, 10 firms received 40 per cent of the total grants.

The most specific proposal put to the Committee was made by Mr. Robert Scrivener of Northern Telecom when he appeared as a witness in 1976. He suggested that Canada return to a policy of providing tax incentives for R & D rather than make grants. Subsequently, many of the large companies giving testimony supported the suggestion. Mr. Scrivener argued that tax incentives would encourage efficient and profitable R & D expenditures and that the grant system had provided an insufficient discipline on the management of R & D. Northern Telecom subsequently argued that a tax credit to be really effective must be of a size that will generate vastly increased R & D activity and it suggested a credit of 20 to 25 per cent.

The government has in the interval taken several initiatives to spur innovation in industry, three in 1977 and another two early in 1978. The 1977 measures involve the widening of the "contracting out" policy under which a larger portion of the government's requirements for research and development would be done by industry rather than in the government's laboratories; an Enterprise Development Program which provides direct assistance from the government for a wide range of R & D proposals originating with companies; and a tax-based incentive offering a 5 to 10 per cent investment tax credit for expenditures by industries on R & D between March 1977 and July 1980. In the April 1978 budget an added stimulus, introduced for a 10 year period beginning in 1978, allows companies to deduct 50 per cent of additional R & D expenditures from their income for tax purposes on top of the 100 per cent already permitted for all R & D. The deduction applies to both current and capital expenditures to the extent that they exceed the average amount done over the preceding three years. This is similar to but less generous than the measure in force from 1962 to 1966. Finally in June 1978 the Minister of Science and Technology announced additional measures—more funds for contracting out research, federal support for the creation of five university-based industrial research and innovation centres, increased funding for the three university grants councils and expansion of the National Research Council's program of industry-laboratory projects. The Minister also stated that the government hoped to see R & D expenditures rise to 1.5 per cent of GDP by 1983.

These measures are welcome evidence that the government is at last concerned about the amount of R & D being done in Canada. The new programs place some reliance on the tax system, which is the most supple instrument and they put responsibility in the hands of industry. At the same time, the Enterprise Development Program maintains and broadens the government's capacity to support through direct grants, smaller companies which may lack financial resources or sufficient profit to derive benefits from tax incentives.

It would only be realistic, however, to recognize that there are limitations to the amount of industrial research and development which will be done in Canada as

compared to the United States. For many U.S.-controlled subsidiaries in Canada, government support policies may be largely ineffective. Professor Ray Vernon, a Harvard expert on multinationals, told the Committee that he thought U.S. multinationals would be almost impervious to Canadian tax incentives designed to attract more R & D to Canadian subsidiaries. Furthermore, the very nature of R & D, he said, leads to its concentration in one place. Because of the early U.S. lead in the creation of multinationals, there has been "a gathering up of critical R & D in the United States", he said. (II, 12:36). Even a Canadian multinational company like Moore Corporation finds compelling reasons to do its research in the United States rather than Canada. Mr. Donald Dunlop, Treasurer of the company stated.

> "The development of expertise and know-how in our particular industry and our company has been generated for many, many long years, principally in the U.S. market place. This is where we have our people resource. This is where all the new ideas are generated to service business with better methods of doing business. I doubt very much whether a tax incentive would cause us to change the location of where we are doing our research." (II, 15:36)

Northern Telecom had a somewhat similar outlook. Although the bulk of its research personnel are in Canada, recently it established an R & D centre in Palo Alto, California. Mr. Scrivener explained the reasons for this decision:

> "... that is where the talent is. There are more people who are expert in integrated circuitry technology and software technology in that part of the world than anywhere else. What we are doing, in effect, is going fishing where the fish are". (II, 3:22)

Mr. William Eberle of the U.S. Motor Vehicle Manufacturers Association confirmed that the major research centres on the continent were in California, around Palo Alto, Berkley or Stanford in California, in the Chicago-Detroit area and in the Boston area. Each of these areas has different skill concentrations. "It is important to recognize", he said, "that we go to those institutions where the expertise is". (II, 17:24)

Not only will there continue to be a drawing to a few centres in the United States of multinationals' R & D facilities, but even in Canada R & D is likely to concentrate in a very few places. The 1977 investment tax credit does not appear to recognize that U.S. experience which has resulted in the concentration of creative talent into a few nodes should be an important example for Canadian policy. Any attempt to push Canadian R & D into regionally diversified centres should be resisted. Yet this is what the 1977 Canadian investment tax credit scheme tries to do. While there is a straightforward 5 per cent tax credit to companies for R & D efforts, this credit is increased to 7½ per cent if the research is undertaken in designated areas and to 10 per cent in the Gaspé and the Atlantic provinces. In effect, the additional incentives constitute a device to encourage regional development.

In the Committee's opinion, any natural tendency by industry to concentrate its research activity in the optimum Canadian centres should not be influenced by extraneous considerations. It may well be that Halifax, for example, will prove to be a natural centre for R & D work in fields such as maritime research. But such a development should not be artificially stimulated in order to promote regional development simultaneously. U.S. experience has an important lesson which should not be ignored—good research requires concentration of effort, not diversification.

This means that the objective of increased R & D and the objective of regional development should not be pursued by the same incentive. Canada's need for improved R & D is too pressing to permit an incentives policy to be used for other purposes. The regional development weighting should be abandoned and a straightforward R & D incentive given.

It is too early to judge what effects the 1977 and 1978 incentive programs will have. The Minister of Finance claimed when introducing his 1978 budget that Canada's tax treatment of R & D had become "one of the most generous in the world". It is true that the most recent measure to allow firms to deduct 50 per cent of additional R & D expenditure from their income for tax purposes represents a useful incentive for companies which have done relatively little or no R & D in the past. However, it offers no incentives to firms which already have a large program of research unless they have reason to increase their activities in this field. Only the modest 5 per cent tax credit of 1977 with no base period will be of benefit to such firms, and it is open for question how much stimulus there is in a 5 per cent tax credit.

The emphasis in this chapter has been on new R & D. For a country like Canada, it may be as efficient and far less costly to acquire and adapt technology developed outside of the company and even outside of the country. This is an approach which the Japanese have mastered. But in order to be aware of opportunities and to modify them, companies must have active R & D programs.

It will be important to monitor the impact of these new measures to encourage effective industrial R & D in Canada leading to innovative exportable products. The provisions of the 1978 tax incentive are in fact less generous than the similar measure in force between 1962 and 1966 which was not conspicuously successful. This must lead to scepticism that the government's target of 1.5 per cent of GDP by 1983 will be achieved, particularly since its estimates assume that industry's share of R & D will increase at 19 per cent per annum. The pull of the large centres of research in the United States and the problems posed by foreign ownership are difficult to overcome. The several measures involving the National Research Council, the university grants councils and university-based research are unlikely to promote the 'in-house' industrial R & D which must be linked to efficient production and marketing if it is to succeed. They may, however, enhance the research environment in certain major centres in Canada within which industry must work.

The Committee concludes that no matter what trade policy Canada adopts, higher levels of industrial R & D are essential. In order to achieve this objective, it may be necessary to offer industry greater tax incentives than those recently introduced.

(iii) *Government Procurement*

Another suggested method for strengthening the Canadian secondary manufacturing industry was to use government purchasing powers more effectively. Mr. John Shepherd of the Science Council of Canada argued that by the "harnessing" of federal and provincial procurement, certain areas of Canadian industry could be stimulated, even reorganized. Government policy, he said, should be directed to building the kind of market base that Northern Telecom has with Bell Canada.

"... government itself is a market. It generates a huge amount of spending power which normally has been exercised without reference to industrial strategy. So governement itself, in many areas such as energy, is a massive buyer and organizer of the market. My plea there is that when government is a customer, it should structure its spending to make sure that Canadian industry gets the job and not others." (II, 18:24)

Examples he cited were in the nuclear and utilities fields.

A number of Canadian manufacturers referred to the advantage which they perceived U.S. producers had from the Buy American Act and they regretted there was no equivalent in Canada. In fact, while it is true there is no Buy Canadian Act, Canadian federal procurement policy already strongly favours Canadian suppliers. The bulk of federal purchasing is conducted by the Department of Supply and Services (DSS) and its practice is normally to buy in Canada except where a product is not available or significantly more expensive than comparable foreign goods. Only in this event are non-Canadian suppliers invited to tender. This practice is not specified in legislation; it is based on administrative procedures determined within the department and approved by the government. The results are to be seen in the relatively low percentage of purchases of defence and non-defence goods by the Canadian federal government in the United States—7.2 per cent of total federal purchases in 1974-75 and 6.6 per cent in 1975-76. (II, 32A: 6). To some degree, these figures overstate the extent of manufactured products procured in Canada, since foreign produced goods handled by Canadian distributors are treated as if they were made in Canada. Also, the percentages of foreign procurement would increase sharply when large items, such as the long-range maritime patrol aircraft, are bought from the United States. Overall, however, the figures indicate that the federal government already makes most purchases in Canada.

In the defence field, Canadian procurement is shaped by the Defence Production Sharing arrangement with the United States which involves an open tendering system on a continental basis by both countries. Mr. Shepherd urged the increased use of Canadian government defence funds to strengthen the Canadian aircraft industry. However, as will be described more fully in Chapter VI, the federal government already asks for extensive offset production in Canada as part of its large purchases, a practice which funnels orders to Canadian industry and to which the U.S. government authorities from time to time have raised objections. Mr. Shepherd would probably like to see the government go further, decide on an aircraft with an international market potential and then direct the defence forces and Air Canada to buy the aircraft in order to sustain production and raise international interest. This is in effect what has happened with the CANDU reactor. As that experience has demonstrated, the approach is one which can be very costly and involves high risks.

In terms of funds spent on procurement, provincial governments and their dependents—the municipalities, universities and hospitals—are much more significant spenders than the federal government. Together they control 78 per cent of the approximately $15 billion spent by the public sector in 1974-75 on goods and related services. If crown corporations are included, the federal share rises somewhat. However, the task of coordinating provincial purchases with federal buying is much more difficult in Canada than it is in the United States. It is accepted in the United States that the federal government through its provision of funds to state and local

bodies may specify how the funds are to be used. Canadian provinces are relatively far stronger than the U.S. states and refuse to accept such federal direction. Provinces may, and on occasion, do decide to join in co-operating with the federal government in agreements for joint procurements if they see a benefit in doing so. However, there is a contrary trend prevalent at the present time, the result of political pressure within provinces, for increased provincial procurement, which further fractures the national market. There is, for example, an inefficient proliferation of wire and cable plants in most provinces in Canada, reflecting the procurement powers of provincial hydro corporations.

If services, which include such activities as engineering, repairs or moving expenses, are separated from goods procured, it emerges that federal, provincial and local governments together in 1974-75 spent under $5 billion on the purchase of goods. Of the 77 classes of goods bought, the largest was $560 million for fuels, lubricants and oils. This class of goods and many others represent standard products whose manufacture involves routine technologies. In short, the capacity of various levels of government to promote industrial development through purchases of high technology goods is limited.

As part of a recent government policy to encourage more R & D in Canada, a June 1978 announcement by the Minister for Science and Technology indicated that future government purchases of goods and services would favour those firms which had a Canadian R & D program. Among foreign controlled companies preference would be given to those whose parent companies provided autonomy to their Canadian subsidiaries for technological product lines. In support of his proposals the Minister is reported in the press as stating that federal procurement included $1.3 billion of high technology products.*

The government's objective is a commendable one. There are certain fields of high technology in which government purchasing can indirectly recognize and support R & D; medical equipment and communications equipment could be added to the nuclear and utility industries as examples. But advocates of such a policy tend to understate the problems and overstate the figures. Mr. Shepherd, citing the huge spending programs of utilities as an area for cooperation, did both at the same time.

> "I have no doubt in my own mind that when utilities can spend perhaps $25 billion between them on new programs for Canadian technology that that purchasing must be directed to building an industrial base . . . " (II, 18:37)

Mr. Shepherd has grouped more than one year's spending into his example, and it assumes a coordination of provincial purchasing which does not exist.

The Minister's statement likewise appears to overstate the federal potential to influence high technology production through procurement. He spoke of high technology purchases of $1.3 out of $4 billion of purchases. In fact, in 1975, total federal procurement for goods and services was $3.6 billion, and of this figure, approximately two-thirds was for related services. Thus federal purchases in 1975 for all types of goods (as distinct from services) amounted to about $1.2 billion, and the majority of these purchases were for standard items, such as fuel or furniture. Only

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* *Globe and Mail*, June 2, 1978

if the purchases of all crown corporations were to be included and controlled, could the federal government's purchasing of high technology have the significant impact implied by the Minister.

Canada therefore cannot hope to emulate the success of a country such as Sweden, which has made creative use of its procurement program. Sweden is a unitary state, with a large military budget and its government disposes of a higher proportion of the GNP than almost any other industrialized non-Communist state.

The government has by its 1978 "Shop Canadian" program attempted to focus the attention of Canadians at all levels on the desirability of buying Canadian goods. The Minister of Industry, Trade and Commerce explained one of the government's aims.

> "Canadian export manufacturers will also benefit from increased sales. The economies of scale will make their products more competitive in foreign markets. As well, they will be able to take advantage of technological advances as they increase their production runs."

If this program succeeds in making individuals as well as procurement officers in companies and in governments at all levels more aware of the need to support and strengthen Canadian industry, so much the better. The announcement by the Ontario government that it would give up to a 10 per cent preference on purchases of Canadian-made goods made by its ministries, agencies, boards and commissions is a welcome development. At the corporate level the program could have beneficial results if it caused re-assessment of the long established cross-border procurement by some multinational firms and stimulated them to look for Canadian replacements. Yet unless the price and quality of Canadian goods are competitive, the "Shop Canadian" program is unlikely to have a very large impact on consumer buying, a reaction which was immediately voiced by several large merchandisers in Canada.

The Committee concluded that government procurement in Canada as a policy instrument for restructuring, reorganizing and strengthening the Canadian secondary manufacturing industry, cannot be relied upon to play a major role. Nevertheless, coordination of purchasing by federal and provincial governments and their dependencies should be pursued vigorously by the Department of Supply and Services in selected fields of particular Canadian competence and requirement as is already being done in the field of nuclear energy for example. There are undoubtedly some benefits to be gained, but the limits must be realistically assessed. To the extent that the purchases of crown corporations can be integrated into these arrangements, the potential benefits could be increased.

e) The Machinery Industries

Too little attention has been paid to the particular problems of the machinery sector of Canadian manufacturing which is responsible for such a large portion of the end product imbalance of payments. Canada's deficit with the United States in machinery trade is considerably larger than in the automotive sector—$3.1 billion in 1975 and $3.5 billion in 1976. Indications are it may continue to deteriorate. A separate discussion of this sector is therefore merited. (Machinery dealt with in this category comprises machinery and equipment used by Canada's resource, processing and manufacturing industries including mechanical equipment for power generation.

It includes agricultural machinery and equipment. It does not include electrical equipment nor transportation equipment of any kind.)

Canada is a massive user of machinery. The total Canadian domestic machinery market in 1975 was $8.8 billion, a figure which, on a per capita basis, is double that of the United States. Total Canadian imports of U.S. machinery in the categories being discussed were $4.3 billion in 1975, rising to $4.6 billion in 1976. The main contributing factor to such heavy use is Canada's need for large construction and resource exploitation machines. For construction machinery alone, Mr. J. S. Thorp, President of the Canadian Association of Equipment Distributors, told the Committee that Canada was by far the United States' best customer, taking $839 million in 1975, over three times the amount bought by their next best customer, Brazil.

At the same time the United States is also Canada's best market. In 1976 Canadian machinery exports to the United States were $1.1 billion, or almost 70 per cent of total exports in this category and included practically every type of machine made in Canada. Considering that exports to the United States represented only 52 per cent of Canada's machinery exports in 1965, this represents a considerable concentration of the export market in the United States, due in part to the linkage between the numerous subsidiary machinery producers in Canada and their U.S. parent companies. Proximity is, of course, another important factor.

Over the past 18 years, starting from a negligible base, growth rates in machinery exports to the United States in several categories have been impressive. For instance, exports of materials handling equipment and machinery rose from $140,000 in 1960 to $133 million in 1977; mining and excavating machinery exports grew from $2 million in 1961 (there were no exports in 1960) to $106 million by 1977; and plastics industry machinery exports climbed from $4 million in 1962 to $82 million in 1977.

Despite these strong rates of growth, exports remain a small percentage of Canadian production, and compare unfavourably with imports. Moreover, because capital spending in Canada during the past three years has been limited, current import levels are judged to be relatively low. They are expected to rise as economic activity picks up and could grow sharply as large capital projects including the gas pipeline from Alaska get under way, all of which could lead to a worsening deficit.

The dilemma for Canadian government policy makers in facing this problem has been the need to keep Canadian users' costs as low as possible for capital machines and equipment, while at the same time providing protection for domestic machinery producers. In 1968 under the Kennedy Round, the Canadian tariff was reduced from 22.5 per cent to 15 per cent. At the same time the government's Machinery Program was introduced under which duty is fully remitted in cases when imported machinery is assessed as being in a "not available in Canada" category. Remission of duty has amounted to more than $1 billion since the Machinery Program began. Taking these remissions into account the relatively high Canadian tariff (15 per cent) on machinery is averaged down to 7.5 per cent. In addition, the "end use" provision of the Canadian tariff permits machinery imported for use in specified resource industries such as mining, oil and gas to enter into Canada free of duty, or at a lower rate. Undoubtedly, the Machinery Program has been of

considerable benefit in lowering the price of capital equipment to Canadian users. It also helped to identify opportunities for new production in Canada by matching domestic requirements for specific types of machinery with Canadian manufacturers' capabilities.

However, the Committee heard testimony which questioned to what degree the program had achieved its objective of encouraging the overall development and growth of the Canadian machinery industry. Mr. J. S. Thorp told the Committee:

> "... that the Machinery Program has not, insofar as construction machinery is concerned, realized the hopes held out for it back in 1968, at least in respect of developing manufacturing in this country, or in attracting new entrants from the United States or overseas." (II, 9:10)

He said there has been a withdrawal of foreign-owned manufacturers and only a negligible increase in new manufacturing activity. Further, Mr. Thorp questioned the consequences of the provision which makes a domestic producer eligible for the 15 per cent tariff protection on "equipment of a class or kind made in Canada" as long as he produces only one unit. He cited the case of the Canadian subsidiary of a U.S. producer which had added a very expensive machine to its range, thereby automatically cancelling the duty remission and increasing by $30,000 the machine's cost to Canadian customers. The question was how many such machines are being made in Canada and how much employment was generated by the cancelled duty remission.

Canadian producers also face difficulties in obtaining good distribution for their products in Canada, a highly important aspect of machinery marketing. Mr. R. W. Chorlton of Wajax pointed out

> "Canadian distributors prefer by and large, to handle American products. Canadian firms which attempt to start up on their own and obtain distribution across Canada find it very difficult." (II, 9:26)

Faced with higher competitive costs than U.S. counterparts, with increased import penetration and with domestic distribution problems, the Canadian machinery industry is apprehensive for the future. Mr. R. W. Chorlton went on to explain

> "There is no doubt in our minds that the Kennedy Round tariff reduction from 22 ½ per cent to 15 per cent resulted in a diminished interest in Canadian manufacturing on the part of the United States and other foreign principals. Any further reduction in tariffs will undoubtedly lead to the slowing down and eventual closing of many U.S.-owned plants as a result of the tariff incentive no longer offsetting the increased cost of shorter production runs. The Canadian market demands the full range of product models and services available to U.S. customers. At the current 15 per cent duty, this has led to a measure of rationalization as higher volume models are produced in Canada, with the remainder being imported from home factories or given token Canadian content, with a resulting decrease in Canadian manpower input. We believe that these production jobs are important to Canada, and any further significant move to a policy of free trade would result in a further serious restructuring of Canadian industry with most—we believe almost all—of the jobs moving south of the border." (II, 9:19)

Despite the impressive achievements of some producers, imports are taking an increasing share of the domestic market—from 50 per cent in 1965 to 60 per cent in 1975. The growing deficit in machinery trade and the vulnerability of the industry to a further lowering of the tariff indicates that some additional stimulus is needed.

(i) *"End Use" Tariff Exemptions*

The provision for importing a range of resource machinery virtually duty free under "end use" tariff items has inhibited the development of machinery manufacturing capabilities in these areas. Yet removal of this special tariff treatment would add significantly to the cost of resource extraction in Canada, the sector of the economy which contributes most to Canada's favourable merchandise trade balance with the United States. In a longer term perspective, however, this is an area in which Canada has in effect offered unilateral free trade without gaining corresponding benefits from the United States. Unless Canada should decide to seek free trade with the United States, **the Committee urges that officials investigate the possibility of replacing the 'end use' exemptions by a more selective scheme which might be either the existing Machinery Program, or an even more selective duty remission arrangement**. Such changes may necessitate negotiations within GATT.

(ii) *A Remission Program, a Possible Remedy?*

While the Machinery Program has reduced costs to Canadian users of machinery and stimulated some indigenous production, it has also encouraged imports. A little-noticed remission scheme exists, however, which is designed to encourage scale production in Canada and indirectly promote exports. First instituted in 1975, this Canadian government program applied to a company's production of a specific sized pleasure boat and has since been applied to companies in several other industries. In the pleasure boat case, remission was granted to the Canadian producer on the customs duty and sales tax paid or payable on new imported pleasure craft to the extent of the amount of additional Canadian "value added" which the Canadian producer had incorporated into his Canadian-based production lines compared to a base calendar year. The ability to import certain product lines duty free enabled the Canadian producer to specialize in fewer lines with longer production runs with the objective of a lower cost product, higher sales, and increased Canadian "value added", i.e., more employment and use of domestic components. Before the remission order, the U.S. parent company had been intending to repatriate production from the Canadian subsidiary back to the United States. In 1976 the Tariff Board assessed the operation of this particular remission order and reported that the company had had a five-fold increase in both sales and Canadian "value added" between 1969 and 1974 and a three-fold increase in employment between 1970 and 1974. Exports rose rapidly and exceeded imports, which also increased. Plant facilities were increased. The Board noted that the program had deterred the U.S. company from closing down the subsidiary and concluded that a measurable and substantial benefit had derived from it.

The Committee recommends that the Department of Finance consider the possibility of offering a duty remission program to individual Canadian machinery equipment producers for particular lines of machinery they might seek to specialize in. As discussed in the pleasure boat case, remission of duty would be granted on imported lines of machinery to the extent of the additional Canadian "value added" incorporated in the machine produced in Canada. In such categories this program would displace the Machinery Program. In the event of a lowering of the protective 15 per cent tariff by 30 to 40 per cent as a result of the GATT negotiations, the

problems of this sector will be intensified. A remission order linked to additional Canadian "valued added" would offer an incentive to a Canadian machinery producer to rationalize his production. While this could lead to some increased costs to users, at least temporarily, the additional, more efficient production in Canada should lead to increased manufacturing, employment and export. Such an approach would coincide with a policy thrust toward the encouragement of indigenous high technology specialization at a time when Canadian market demands look strong with various large capital projects in play. The danger of Canadian subsidiaries of U.S. firms withdrawing production in Canada as the tariff barriers are lowered would be countered by an inducement to rationalization of their production on a North American basis. Successful Canadian-owned companies with no importing or distributing ties might be encouraged to form a relationship with a U.S. manufacturer for such purposes. The possible incentive of such a program toward vertical integration by foreign-owned corporations would be checked by the restrictions of the Foreign Investment Review Agency. The overall thrust would be to so strengthen and restructure the machinery industry that it could resist imports and increase exports.

There are some potential difficulties which would need to be overcome. The setting up of a remission scheme might appear to be easiest when there is a common ownership, i.e., parent-subsidiary arrangement. But there would seem to be no reason why the program could not also work at an arm's length relationship. Care would have to be taken that such parent-subsidiary rationalization did not lessen the possibility of the even more desirable all-Canadian rationalization between two manufacturers in Canada. There is the possibility that the United States could impose countervailing duties on the exported product if a U.S. competitor company sees a U.S. company benefitting from the program through its Canadian subsidiary. However, since the duty remission is not linked to the Canadian manufacturers' exports but to the additional Canadian "value added", there would be difficulty in proving it was a "bounty" or "grant" as required under U.S. procedure. In any case, the remission has the effect of encouraging U.S. exports to Canada and any U.S. manufacturer would be free to enter into a similar arrangement. Similarly, while a Canadian company could charge that the remission program bestowed unfair advantage on the competing company, there should be nothing to stop it from setting up a similar arrangement and asking for that program to be applied to it.

A duty remission program of this kind is complex to operate and not well suited for long-term application. But if a decision were taken to move toward free trade, it would be ideal during the transition period, helping industry to rationalize and prepare for the increased competition.

(iii) *Farm Machinery*

The farm machinery industry in Canada is a special case. It is usually perceived as an area of complete free trade between the two countries. Yet testimony revealed that some Canadian producers of agricultural machinery, particularly smaller companies situated mainly in Western Canada, were at a considerable disadvantage compared to their multinational competitors because of U.S. tariff designations on certain items.

The farm machinery market in Canada is a segment of the North American market and the industry in the two countries is dominated by a few large firms. Three large multinationals, one of which is Canadian, have manufacturing plants in both countries and some large U.S. companies sell farm machinery in Canada but have none of their production here. Despite an increase in Canadian production in the 1970s, the Canadian farm machinery industry has not maintained its share of either the Canadian farm machinery market or of total Canada-United States production compared with market shares in the late 1960s. In 1977, the Canadian deficit on bilateral farm machinery trade was about $670 million, up from $170 million in 1971. Most of the unfavourable Canadian trade balance is in tractors and parts. Only for grain combines and parts does the value of exports exceed imports.

Despite widespread assumptions to the contrary, there is no free trade agreement to cover the movement of agricultural machinery and parts between Canada and the United States. The granting of free entry for selected items in this category was a unilateral act by each country, designed to lead to lower costs of agricultural production for farmers. The different definitions in the differing tariff systems in the two countries have resulted in problems. Canada, for instance, allows free entry to all general purpose tractors; the United States allows only tractors "suitable for agricultural use" to enter free. As a consequence of the wider Canadian definition, Canada imports internal combustion tractors on crawlers or wheels for use in resource industries. This specific import represents 20 per cent of the total Canadian construction machinery market, worth $200 million. Mr. J. S. Thorp of the Canadian Association of Equipment Distributors remarked that it was understandable that the manufacture of such items in Canada had never been seriously considered. U.S. producers with subsidiaries in Canada naturally locate their tractor production in the United States. Location of production facilities in Canada would mean being penalized by the more restrictive U.S. tariff if they tried to export to the United States.

The main difference in the tariff structures of the two countries, however, concerns farm implement attachments and parts. In Canada, an attachment to a machine, intended for farm use, enters free. In the United States, under Tariff 666.00 there is a more restrictive system whereby the exporter must demonstrate that the *chief* use of the product is on United States farms. This demonstration involves a costly process of documenting usage patterns and of soliciting signed statements from distributors that the item is being used by their customers primarily for agricultural purposes. Canadian exporters* complained to the Committee that even for attachments explicitly designed for agricultural use, such as dozer blades, front end loaders, hydraulic cylinders and shaft monitors, they have been unable to demonstrate in a way acceptable to U.S. authorities that the items qualified for free entry. Yet, these same items enter Canada from the United States duty free.

Another difficulty concerns new products which may have an important potential market on farms as well as for other use. Such products would not be classified as farm machinery in the United States and thus would not be eligible for duty-free

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* The Committee received a brief from the Prairie Implement Manufacturers Association which was printed as "Appendix 23A" in the Proceedings of the Committee of June 7, 1977; issue No. 23.

treatment at the U.S. border, whereas the Canadian "end-use" clause would permit duty free entry to farms in Canada.

The difference in tariff treatment is most evident with respect to repair or aftermarket parts and explains why almost all repair parts sold to Canadian farmers are imported. With documentation certifying that the end-use of the part is for manufacture or repair of agricultural equipment, parts can enter free of duty into Canada. In the United States, parts normally have a specific tariff classification, eg. gears, pumps, drive chains, etc. and the listed duty must always be paid, whatever the end-use. It makes no difference that the parts are being sent to the U.S. in order to repair a Canadian-made machine which was previously exported duty-free to that market. For a part that is not specifically listed, it must be shown that it is designed for farm machinery before favourable duty treatment is received.

For a manufacturer, there are locational implications arising out of these differences. Where economies of scale are important and it makes economic sense to supply both markets from one source, an implements or parts manufacturer would pay less duty by locating in the United States a plant which manufactures parts and attachments dutiable in the United States but not in Canada. He can then ship them duty free to Canada. The relevant rates of the U.S. duty are not particularly high, usually between 5 and 15 per cent. But existence of a duty and the manner of its application imposes a costly administrative burden on Canadian manufacturers. Moreover, the U.S. customs authorities are far stricter is auditing the evaluation of an item that bears duty than an item that enters free. A multinational corporation such as John Deere or Massey-Ferguson has the freedom a small firm lacks to structure its production activities to take advantage of the present tariff structure. Mr William Mounfield of Massey-Ferguson, in fact, testified that the present U.S. tariff was not an irritant to his company. However, small national firms represented by the Prairie Implement Manufacturers Association complained that the asymmetric tariff structure discriminated against their growth and provided an incentive, in addition to labour and capital costs, to move their producing activities to the United States.

The Committee agrees with the Prairie Implement Manufacturers Association that Canada should have "the same free access to the U.S. market as U.S. manufacturers have to Canada." (II, 23A:3) It is time this unfair anomaly was wiped out. The problem is how to do this.

Revenue Canada officials assured the Committee that continuous efforts are being made to assist the Canadian agricultural industry in obtaining favourable U.S. classification rulings for Canadian exports. They also indicated that they were pursuing this question with the United States at the Geneva GATT negotiations. However, because of the structure of the U.S. tariff system, modification for farm machinery would have implications for the entire tariff classification. The United States has consciously moved away from the "end use" classification system considering it to be almost impossible to enforce or administer. It would be most unlikely to revive it for farm machinery.

Application of a duty remission program, as suggested earlier in the chapter for other machinery, might provide Canadian producers especially subsidiaries of U.S.

multinationals with incentives to increase the manufacture of parts, attachments or tractors in Canada. However, this would entail cancellation of the Canadian "end use" classification for these items, a move which could lead to higher costs to Canadian farmers for certain products.

A decision by the United States and Canada to grant unconditional free trade for parts, whatever the "end use", would cause other complications. Many parts such as gears, pumps, etc. would be interchangeable with parts used in automobiles and trucks. As such they are classed at present as aftermarket parts under the Automotive Agreement and specifically excluded from duty free entry. Only if the decision was made to extend the Automotive Agreement to cover replacement parts would this alternative appear to be feasible.

The Committee concluded therefore that the most promising and perhaps the only available solution to this problem is the negotiation of a broad and fully reciprocal free trade arrangement in this sector with the United States. The arrangement should specifically include tractors for other than agricultural use as well as the attachments, parts and new types of innovative items now dutiable in the United States. The only significant item of trade on which Canada would have to relinquish duties would appear to be farm wagons and sleds. While such an agreement now is probably too late to have much effect on the tractor production patterns of the large existing multinationals, removal of the asymmetrical treatment would eliminate a pressure on smaller Western firms to move their production facilities to the United States and would encourage more parts and attachment production in Canada. In a free trade arrangement, smaller producers would then be able to enjoy the same economies of scale in Canada now available in the U.S. market.

f) Assistance to Manufacturing Companies with respect to Customs Duty

In order to make Canadian industry more competitive, two procedures—drawbacks and duty remissions—have been put in place which provide for the recovery by or remission to, a company of duty and taxes paid or payable on imported goods. In the Committee's opinion the application of these two procedures could be somewhat improved. A third type of procedure, a remission order designed to encourage domestic production and indirectly to increase exports has been dealt with earlier in this chapter. The proposal for free trade zones is also reviewed.

(i) *Drawbacks*

Under the Canadian Customs Act, there is a provision for a drawback or recovery of duty and taxes by a company under two circmstances. First, if the item is listed in Schedule "B" of the Tariff, a drawback of 50 to 99 per cent is granted depending on the commodity. Tariff item 97052-1, for example, is the authority under which machinery "of a class or kind not made in Canada" when used in automobile manufacturing is granted a drawback of 99 per cent. Secondly, an "export-oriented" drawback is earned by a company for an imported product which is subsequently re-exported, or which is used in the production of exported goods. The rationale is that exporters should not be handicapped in competing for external

markets because of higher material costs created by the tariff. In 1975-76, the Department of National Revenue granted 22,000 drawbacks valued at $138 million.

There have been complaints by industry that the present system imposes unnecessary added costs for Canadian companies. Reimbursement of duties paid may be delayed over a year from the time of entry, with the result that cumulatively large sums may be tied up and interest charges and inflationary devaluation incurred. In addition, time, effort and cost is involved in substantiating and processing the claim. In certain circumstances, this system may also add to the cost of Canadian goods in foreign markets since, for duty assessments in foreign countries, foreign customs officers sometimes add the duty paid by Canadian firms to their valuation of the Canadian article whether or not a drawback is due. There is, moreover, an automatic loss of 1 per cent of the duty on each item as the drawback is limited to 99 per cent. Canadian manufacturers pointed to the systems of temporary duty free entry which are used instead of drawbacks by several other industrial countries as encouragements to exporters.

The Committee recommends a change in the present drawback to a system providing for duty exemption or remission at the time of entry for goods imported for use in producing exports or for subsequent re-export. The procedure should be decentralized to the point of entry and exemptions granted on the basis of declarations by the importer, subject to stiff penalties for infractions or subsequent failure to re-export. The possibility for appeal or reversal of rulings should exist. This modified system would make a modest contribution to easing the liquidity problems of Canadian exporting businesses and would also save companies some administrative costs, thereby enhancing Canadian competitiveness abroad.

(ii) *Duty Remissions*

Another rarer type of remission is granted under special orders-in-council to industrial firms. Under such orders, customs duty and frequently sales tax are remitted in advance for a limited specified period on imported goods used for export. The objective is similar to that in granting drawbacks; that is, to increase the competitiveness of exporting firms.

Unfortunately these procedures, involving as they do the approval of an order-in-council, can become tied up in an administrative snarl. One company was advised in June 1977 that it would be advised imminently of a decision. The next communication it received was in March 1978, informing it that a remission order valid from October 1977 to December 1978 had been granted. Unfortunately, by the time of receipt, 5 of the 14 months of the validity of the order had already passed and the benefit was correspondingly reduced.

The Committee considers that the Departments of National Revenue and Finance should investigate what could be done to streamline the procedure for granting the special remission order. Orders-in-council are unwieldy mechanisms in these instances. Ministers are too busy for such tariff details. Since the Customs Act is currently undergoing a major revision, **the Committee recommends that consideration be given to amending the Customs Act to give the remission procedure a legislative basis.**

(iii) *Free Trade Zones*

The Canadian Importers' Association advocated that Canada adopt a system of free trade zones. These zones have been popular in Europe and the United States has established 17 of them. Such zones are administrative areas where goods could enter from abroad, be processed, transformed or stored and re-exported without Canadian customs being involved. Only if the goods were brought from the free trade zone into Canada would duties be levied.

On investigation, the Committee discovered that the U.S. free trade zones were not particularly active. Very little manufacturing is done within the zones. Many of the goods were eventually exported to the United States and not to other countries. The value of goods entering into Canada from these zones appears to be trivial. Likewise Mexico's use of free trade zones seems to be intended primarily to promote social objectives—to discourage further congestion of their already overcrowded cities. With the suggested streamlining of administration, the Committee is satisfied that the Canadian system of drawbacks, bonded warehouses and special duty remissions provides an established, effective alternative to the free trade zones.

3. The Tourist Industry

Canada's deficit in invisibles including services has grown rapidly in recent years. The proportion of the deficit represented by the travel account increased sharply, from 10 per cent in 1975 to 20 per cent in 1976. The main reason for this jump in the travel deficit has been a turnabout in the pattern of travel between Canada and the United States. Until 1975, Canada had a surplus on the bilateral travel account, but that year the pattern was reversed and in 1977 the deficit reached $770 million. There is concern that this shift reflects major social trends and will therefore be difficult to change.

Beginning in 1975, the number of U.S. tourists coming to Canada dropped for three consecutive years, while the number of Canadian visits to the United States has risen. In 1976 for the first time more Canadians visited the United States than vice versa. At the time it was thought that the U.S. bicentennial celebrations were the cause, but it now is apparent that more deep-seated reasons are involved. Canadians are travelling more and appear to be developing a lifestyle which includes a mid-winter holiday, most frequently in the sun of Florida or California. Americans on the other hand are travelling overseas in ever increasing numbers. Those who continue to come to Canada are finding it more expensive than it had been. Furthermore, witnesses told the Committee there were U.S. perceptions that Canadians were less hospitable and friendly than formerly. The political situation in Quebec was also cited as a probable deterrent to U.S. tourism.

There is little doubt that rising Canadian costs have seriously discouraged visits by Americans. A recent Statistics Canada survey has found that the cost of travel in Canada had increased substantially faster than it did in the United States. Using 1971 as a base year, travel cost indicators in Canada had climbed to 160 by 1978 whereas the figure for the United States was only 140. The Canadian increase was

about 20 per cent higher than the overall rise in consumer prices over the same period.

Witnesses told the Committee that the increase in money wages in the hospitality industry in Canada was much more rapid than the Canadian average. Mr. F. G. Brander, President of the Travel Industry Association of Canada reported that the average wage of $7,828 in the Canadian hospitality industry was 24 per cent higher than the U.S. figure of $6,309. Some Canadian regions have been particularly affected. Mr. R. K. Groome of the Hilton organisation reported that wages in British Columbia were the highest in the North American hotel business. He provided figures illustrating the difference in labour costs between Canada and the United States.

> "The average wage percentage, expressed as a figure of total income, in the United States runs between 25 and 35 per cent of the total revenue in a hotel paid out in wages. In Canada now there are no major hotels, of which I know, expending less than 40 per cent, and some are spending as high as 45 and 50 per cent of their dollar revenue in wages." (II, 21:39)

The fact that time and a half must be paid after 40 hours of work in Canada as compared to after 44 hours in the United States also contributes to higher labour costs in Canada.

Mr. Brander estimated that menu prices were 10 per cent higher in Canada than the United States and liquor prices substantially higher. The price of a bottle of spirits in some provinces is almost twice what it is in New York State. A particular concern to the industry is that, contrary to what is the case in most parts of the world, none of the provincial liquor commissions offer volume buyers any form of discount and even add delivery charges, a fact which means that hotel and restaurant operators pay more for wine and liquor than the individual consumer does. Higher construction costs and higher financing costs were also cited by the Canadian tourist industry witnesses as adding to the industry's uncompetitive costs in Canada. This fact paralleled the Committee's findings in other sectors. Witnesses also commented on the impediments created by the Canadian customs regulations and practices for incoming convention visitors wishing to import exhibits for display and not for selling purposes. These practices were cited as a discouragement to Canadian locations for conventions.

A strongly voiced complaint from the tourist industry pointed out that the Canadian hotel industry was burdened by a much higher municipal tax rate on hotel rooms than in the United States. Comparative tax rates for 1977 paid in 13 Canadian and U.S. cities are presented in Table 5 on the following page.

This unfavourable discrepancy and its negative effect on tourism has since been acknowledged by both the Ontario and Quebec governments. In 1978 both provinces eliminated the sales tax on hotel rooms, a measure which will contribute to bringing the comparative U.S. and Canadian hotel rates into line.

Taxation of liquor also places the tourist industry at a competitive disadvantage. While provincial jurisdiction over alcohol sales results in a variation of policies across Canada, Mr. Groome's description of the situation in Quebec is fairly typical of that in other provinces.

Table 5

Municipal taxes per hotel room for selected U.S. and Canadian cities

City (rank order of averages)	*Lowest Amount Per Room*	*Highest Amount Per Room*	*Average Amount Per Room*
1. Montreal	$1,185	$3,291	$1,923
2. Quebec City	1,688	1,956	1,842
3. Toronto	677	2,197	1,437
4. New York	481	2,000	1,188
5. Winnipeg	994	1,371	1,143
6. Halifax	749	1,491	1,127
7. Boston	483	1,356	1,004
8. Edmonton	687	1,013	896
9. Calgary	667	951	812
10. Vancouver	443	1,301	790
11. Chicago	465	959	608
12. Philadelphia	160	903	533
13. Washington	166	721	396

Source: Laventhol and Horwath, presented by witnesses from the Travel Industry of Canada in testimony to the Committee May 24, 1977.

"A licence holder in the province of Quebec pays thousands of dollars for his liquor licence and then pays the regular price for a bottle of liquor, plus 5 per cent, and then a 70 cent per case delivery charge on top of all of that. In addition, there is a 10 per cent tax on the retail sale." (II, 21:41)

Witnesses asserted that higher liquor prices were one of the factors making menu prices 10 per cent higher in Canada than in the United States.

In 1975 and 1976, U.S. visitors' chagrin at the high Canadian prices was compounded by the high exchange rate on their dollar when the Canadian dollar's value reached as high as $1.03 vis-à-vis the U.S. dollar. According to the industry witnesses, this fact made visitors much more sensitive to the service they were receiving and the prices they were paying for meals and liquor. The lower rate of the Canadian dollar since 1977 is bound to have an automatic ameliorating effect on the high Canadian prices in the eyes of the U.S. purchaser. It should also discourage some Canadians from going to the United States or from staying as long.

Finally, a major adverse effect on the bilateral travel account has been caused by Section 602 of the U.S. Tax Reform Act of 1976. This legislation restricts the number of foreign conventions that can be deducted for income tax purposes to two, and imposes much more stringent conditions on reporting of expenditure. Under present U.S. law, a convention is only eligible for a deduction if its location is consistent with the "territorial scope" of the organization. Canada similarly limits the number of conventions eligible for tax deduction to two *but does not discriminate between domestic and foreign-held conventions.*. The U.S. restriction and the accompanying stringent reporting requirements apply only to foreign conventions.

Since this legislation was first introduced in the U.S. Congress, groups and organizations that are North American in scope and which have traditionally held

their conventions in Canada on a cyclical basis have been cancelling their bookings. If conventions are shifted to the United States, the tourism deficit is increased, not only by the loss of U.S. business in Canada, but also by the increase in Canadian spending south of the border. The net effect on the travel account of both these factors was estimated to range between $100 and $200 million. In respect to this problem, Mr. Brander told the Committee,

> "If Section 602 remains in force it will mean a loss of at least the major part of these important conventions, plus the further escape of capital from Canada, as the Canadians who attended what we might call these United States conventions that are held on a cyclical basis in Canada will now be held in the United States, and we will find Canadians going down to attend even more conventions in the United States." (II, 21:15)

Mr. Groome supplied the Committee with details of cancelled hoel reservations by U.S. convention groups in four major Canadian cities which showed that in the first three and a half months after the U.S. legislation took effect, hotels in these cities lost $24 million.

> "If you multiply that by three, which is the generally accepted multiplier of other dollars spent by the convention delegate coming to Canada, including whatever he spends on air fare, taxis, entertainment, shopping, you will come up quickly to a total of about $100 million." (II, 21:46)

Included among the cancellations were such large and prestigious organizations as the American Newspaper Publishers Association, the Mortgage Bankers Association and the American Bar Association.

The federal government has pursued this issue vigorously with the U.S. Administration, which responded to some degree in early 1978 by proposing to Congress modifications to restore to Canada some of the benefits it formerly enjoyed. However, there is no certainty that Congress will act. Unfortunately the convention tax issue has been linked in the minds of many Members of Congress with a recently enacted Canadian tax amendment (known as Bill C-58) designed to encourage Canadian advertising in indigenous periodicals and television stations. Affected U.S. interests have lobbied and have so far been successful in making the case that the Canadian Income Tax amendment is discriminatory to U.S. interests and that relief to Canada on the convention tax issue should be conditional on Canadian withdrawal of the recent legislative change. This is a complex and politically sensitive situation, but one in which the loss to Canadian interests is many times greater than it is to Americans. **The government must try to find some solution by compromise.**

Remedial measures for the tourist deficit must have two market objectives: first, to persuade more Canadians to travel within Canada, and secondly to encourage more Americans to come to Canada and to stay longer. For both objectives, witnesses agreed that stepped up advertising and marketing approaches were needed. Mr. Brander stated,

> "Canada cannot be competitive in the international or the domestic tourism market if it will not increase its marketing and advertising effort. Advertising within Canada and foreign markets must be increased dramatically if the tourism flow crisis that we have now is to be remedied. The federal government must distinguish between "cost" expenditures and "investment" expenditures. The Canadian Government Office of Tourism must be allotted a more adequate budget, in our view. It goes without saying, though, that these dollars must be spent wisely. Market needs must be re-assessed; more programs must be initiated or changed to help ensure that the Canadian tourism plant can compete in a quickly changing marketplace." (II, 21:17, 18)

From 1973 to 1977 the Canadian Government Office of Tourism (CGOT) budget increased by only 19.6 per cent while the Department of Industry, Trade and Commerce's budget increased by 61.7 per cent and the federal government's overall budget by 100 per cent. There is no doubt that it is already recognized that the United States should be the major focus of Canadian government tourist promotion. Mr. T. R. G. Fletcher of the CGOT told the Committee that in 1975 three-quarters of its expenditures ($12 million out of $16 million) was directed toward encouraging Americans to travel in Canada and about $2 million spent to encourage Canadians to travel more within Canada. The Committee considers that these efforts should be not only sustained but upgraded. **The Committee therefore recommends increased funding for the Canadian Government Office of Tourism.** Efforts to encourage increased travel in Canada should be coordinated as far as possible with provincial promotions.

In the area of package tours, Canadian airlines until recently have had a poor record of stimulating cross-Canada travel. Instead they have emphasized almost exclusively the south-bound sun-seeking all inclusive package. The U.S. airlines, however, for some time, have offered advance booking charter (ABC) flights across the United States. They also have all inclusive U.S. ski packages across the United States to western ski resorts of Vail or Aspen and "no frills" round trips have been available on regular air service flights from New York City to Los Angeles on week days at very low rates.

Early in 1978 Canadian airlines began at last to compete with these attractions to a limited extend. Approval was finally obtained from the Canadian Transport Commission for cross-country advance booking charters (ABC). A limited number of charter class Canada (CCC) seats are now available on Canadian internal flights. Air Canada introduced a "no frills" Nighthawk fare for long flights within Canada with no advance booking requirement. Both Air Canada and C.P. Air now have all-inclusive ski packages from Toronto to Banff aimed at the domestic market. Such promotional schemes are long overdue and could help to direct Canadian travel to east-west flows instead of north-south. There are still some gaps, however, in the airline offerings. The ski packages involving both the airlines and the hotels are of a seasonal character. Little is available in the way of an inclusive package tour in the summer which might attract both U.S. visitors and Canadians to plan cross-country Canadian summer vacations.

In summary, considerable recent progress has been made to stimulate the Canadian tourist industry. The new possibilities for cheaper cross-Canada flights are encouraging. The 1978 federal-provincial ministerial decision to promote tourism and package tours was a welcome development. The removal by some provinces of onerous taxes on hotel rooms should assist Canadian hotels in attracting more U.S. and Canadian visitors. The drop in the value of the Canadian dollar vis-à-vis the U.S. dollar has undoubtedly been helpful to this industry. By mid-1978, the forecast was for increased tourist travel in Canada and a reduced number of Canadians going to the United States.

Yet there remains much that can and should be done to improve the situation of this major national industry, whose foreign exchange earnings rank fifth among the

country's industries. It is also a significant employer of labour (88,000 in 1976 directly or indirectly) and this is labour with important special characteristics—offering employment in many remote areas where there are few other opportunities and providing work for unskilled people in many cities and towns.

Together with the Committee's recommendation for increased funding of the Canadian Government Office of Tourism for promotional activities, **the Committee recommends the establishment of a federal-provincial task force to examine all elements of the tourist industry.** It should be instructed to recommend to both levels of government imaginative changes to improve the competitiveness of this fractionated and neglected industry which cumulatively has a major impact on Canada's payments balance with the United States.

The Problem of Minimum Wages

The high level of Canadian minimum wages as compared to those in the United States has adversely affected competitive costs in Canada by creating an upward pressure on wage levels generally. In no industry are minimum wages of more direct relevance than in the tourist or hospitality industry.

As can be seen from Table 6, during the 10 year period from 1967 to 1976 the average Canadian minimum wage measured from about 75 per cent of the U.S. federal minimum to 120 per cent of the U.S. minimum.

Table 6

Indexes of Minimum Wages

	CANADA			UNITED STATES	
	Federal	Composite[1] (Fed. & Prov.)	Y/Y[3] change in Composite	Federal	Y/Y change
1967	75.7	73.8	4.8	87.5	
1968	75.7	78.6	6.5	100.0	14.3
1969	75.7	86.9	11.1	100.0	0
1970	100.0	100.0	14.9	100.0	0
1971[2]	103.1	108.3	8.3	100.0	0
1972	109.4	116.1	7.2	100.0	0
1973	118.8	126.5	9.0	100.0	0
1974	137.5	146.4	15.7	125.0	25.0
1975	162.5	183.4	25.3	131.3	5.0
1976	181.3	205.6	12.1	143.8	9.5

1. Provincial Rates (90%) are weighted by provincial labour force 1975; federal weight is 10%
2. 1966-71 index is reproduced from Prices and Incomes Commission Report.
3. Y/Y = year by year change (1970 = 100)

Sources: Labour Gazette, var. issues; Final Report of Prices and Incomes Commission; U.S. Statistical Abstract, 1977, p. 411.

In mid-1977, the average minimum wage in the Canadian provinces was $2.85 an hour, much higher than in many contiguous U.S. states and 15 per cent higher than the U.S. federal minimum of $2.50 an hour. By 1978 the Canadian federal minimum was $2.90 and the Quebec minimum stood at $3.25. Moreover, the U.S. minimum wage legislation has many more exemptions than the Canadian laws, so that the effective differences are even greater than is indicated by the difference in rates. For instance in the United States, small businesses are exempted from paying the minimum wage.

Increases in minimum wage rates have two important impacts. First, they put great upward pressure on wages just above the minimum and, through time, on all wage rates as higher rates are adjusted to maintain long established differentials. Second, increases in minimum wages directly increase costs and reduce employment in low wage manufacturing and service industries. Studies in the United States have concluded that at both the federal and state level, minimum wage legislation has had a negative impact on employment levels.

The industry that is most directly affected by the high Canadian minimum wages is the Canadian hotel and restaurant industry. Mr. R. K. Groome of the Hilton organization told the Committee

> "We now have the highest minimum wages in North America. The federal minimum wage, unless I am mistaken, is $3 and two of the provinces have a minimum wage of $3 while the highest minimum wage anywhere in the United States is $2.50 or $2.60. So we have an automatic disparity in wage levels." (II, 21:41)

Further, in this industry, the impact of the minimum wage is compounded by the low exemption for tipping. In the U.S., the general rule is that a 50 per cent exemption to the employer from the minimum wage requirement is given for tipping revenue. For example, in a state with a minimum wage of $2.50, a bellman would be deemed to be receiving the minimum wage if he were paid $1.25 by his employer. In Canada, the allowable deduction is smaller and is deducted from a generally higher base. Only Quebec and Ontario allow any differential at all. In 1976 in Quebec, for an occupation with tipping revenue, the differential has been forty cents on a minimum wage of $3.15 (for employees over 18 years old). In Ontario, with a minimum wage of $2.65 per hour, tipping is only taken into account in setting the minimum wage for waiters and waitresses serving liquor in a licensed outlet. For these workers, the minimum wage has been $2.50 per hour, i.e., a 15¢ differential. The 1978 Ontario budget provided some improvement in the matter of the tipping exemptions, but it is still much more restrictive than in the United States.

Witnesses representing the tourist industry testified that for employees involved in serving food and beverages a tripling or quadrupling of the basic wage rate from tipping was not uncommon. Mr. Groome stated that there are "banquet waiters who earn $20,000 a year, of which $12,000 or $13,000 is gratuities". (II, 21:21) Whatever the general impact of minimum wages on employment and the welfare of marginal workers, the most ardent supporter of this legislation would be hard pressed to justify its augmenting the income of employees that earn as much from tips in the hospitality industry as many employees do.

The original rationale for minimum wage legislation was to better the lot of lower paid employees. Some witnesses questioned that the anticipated benefits of this

legislation have been realized and whether this approach is the best means of pursuing this objective. Mr. John Bulloch, President of the Canadian Federation of Independent Business, summarized this viewpoint.

> "To have higher minimum wages in Canada than in the United States is, in my opinion, foolish. There have to be better ways of dealing with the social problems of those who are called our "working poor" than the minimum wage route, which is a very inefficient route. You have situations where, for example, a 60 cents an hour difference between Montreal and U.S. firms that are involved in fairly standardized types of manufacturing simply result in those firms just moving their operations across the border." (II, 22:20,21)

The Federation argued that the minimum wage has reduced the number of jobs available to this group and in particular, many apprentice-style jobs which were low paying, but where the employee was receiving training in a skill that would generate income later, disappeared. The high unemployment rates among teenagers appears to be, in part, a result of the incidence of minimum wage laws. This point of view has recently received recognition from several provinces which have instituted programs to subsidize employers who hire students. Ontario and Quebec for example pay employers part of the wages of a student enabling enterprises to use inexperienced or apprentice-level youth in jobs for which they could not afford the full minimum wage.

Direct comparisons with the minimum wage situation in the United States however ignore the fact that U.S. low-income families are able to supplement their income with food stamps and other benefits. To the extent that the gap between the Canadian and the U.S. minimum wage is narrowed, it will be necessary to supplement the income of low-income families in Canada by direct means. Canadian competitiveness would be better promoted by such an approach rather than having a higher minimum wage in Canada than the United States.

The present disparity in Canadian and U.S. minimum wages has been a factor in raising average Canadian wage levels in the tourist industry to as much as 24 percent higher than in comparable U.S. industry. The legislated minimum levels are, in fact, so far out of line in a number of provinces as to make even parity a difficult objective to achieve except gradually over a number of years. The Canadian federal and provincial legislators should be more aware of the upward pressure effect of minimum wage levels on other wage levels. In order to keep their industries competitive they should understand the importance of keeping an eye on the minimum wages in the contiguous states across the border to ensure that their minimum wage level is no higher. There is no reason why Canada should be a North American leader in minimum wages.

Accordingly, **the Committee recommends that increases in Canadian minimum wages be restrained so that the gap with those in the United States, in particular with the competitive northern states, is gradually closed. As movement in this direction occurs, it would be necessary to put in place programs for supplementing the income of low-income families in Canada.**

4. Small Businesses

Small businesses constitute the vast majority of productive enterprises in Canada. Although they predominate in the service and tourist sectors, they also

constitute 80 per cent of manufacturing companies. In spite of their very large numbers, however, small businesses in Canada provide less than 20 per cent of all manufacturing employment in Canada and less than 15 per cent of the total value of manufacturing shipments.* Since Canada lacks a legal definition of a small or medium sized business, statistics are somewhat unreliable.

In a number of industries Canada's geographic and demographic make-up favour the producer serving a small local market. Proximity to markets is a crucial element of secondary manufacturing. Transportation costs reinforce this advantage and this factor will gain in importance as energy costs grow, as Mr. John Bulloch, President of the Canadian Federation of Independent Business, reminded the Committee.

> "The more efficient types of structures in the future will be smaller enterprises that are more regional than national in their composition because of the growing influence of energy-related transportation costs. There will be a mini-plant movement which should get under way in the early 1980s in terms of efficient, sophisticated, smaller operations that are more regionally located because of transportation costs—brick plants, cement plants, bakeries, dairies, and this type of thing." (II, 22:11)

Over the years, a number of government programs have been put in place to provide various forms of assistance and support, but they have been somewhat random in their impact. More serious from the point of view of the small business community has been the lack of a focal point in government to which they could relate, such as the Small Business Administration in the United States, and which could defend and promote their interests.

Small businesses in Canada face some special problems. Their financial resources are small, so that they find great difficulty in borrowing if they need funds to take advantage of a special opportunity. Paper work demanded by both levels of government can be very onerous. Small Canadian firms complained that many U.S. subsidiaries in Canada were restricted in their authority to subcontract, thereby cutting off an important source of orders.

In order to understand the concerns of the small business community and appreciate its potential in the field of trade with the United States, the Committee invited the Canadian Federation of Independent Business, which was formed a decade ago to represent small business, to testify.

It is interesting to note how many of Mr. Bulloch's concerns were shared by other witnesses from the private sector who represented large firms. These included the need to hold down unit costs, the effect of too-high minimum wages, the cost of borrowing, the over-valued Canadian dollar and, in general, the need to increase efficiency.

The work of the Federation is already having perceptible results in terms of government action. The first major step was the establishment of the Ministry of State for Small Business and its presence has produced action in a number of fields of interest to small business. The time-consuming requirements of government for

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* Background study for the Science Council of Canada, April 1973, special study No. 26: *Governments and Innovation*, page 161

form-filling are being somewhat reduced. A program to provide management advice, Counselling Assistance to Small Enterprises known as CASE, has been described by Mr. Bulloch as being "outstanding". A special federally-funded bank for small business, the Federal Business Development Bank (FBDB) has been set up and Mr. Bulloch maintained "it is doing a very good job". (II, 22:23) But the Federation thinks that the FBDB should be the "lender of last resort", and that the primary source of financing should be through the private banks. To further assist small businesses the government has proposed the creation of venture enterprise investment companies (VEICs) with special tax breaks to create pools of risk capital.

Mr. Bulloch drew attention to the high proportion of Japanese exports which are manufactured by small businesses in Japan—40 per cent—and compared this situation unfavourably with that in Canada. While he was persuasive in suggesting that small businesses in Canada had an unrealized potential for export, particularly to the United States, it must be recognized that the strong performance of small business in Japan reflects the strength of its secondary manufacturing industry, an area in which Canada is weak. In contrast, in fields in which Canada has a strong export performance such as automotive products, mining and mineral refining and smelting or plywood manufacturing, only big companies can establish the large capital intensive plants and the integrated production processes.

In response to a question to its membership as to how small businesses in Canada would react to free trade with the United States, the Federation received 10,000 replies. Surprisingly just under one-half supported the free trade idea revealing a much more open attitude to the idea than many large business representatives the Committee heard. Mr. James Conrad of the Federation staff explained the result in these terms.

> "The small businessman is prepared to compete with a low tariff situation . . . He operates in a competitive environment; he is prepared to compete; he is prepared to expand his sales in the United States". (II, 22:27)

The need for rationalization and for achieving scale production in Canadian manufacturing industry has been stressed in this report. It is important to emphasize, however, that with modern capital intensive technologies, scale production is not a function of bigness or of large numbers of employees. What is required is specialized manufacture and adequate markets. The Japanese experience with exports by small business suggests that a move toward free trade with the United States could open important opportunities to small manufacturing enterprises in Canada to expand their production and sales. The response of members of the Federation is welcome evidence that they are prepared to face the challenge.

V NON-TARIFF MEASURES

In recent years, non-tariff measures have gained increasing prominence as barriers to trade, often more effective but less visible than tariffs in deflecting imports and much more difficult to bring under international control.* If tariffs are reduced as expected as a result of the GATT multilateral trade negotiations, non-tariff measures will play an even more important trade-inhibiting role. The GATT conference is conscious of this situation and is committed to deal with it as well as tariffs.

Between Canada and the United States, non-tariff measures have until now been less important in shaping bilateral trade patterns than tariffs. This is particularly true in comparison to either country's trade with Japan or the European Community. Nevertheless, a number of non-tariff measures are used by both Canada and the United States. Mr. Tom Burns of the Department of Industry, Trade and Commerce told the Committee "the United States' panoply of non-tariff measures is more of a barrier to Canadians than our panoply is to them." (I, 19:21) A list of some of the more important non-tariff measures notified by each country against the other, under the GATT notification procedure, is set out in Appendix II. They include customs valuations, countervailing measures, quotas, health and safety standards, subsidies and government procurement.

1. Customs Administration

a) The U.S. System

The U.S. non-tariff barrier (NTB) cited most frequently by Canadian officials and businesses as having a notable impact on Canadian exports is the administration of the United States customs. Canadian exporters complained of long delays (sometimes as long as two years) before an official ruling by the U.S. customs administration concerning a tariff classification could be obtained. An official ruling, once obtained, establishes the rate on the shipment in question and provides greater certainty of the rates of duty that will have to be paid on future shipments, since a ruling on a product cannot be altered without due notice and process. Unfortunately, however, a ruling is not applicable to all like products imported by other firms. Each shipper must acquire a ruling to avoid uncertainty over classification. Further, delays ranging from several months to years have been experienced in the processing of entry forms between the time of entry and the appraisal of the goods establishing the duty rate.

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* Non-tariff barriers to trade are generally defined as policies, legislation, regulations or practices which have the effect of restraining imports. The definition can also be broadened to include voluntary export restraints and export and import quotas.

Once a rate has been established, the total duty paid depends on the evaluation of the goods. The United States has three methods of evaluation. The "old system" remains in force for a special list of about 1000 products. It values the product at its export or foreign value, whichever is higher. The foreign value is the value at a sales level where *anyone* can purchase it. If different prices are charged to large customers than small, the value for duty purposes would be established at the price charged the small retailer, since, by definition, the discount for large orders is not available on purchases of any size. In effect, volume discounts are ignored. This old value system, which applies among other products to auto aftermarket parts, has the effect of raising the duty significantly. Officials told the Committee that this was one of the principal non-tariff barriers they wished to discuss with the United States at Geneva.

The new U.S. value system covers the bulk of remaining goods. It is less protective but there are frequently costs included in the valuation for duty purposes, which are relevant to some export and domestic sales but not to the particular one being assessed. An example would be costs for warehousing in Canada that did not apply to export sales to the port in question. With both the new and the old system, considerable discretionary scope exists for assessing the value of transactions between related companies or within the same company.

A third system of evaluation, which has received considerable attention from EC industrial interests is the "American selling price" system. However, it applies principally to benzenoid chemicals which are not now an export of Canada to the United States.

b) The Canadian System

The Canadian customs system differs from that of the United States. Most decisions on classification are made by the customs officer at the time of entry. An importer has a right to register an appeal of this decision within 90 days. On rare occasions the Department of National Revenue will change a custom official's decision. It appears that less uncertainty for the importer is generated by this system as compared to the provisional rulings used by the United States.

The Canadian valuation system is based on the fair market value of like goods as sold in the home market of the exporting country. An overriding feature of the Canadian valuation system is that the value for duty must not be less than the selling price to the Canadian purchaser exclusive of all charges on the goods after they leave the point of entry. Quantity and trade level are taken into account in the calculations. The United States has criticized the procedures for valuation when there are no similar trades in the country of origin. The procedure in such cases is to add an estimate of normal profit on such sales to the costs of production. The Americans believe that the resulting valuations are too high. U.S. exporters also complain that they must divulge confidential information to the customs officials—information which could plague them in anti-dumping or countervail suits. That the Canadian customs officers are bound by oath to respect the confidentiality of information provided to them does not significantly reduce this concern. The extent to which Canadian customs officials seek information abroad from exporting companies is unique.

Given the similarity of Canadian and U.S. trading practices and the importance of the trade between the two countries, **bilateral efforts to make the two systems of valuation for duty purposes more similar would be constructive. Codes for reciprocal treatment of similar situations would be easier to negotiate and enforce if the basic systems were more compatible.**

2. Countervailing Measures

The United States countervailing duty law is of major concern to Canada. This law is not fully in conformity with GATT in that it does not require a finding that material "injury" to domestic industry has occurred before an extra duty can be imposed, compensating for foreign subsidies affecting export prices. This variance of the U.S. countervail is technically permissable because the U.S. law pre-dated the GATT provision. However, when the United States extended its law to cover non-dutiable goods in 1974, they were obliged to include the injury provision for these goods.

The injury provision has been part of the anti-dumping code and has prevented some abuses in its application. For example, in 1973, ALCOA lodged a dumping complaint against ALCAN's exports to the United States. Although the Tariff Commission ruled that dumping had technically occurred, no injury was found, and consequently, no anti-dumping duties were levied. For this reason, **persuading the United States to make their countervailing duty law conform with the requirements of Article VI of GATT is and should be an important objective in the present tariff negotiations.**

Another problem with countervailing duty is the ambiguity surrounding the extent of its applicability. General subsidies or tax preferences tied to export performance, such as the duty remission plan on automobiles which preceded the 1965 Auto Pact, obviously qualify. However, *any* tax or subsidy that influences costs will indirectly affect the competitiveness of Canada's goods in the United States.

In 1973, acting on a complaint, the United States Treasury decided that exemptions from municipal tax, aid from Industrial Estates Limited in Nova Scotia and federal regional grants to the Michelin Tire Company represented an export bounty. A countervailing duty of over 6 per cent was imposed; this level of duty adjusts with a number of factors and is now between 2 and 3 per cent. Michelin has so far paid over $6 million in these duties. The company has continued to appeal the case which is still before the courts. Concerning injury and the pervasiveness of similar practices in the U.S. in this case, Mr. A. V. Peters of Michelin commented:

> "When we raised this question of injury in a discussion with representatives of Treasury . . . we were told that it was completely irrelevant. . . . When we raised the question of the assistance available in the United States—in some states, because in the United States it is very often a local question—it was much more extensive than what we know in Canada. The answer was always, 'it is irrelevant'." (II, 24:10)

The Committee considers that an effective delineation between substantive subsidies encouraging export expansion and subsidies which have a minimal effect on export prices and which are elements of programs with other legitimate purposes, must receive high priority in bilateral discussions with the United States as well as

in the multilateral tariff negotiations. In 1977 Canada promulgated its own countervailing duty regulations that are consistent with the GATT articles. Clearly, if the United States substantially widens the application of countervailing duty, Canada will retaliate. Both parties will lose from the resulting contraction in trade and the frustration of legitimate objectives such as regional development.

A retaliatory sequence did start following the introduction of the Domestic International Sales Corporation (DISC) by the United States in 1971. The Canadian government countered with the reduced corporate tax rate for manufacturing industry. In September 1972, it also imposed the Import Surveillance Program designed to identify export-tied tax reductions, such as offered under DISC. As the Committee heard from the Canadian Importers' Association, the Surveillance Program is in itself a hindrance to trade. Importers of goods valued over $10,000 must provide information on tax benefits received and the extent to which they affect prices. Without such a declaration, goods can enter but a deposit of $100 per shipment must be posted. The Surveillance Program was prudent preparation for a "countervail war".

The United States government was also preparing itself for such an eventuality. The U.S. Trade Act of 1974 provided a number of wide-ranging powers that could have severely curtailed trade, if interpreted in a protectionist manner. Article XIX of GATT permits emergency safeguard action if imports cause or threaten to cause material damage. In the 1974 law, U.S. procedures under this escape clause became more protectionist with the President having less scope to avoid taking restrictive action, if the International Trade Commission found that imports were linked to injury, either potential or actual. In addition, the President was given powers to act, if another country's commercial policy restricted or discriminated against U.S. trade, if unjustified denial of access to primary goods occurs, if foreign subsidies or taxes unduly affect U.S. commerce, and if "unfair" marketing practices disrupt a U.S. industry. These powers are so all-embracing that there is no longer an effective constraint within U.S. law preventing the President from undertaking protectionist policies. These powers have been buttressed by a substantial expansion of operational staff. One commentator writing in the *Journal of World Trade Law* during 1974 noted that the staff dealing with anti-dumping and countervail complaints had increased by a factor of ten in the preceding two years.

Fortunately, no such "war" has occurred, and the Michelin case has not stimulated a spate of similar cases. Although this has been fortunate for the two countries, Michelin considers itself a casualty of governmental manœuvring. Mr. Peters commented:

> "I have the impression that discreetly I am being encouraged to have the company drop its case. In other words, our case is becoming an embarrassment of some sort. Since the realization came that it was a decision against Michelin, it is quite conceivable that reassurances were given that the countervailing duties on that basis would not be imposed on other companies, and everybody seems to be happy but Michelin." (II, 24:9)

Beyond providing information consistent with Canadian law and international protocol, the Canadian Government can provide only limited assistance to an individual company in a case involving foreign law, and has properly concentrated its diplomatic attention on negotiating a more favourable environment for Canadian industry as a whole.

3. Anti-Dumping Measures

As with the countervailing measure, U.S. and Canadian anti-dumping provisions differ because the U.S. law was enacted prior to the formation of an international code under GATT. A potentially significant difference involves the interpretation of "injury". The Canadian law requires that dumping be the *principal* cause of *material* injury; U.S. law only requires that "injury by reason of dumped imports" exist, and the competent U.S. authorities have much more freedom in interpreting what constitutes injury. In practice, however witnesses testified that U.S. enforcement practices to date were similar to the Canadian.

Another difference is that, in the United States, the Secretary of the Treasury can initiate an anti-dumping investigation on the complaint of a single member of an industry. In Canada, the Deputy Minister of National Revenue has to determine whether there is evidence that dumping has affected domestic producers *as a whole* before action is initiated. On the other hand, U.S. law requires anti-dumping action to be taken within a certain time frame. Decisions on Canadian anti-dumping cases have taken considerably longer to determine until recently when guidelines for processing complaints which provide for similar timing to U.S. practice were adopted by the Department of National Revenue. Canadian companies producing for the domestic market have complained of the high cost and long periods of time involved in getting relief. Canadian importers on the other hand complain that the Canadian anti-dumping authorities are over-zealous in regard to alleged dumping.

Between 1969 and mid-1977 Canada investigated 44 anti-dumping cases involving U.S. exports into Canada, approximately five cases a year. The frequency of U.S. anti-dumping investigations has, until recently, been similar. However, the scope for other investigations concerning injury have been substantially widened beyond the boundaries of traditional dumping and countervail by Section 337 of the U.S. Trade Act. Under that section, the International Trade Commission is empowered to counteract "unfair methods of competition and unfair acts in the importation of articles into the United States". Imports may be restricted if a marketing practice has "the effect or tendency . . . to destroy or substantially injure an American industry or prevent the establishment of such an industry". Over 20 investigations, under the powers granted in this section, have been initiated since the U.S. Trade Act became law in early 1975.

On occasion, as during the U.S. automotive anti-dumping investigation of 1975, Canada has complained that U.S. anti-dumping procedures were not initiated in conformity with the GATT anti-dumping code. As the U.S. law pre-dated the GATT code there is no requirement to bring the legislation into full conformity. In the automotive case, one Congressman's complaint on behalf of the UAW was sufficient to launch the case. Canada, along with other countries, contends this does not constitute a complaint on behalf of an "industry" as defined by the code.

Nevertheless, on balance, the situation has improved in respect to anti-dumping. Prior to the Kennedy Round of multilateral trade negotiations, anti-dumping was a very considerable trade barrier between Canada and the United States. According to a Canadian official, the successful Kennedy Round had a positive effect on the U.S. anti-dumping procedures, "eliminating all of the worst excesses". However, the

Committee agrees that **Canada should continue to press in the GATT negotiations to have the United States broaden its "injury" provision in anti-dumping cases to parallel the GATT code.**

4. Government Purchasing

Because of the increasing importance of government economic activity in North America, government purchasing policy is an important actual and potential deterrent to bilateral trade. Both federal governments favour domestic sources. The U.S. government generally implements the Buy American Act of 1933 by providing a preference margin of 6 per cent for a domestic bid over a foreign bid (including duties); this preference is raised to 12 per cent, if the domestic bidder is a small business. These preferences are, in effect the floor for discrimination and some major departments apply higher preferences. City and state governments generally apply either formal or de facto preferences in their purchasing policies.

In 1977, a bill to extend and strengthen the Buy American Act was introduced in the U.S. Congress. If passed, it would virtually close off access for Canadian products, except for defence, to U.S. federal procurement purchases as well as a large portion of state and local government procurement. For instance, the 6 to 12 per cent price preferences would be raised to 15 and 20 per cent and the amount of U.S. content required would be raised from to 50 to 75 per cent. In addition, more stringent controls have been attached to certain state and local projects funded by U.S. federal funds requiring stricter observance of "Buy American" restrictions in purchasing. These U.S. federal procurement measures have been paralleled by a rash of new buy-local-state laws in 1977 and 1978.

As has been mentioned before, Canadian governments also apply preferential margins in their purchasing. The federal government accepts a premium of 10 per cent of the difference in foreign content between two bids. An example, provided by the Department of Supply and Services (DSS), illustrates. Suppose

> "... two bids were received from Canadian firms, one at $100 included a foreign content of $20 and the $96 bid included a foreign content of $80. Thus the foreign evaluation differential that DSS is allowed to work with is calculated by taking 10 per cent of difference between the two foreign contents, i.e. 10 per cent of $80—$20, $6. This $6 foreign content evaluation differential is then added to the lower bid price, i.e. $96 plus $6, $102 with the result that a contract would be awarded to the $100 bidder since his bid is competitive on this basis. (II, 23A:5)

Provincial governments generally provide greater preference, either formally or informally, to firms located in the province. The purchasing practice of Provincial Liquor Boards have been cited by the United States in the GATT negotiations as a non-tariff barrier of particular concern to them.

On both sides of the border the domestic preferences are bolstered by a series of other protective measures. In Canada, foreign firms are not invited to bid on many contracts; if the product is required quickly, only local firms may be invited to bid; on some contracts, a minimum Canadian content may be prescribed. In the United States, large contracts are reviewed and decisions may be altered for the 'national interest'. Mr. Allan V. Orr of Atlas Steels told the Committee that foreign specialty steels were excluded from U.S. defence contracts by legislation.

Practices of administrative agencies widen the scope of the Buy American Act. The Rural Electrification Authority lends funds to independent telephone companies at very low rates of interest, but the funds must be used to purchase capital equipment. A six per cent preference is shown to equipment which has a 51 per cent U.S. content. Since Western Electric supplies the Bell System, the independent telephone market is one of the major telecommunication equipment markets remaining. If a Canadian company like Northern Telecom wishes to penetrate this market, it must establish a subsidiary manufacturing facility in the United States.

Location of production, not ownership, is the key to present preference arrangements in both countries. Moore Corporation, a Canadian-owned company, is the largest supplier of business forms to the United States government from its U.S. plants. Mr. Bruce Sully of Dominion Road Machinery acknowledged the impact of government purchasing on his company's decision to build a plant in the United States.

> "... it is imperative that our product be manufactured in the United States, particularly since approximately 70 per cent of our business is politically-oriented and, therefore, subject to continued threats to implement 'Buy America Act' and very often strong presentations to 'Don't Buy Foreign!' " (II, 9:15)

Mr. R.W. Chorlton of Wajax, a company which manufactures fire control pumps in both Seattle and Montreal, said that more economical production could be achieved with one plant. However, since state and federal authorities represent the main market in the United States, the company would lose its U.S. sales if production were consolidated in Montreal. With the present less protective Canadian purchasing policies, the closing down of the Montreal manufacturing plant, and consolidation of production in Seattle would be an attractive alternative to the status quo, particularly if tariff rates were lowered multilaterally.

The fragmentation of Canadian production facilities by protective provincial purchasing policies also decreases Canadian cost competitiveness in foreign markets. Where provincial agencies, or crown corporations, or regulated utilities are important customers, pressures to locate production activity in the province are exerted. For a utility company, the provincial governments would be willing to impose an implicit tax in the form of higher utility rates, for instance, in order to subsidize local production. Mr. Alfred Powis, President of Noranda, described the situation.

> "A specific province will say, 'We will only buy a certain product if it is produced in this province'. This becomes significant in terms of wire and cable, for example, with regard to which, if you want to sell these products to such a provincial utility as I have referred to, you had better make it in that province." (I, 36:15)

The incidence of government purchasing varies considerably between industries. For most industries, it is not a dominant factor, but for industries such as telecommunications equipment, aerospace, electronics, wire and cable, electric generating equipment, and business forms, it is known to be extremely important. **Rationalization of federal and provincial purchasing policies would be a desirable first step in designing a better code for government purchasing. A second step would be to negotiate mutually advantageous arrangements with the United States in respect to procurement practices.**

5. Packaging, labelling, metrication, building codes and other standards.

Packaging and labelling requirements can also act as deterrents to trade. In the United States, enforcement of the labelling requirements is much more stringent on imported goods as compared to domestic goods. Domestic goods are subject to spot checks while imported goods are examined in detail at border crossing points. The U.S. Government has complained to GATT about the Canadian bilingual labelling requirements on mass produced goods. Country of origin labelling requirements can also be an important cost element for potential exporters. For example, business forms must bear the appropriate imprint "Made in the United States" or "Made in Canada". How this information protects the customer is not clear. It was cited by Moore Corporation as a reason why cross-border trade in business forms was trivial. About ten years ago, U.S. lumber interests supported an unsuccessful attempt to require Canadian lumber to bear a country-of-origin marking.

Metrication requires continuing cooperation between the governments and industry of both countries to avoid detrimental effects on bilateral trade. The Canadian program is more advanced than the U.S. program and the timetables for adoption of metric measures in each industry vary between the two countries. The Canadian Metric Commission has indicated it recognizes the importance of reconciling the Canadian and U.S. programs, and is undertaking negotiations to that end.

In both countries, building code standards, safety standards and grading requirements frequently have a disproportionate effect on imports as compared to domestic products. Tax policies, such as the U.S. treatment of convention expenses abroad, DISC, Western Hemisphere Trading Corporations and regional subsidies are also nontariff measures. Until recently U.S. copyright law contained a manufacturing clause that limited protection to the author unless the book, periodical etc. was manufactured in the United States. Canadian officials actively pursued change in this U.S. law. Recently the Americans withdrew this provision from the law. The change was to occur after a period of five years but Canada was given immediate exemption.

6. Conclusions

There is a very large variety of non-tariff measures which could or do distort trade. Some are blatantly protectionist; others relate to legitimate social purposes such as health, safety, or bilingualism. In a period of economic recession, unemployment or inflation, non-tariff measures represent tempting protective devices because they are often less visible than tariffs and harder to monitor and challenge. In times of economic difficulty, as tariffs are liberalized, the pressure to achieve comparable protection through NTB's can become irresistible.

Negotiators at the GATT multilateral trade negotiations have been attempting to formulate international codes of conduct for various categories of non-tariff measures, namely government procurement, subsidies and countervailing duties, regional development grants, and product and safety standards.

In the GATT negotiations on countervail, Canada is pressing the United States to insert an injury provision in their law and to reach an agreed definition of what constitutes regional development grants before it is classified as a subsidy. DISC is

another issue which may be modified as a result of the Geneva talks. Mr. William Eberle, the former U.S. trade negotiator, told the Committee that the 1974 Trade Act had a provision which obliged Congress to vote on any non-tariff measure agreement within 90 days. Congress could no longer kill such agreements merely by refusing to deal with them as it had after the Kennedy Round.

However there is widespread scepticism as to whether effective monitoring and enforcement mechanisms for some of the international codes of conduct can be established, for instance in the important area of government procurement. Retaliation in one form or another is likely to occur if one country strengthens its measures and remains immune from effective international sanctions.

In view of the difficulties of achieving success in this area at GATT, **the Committee is of the opinion that bilateral negotiations with the United States might well prove to be a more fruitful and realistic avenue for Canada to reach a reciprocal and advantageous understanding in this area.**

VI TWO SPECIAL CASES OF LIMITED FREE TRADE

The Defence Production Sharing arrangement and the Automotive Agreement constitute limited sectoral free trade arrangements between Canada and the United States. While both programs have been of benefit to Canadian industry and trade, there are currently stresses and strains evident in each arrangement.

1. Bilateral Trade in Defence Products

Bilateral economic cooperation in the defence field goes back to the Hyde Park declaration of 1941. However, the present dimensions of the program were negotiated in the late fifties when it became clear that Canada could no longer hope to be self-sufficient in the major areas of military equipment production. The Canadian government then decided to concentrate on carefully selected areas of defence production in fields in which Canada had special experience and need such as communications, navigation and transportation. In the interests of North American defence, the United States agreed to share its defence technology with Canada and to open the huge U.S. defence market to Canadian manufacturers of military equipment on what amounted to privileged terms. The Defence Production Sharing arrangement, which has been worked out in a series of agreements over the years, offered an economic basis for a specialized Canadian defence industry.

In general terms the Defence Production Sharing arrangement provides for duty-free movement across the border in military goods. The U.S. government lifted the Buy American Act requirement for a wide range of military commodities and removed U.S. duties (from 12 to 17 per cent) for Canadian goods subcontracted by U.S. firms. Canadian tariffs were largely removed in 1966 but to compensate for "anomalies" in the U.S. regulations governing access and to protect smaller Canadian suppliers, duty free entry was only accorded for purchases having a value in excess of $250,000. The "anomalies" included "small business set asides" which favour procurement from designated small U.S. industries, the "specialty metals" regulation which restricted procurement of items containing specialty metals to U.S. sources and the "no foreign" preference which protects U.S. technology in specific sensitive areas.

Canada also retained a 10 per cent domestic price preference which the United States has periodically cited as a trade irritant. Mr. Frank Jackman, General Director, Office of International Special Projects, Department of Industry, Trade and Commerce characterized it as "discretionary" preference and explained it had been retained

> "as a counterbalancing force to some of the other protective devices on the U.S. side and to ensure that at the lower end of the spectrum there is no undue damage done in terms of disparity of size and economic power between firms competing on both sides of the border. It does remain an item which . . . we assume we will continue to debate" (I, 30:24).

In 1963 a balance of payment "understanding" was reached by both countries stipulating that Canadian and U.S. trade in this area should be "in rough balance". Mr. Jackman told the Committee that periodic attempts "to define just how rough is rough have never really met with much success" (I, 30:8). Nevertheless, as long as there has not been too great a divergence, both sides have remained relatively satisfied. Generally speaking, Mr. Jackman said, sales decisions in this area have not been administered but secured through competitive bidding.

When there is too great an imbalance in this bilateral trade, an 'ad hoc' mechanism is brought into play which appears to be one of encouraging and of cajoling. A joint official-level steering committee exchanges views on each country's long term requirements to try to find areas where needs match or where cooperative or joint development in the production of equipment would prove economic. From time to time, when there appears to be too much of an imbalance, the committee decides to take

> "a closer look at some of the requirements on either side of the border, to make sure that a firm on one side or the other of the border does in fact seek equipment supply from a producer in Canada or the United States. We tend to, through stimulation of the process, ensure that there is an active shopping on both sides of the border, as opposed to providing direction that 'thou shalt'. Rather than say 'thou shalt', we say 'thou should' " (I, 30:25).

Under the terms of the agreement, Canadian firms can compete for all but the most sensitive U.S. defence contracts. In particular, the program has led to a large two-way trade in subcontracted items. A requisition on a prime contract may be raised by the department of defence in either country and the low bid may come from industry in either country. The successful company will then seek the best source of supply in Canada or the United States for subcontracts. There has been a tendency, which works to Canada's advantage, for firms to establish patterns of procurement and to shop for components in Canada as well as the United States.

During the first 15 years of the existence of this program, that is until 1974, the United States spent over $3.3 billion on prime contracts and subcontracts in Canada and Canada spent over $3 billion in the United States, giving Canada an accumulated surplus by 1974 of $361 million. From 1970 to 1974 the average annual value of Canadian exports to the United States under the Defence Production Sharing arrangement was just under $200 million, about half of which was in subcontract work.

This program has brought a number of benefits to Canada in terms of employment and technology. Testimony indicated that 10,000 to 12,000 persons are directly employed in manufacturing items sold to the United States and in excess of 100,000 workers are involved at least part-time in the "flow-down effect", that is working in the supplying firms. Furthermore, the jobs provided are at a high level of skill. Participation in this program has also contributed to the maintenance of a manufacturing base in fields of high technology, such as transportation, communications and navigation. By concentrating on installed equipment and avionics rather than airframe items, an official told the Committee, Canada had been able to develop in cooperation with the United States certain specialized items such as a radio relay system which have been widely accepted abroad by Canada's allies. Other technological breakthroughs such as gas turbine technology, sonobuoys and

flight simulators were developed for military use and subsequently achieved success in civilian markets. In keeping with the objectives of the arrangement, there has been some dispersal of the defence industrial base across the country, an advantage for both strategic and regional disparity reasons. There are some benefits in terms of trade with third countries as well since sales by the United States of defence items to other NATO countries may include Canadian-produced components, this can create a subsequent demand for Canadian-made spare parts.

A major and often-cited advantage to the program is the easy access it provides Canada to U.S. high technology. There are, however, problems associated with such ready access. As this report has already discussed, Canada relies on imported technology more than any other industrialized country. In certain defence industry fields, as in many other high technology areas, the effort made by Canada to keep abreast of international capabilities has declined. The Defence Production Sharing arrangement has accentuated this trend because the subcontract work or offset procurement production done by Canada on major U.S. military equipment is produced under licence from the parent firm.

A growing problem under this arrangement relates to the system of offset procurement. In any large purchase of military equipment such as long-range patrol aircraft, Canadian decision-makers tend to look very closely at the amount of component work which the foreign companies will contract out to Canadian companies. It is one of the elements which the various competitors are asked to detail in their proposals. An official told the Committee that the United States has acquiesced in this procedure to try to improve Canadian content on very large purchases.

It is difficult to determine the additional costs that Canada may incur through this system of offset procurement. If it involves setting up relatively short and sometimes duplicate production lines in Canada, the costs will obviously be higher. On the other hand, there can be industrial benefits. In every instance the offset purchase will have some multiplier effect. In some cases, the U.S. manufacturer may make additional sales to third countries and subcontract the new business to the Canadian facility. The Committee considers it would be helpful if more information could be made available on the relative costs and benefits of offset arrangements.

The policy of pressing for Canadian content in offset procurement has had a questionable impact on the vigor of the Canadian defence industry itself. Production done continually under licence, even of highly sophisticated components, does little or nothing to give this industry the necessary viability to get into U.S. or other markets with its own products. It creates an unfortunate dependence on imported technology. Once an offset contract is complete, the vast majority of the additional jobs it created are likely to disappear. In such a system there is nothing to stimulate the development of research-based innovative products. The present situation augurs poorly for the future of the industry. While the original intention of the arrangement was to preserve a viable defence production industry in Canada, it may well be that Canada has already lost the capability to design and produce almost all separate weapon systems and, with that, other important innovative capacities as well.

The arrangement with the Lockheed Corporation for the purchase of the long-range maritime patrol aircraft involved a debateable new form of offset. In

addition to traditional undertakings for the Canadian manufacture of tail assemblies and some other components for up to 150 P3C's (the U.S. version of the long-range maritime patrol aircraft), Lockheed has accepted a legal obligation to secure, during the first 10 years of the contract, $400 million of new sales of Canadian products, at least 66 per cent of which must be in the aerospace field. The novelty concerns the one-third of sales which can be in any manufactured goods; only raw materials, food and automobile products are excluded. The aim is to take advantage of the enormous buying power of Lockheed ($35 million of supplies annually, all ordered through a central procurement agency within the company) and of the buying power of the 30 odd major subcontractors, some of which are larger than Lockheed itself. To qualify, purchases must be new or in excess of previous purchases. Moreover, the U.S. importer must pay duty if the item is dutiable. If U.S. components are assembled in Canada, only the Canadian added value is dutiable.

The Lockheed company has mounted a major sales promotion effort designed to sell Canadian products within Lockheed itself and to its major subcontractors. In the traditional aerospace field, it is experiencing no difficulties and is, in fact, ahead of its obligations. In terms of actual sales, 90 per cent of Lockheed's purchases by early 1978 were in the aerospace field. But the company is encountering difficulty in promoting sales in the one third "other" category of manufactured goods. The problem in part appears to be the reluctance of Canadian manufacturers to become involved in a form of trade which is unusual and which they may also fear will not recur. In spite of visits to some 500 companies by Lockheed sales promoters, only 10 per cent have shown any interest by early 1978.

This new technique for tapping the purchasing power of large U.S. corporations through offsets has been resorted to because the market for sub-assembled air frame parts and for aerospace components has been saturated. Other countries purchasing U.S. defence equipment are also insisting on offsets with the result that the room for arrangements in the related aerospace industries may be shrinking.

Another possible solution had been suggested by the Hon. Barnett Danson, the Canadian Defence Minister, in the spring of 1977. He said it would make economic sense if Canada were able to develop and build certain of the equipment needed jointly by the two countries. If the United States would agree to purchase Canadian-made equipment to fill all its needs for a particular item, Canada would be in a position to buy large defence items off-the-shelf from U.S. plants and not have to insist on specific off-setting contracts as a precondition. There would be less duplication of research and development, no added costs for Canada in setting up production lines for its own short-run needs, a North American standardization of military products and Canada would have an assured market for a limited range of high technology goods.

While the proposition is attractive, there are a number of problems. For example, what items would be available for Canadian production in this market? Electronic equipment for NORAD northern communications, coastal patrol vessels and anti-submarine equipment have been mentioned. But would the United States agree that its entire requirement for any significant military item should be procured

abroad, even from a country as closely allied as Canada? Could sales of these items be made in sufficient volume to balance the cost of a major item such as a new fighter?

On balance, the Committee approves the objectives of this idea, but is not optimistic regarding its potential as a solution to the growing problem.

Presumably because there was no positive response from the United States to this proposal, the Canadian government appears ready to repeat the industrial benefits package which it used in the Lockheed case in the purchase of the new fighter aircraft, a larger order valued at $2.3 billion. This time it is prepared to buy an off-the-shelf model which should mean lower unit costs rather than require the changes which added so much to the cost of the Lockheed Aurora. In exchange, as with the Lockheed order, it is asking for offset contracts in the aerospace industries, in the non-aviation industries making other defence equipment, and in domestic industries which have no relation to aerospace or defence products whatsoever. How this is handled will be extremely important.

The large Canadian order, for 130 to 150 aircraft will undoubtedly justify economic manufacture of certain air frame components in Canada, but this would offset only a portion of the total cost of the fighter. Nor will the saturated aerospace market be able to absorb the balance. Hence, almost inevitably, in following the offset route, the government will look for commitments from the manufacturers to sell other unrelated manufactured goods.

But if there are difficulties in the Lockheed case in finding enough Canadian manufacturers who wish to participate, they are likely to be intensified in the fighter aircraft purchase. Because of the offsets already negotiated under the Lockheed purchase, even the traditional offsets procured in the form of assembly or of component products purchased from the defence or aerospace industries may be difficult to place, particularly to balance such a huge order. Finally, the procedure raises the question of whether the decision on the correct aircraft for Canada's requirements will be skewed by the relative attractiveness of the packages of offset arrangements which different aircraft manufacturers may offer.

In spite of certain deficiencies, the Defence Production Sharing arrangement represents a mutually beneficial means of enlarging trade between Canada and the United States and of extending the range of free, or almost free, trade between the two countries. However, the recent large Canadian aircraft purchases, actual and proposed, have strained the capacity of the system to balance defence trade, which accounts for the complicated and costly offset arrangements written into the Lockheed contract and proposed for the fighter aircraft. Until 1975 the trade was in rough balance—Canadian procurements were relatively low and U.S. procurements were increased by the demands of the war in Vietnam. But that stimulus no longer exists and Canadian equipment purchases are growing rapidly. The balance in favour of the United States was over $700 million in 1976 alone, and the fighter purchase, if one of the U.S. aircraft is bought, would push the balance far out of line.

The problem of maintaining the agreed "rough balance" is being further complicated by restrictive measures applied by the U.S. Congress. Among such

measures, the U.S. Defense Department issued regulations in August 1977 under direction from Congress which impose new administrative rules on the export of high technology in weaponry. The new restrictions represent a response to the outspoken criticism of some powerful segments of U.S. opinion, including organized labour, on the transfer of technology out of the country. Any muzzle limiting access to high technology would severely affect Canadian firms which depend on subcontracting—especially in the high technology industries such as aerospace, avionics, computers, etc. Raising the issue in December 1977 in Washington, the Minister of Science and Technology received assurances that the new instructions were not meant to restrict technological exchanges with the United States' allies and U.S. firms in competing for Canada's new fighter contract. However, as the new regulations cause administrative delay with subcontracts in Canada there is some risk that U.S. firms may avoid the problem by seeking only domestic suppliers. According to press reports, delays in approval for Canadian firms in U.S. defence contracts have already been experienced and Canadian subcontractors have been faced with some difficulty in getting the necessary information in order to make bids on U.S. contracts. Consultations on the problem are continuing, but the fear remains that the traditional close cooperation in defence production may taper off unless there is some special exemption for Canada to eliminate the bureaucratic approval prerequisite.

Another possible obstacle to the effective operation of the Defence Production Sharing arrangement has been raised by an action of the House Armed Services Committee, which added a rider to the 1979 defence appropriations bill. This provision would prohibit the U.S. Defense Department from buying any equipment from abroad which included foreign produced specialty steel and would largely close off foreign procurement by the Defense Department. A similar measure was passed some years ago and it was only last year that the former specialty metals rider was withdrawn by Congress. It will be several months before the fate of the new specialty metals rider is determined. But in the meantime, it is forcing U.S. aircraft manufacturers bidding on Canada's fighter aircraft order to reassess their situation.

These and other measures could undermine the Defence Production Sharing arrangement. Unfortunately, Canada lacks sufficient leverage to cause the United States Congress to grant a special exemption to Canada. This is in part because other U.S. allies, particularly in NATO, would raise objections unless they were accorded equal preferred treatment. This does not mean that Canada should cease its efforts to have the recent U.S. measures withdrawn or amended so as to exempt a country with which the U.S. had a long-standing defence production sharing arrangement. Canada would, however, be in a much stronger position to be exempted from all such protectionist measures if it were in a free trade arrangement with the United States. **To maintain an effective Defence Production Sharing arrangement, it may be necessary for Canada and the United States to move in the direction of a bilateral free trade arrangement.**

2. Bilateral Trade in Automotive Products

The cross-border flow of automotive products constitutes the largest, most complex and currently the most controversial area of trade between the two

countries. The Committee devoted four lengthy hearings entirely to this subject and two others in which the automotive sector was of major concern.*

As can be seen from the accompanying Table 7, Canada-United States trade in automotive products—the total of exports and imports—surpassed $20 billion in 1977. This represents one-third of the total trade between the two countries.

Table 7

Canada-United States Trade in Automotive Products

	1975	1976	1977
		($ millions)	
United States Imports from Canada			
Cars	2,858	3,430	4,032
Trucks, etc.	932	1,344	1,964
Parts	2,045	2,942	3,721
Tires and tubes	68	163	144
TOTAL	5,903	7,879	9,861
Canadian Imports from United States			
Cars	2,184	2,321	2,825
Trucks, etc.	942	970	1,123
Parts	4,522	5,474	6,847
Tires and tubes	174	115	153
TOTAL	7,822	8,880	10,948
Balance			
Cars	674	1,109	1,207
Trucks, etc.	— 10	374	841
Parts	— 2,477	— 2,532	— 3,126
Tires and tubes	— 106	48	— 9
TOTAL	— 1,919	— 1,001	— 1,087

Source: *Statistics Canada daily*, March 15, 1978. A more accurate measurement of trade in automotive products is obtained by comparing the import statistics of each country. Accordingly, figures for Canadian exports are derived from the counterpart U.S. statistics of imports.

No factor has had greater impact on the development of this industry than the signing of the 1965 Automotive Agreement. Prior to the agreement, the trade imbalance with the United States in this sector was reaching an intolerable level. Canadian automotive products manufacturers were in trouble with high costs due to short product runs and the market demand for a proliferation of models. The problems beset Canadian parts producers as well as vehicle manufacturers and the forecast was for an ever-deepening deficit in the bilateral payments account for these products. In the early 1960s the Canadian government introduced a pilot project remitting duty on the import of parts as long as the export of parts expanded by an

* The witnesses included Mr. Roy Bennett, President of the Ford Motor Co. of Canada, Mr. Dennis McDermott, Canadian Director of the UAW, Mr. Patrick Lavelle, President of the Automotive Parts Manufacturers Association of Canada, Mr. William Eberle, President of the Motor Vehicle Manufacturers Association of the United States, Mr. Tom Burns, Senior Assistant Deputy Minister and Mr. Doug Arthur, Special Advisor (Automotive), the latter two from the Department of Industry, Trade and Commerce.

equivalent amount which was measured with reference to a level in a specified year. Spurred by the possibility that the U.S. courts might rule that countervailing duties should be imposed by the U.S. Treasury, the two governments entered into negotiations for a sectoral trade agreement. Acess for Canadian-made vehicles was sought and attained to the total North American market. The Automotive Agreement was concluded between the two countries in 1965.

Under the agreement, duties were effectively removed for trade in motor vehicles and original equipment parts although in Canada only *bona fide* manufacturers were eligible for the duty exemption. The U.S. provisions differed from the Canadian in granting free trade for vehicles and parts as long as 50 per cent North American content was contained in the item. The Canadian vehicle manufacturers had to abide by certain safeguards which committed them to increasing their *production* of vehicles by at least a certain ratio to the increase in Canadian *sales* of vehicles. In addition, in separate "letters of undertaking" the Canadian manufacturers undertook to increase the Canadian value-added by at least 60 per cent of the sales growth.

In subsequent debates over particular issues in the bilateral automotive trade, one side or the other turns frequently to the original objectives of the agreement to support his argument. The three stated objectives were:

a) The creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;

b) The liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries;

c) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production and trade.

Since 1965, a comprehensive restructuring of the Canadian automotive industry has occurred and a substantial integration of Canadian activities with their U.S. counterparts has been achieved. Specialization and rationalization are reflected in a massive growth in inter-country trade, as parts and vehicles flow back and forth between plants located on both sides of the border. In gross terms, vehicle exports have grown relative to imports and the converse is true for parts. Mr. Roy Bennett of the Ford Motor Company testified that about 70 per cent of his company's Canadian-produced vehicles are exported. He explained his view of the advantages of the agreement to the Committee.

> "... the real, main lesson to be learned from the Auto Pact is the tremendous advantages that are created for Canada when you do rationalize production and have large economic units of production. In other words, the Auto Pact has led to much greater efficiency in our industry. It has led to a reduction in costs, with a corresponding reduction in the prices of the products."
> (II, 7:26)

In 1964, the Canadian deficit on automotive trade accounted for nearly 80 per cent of the total trade deficit with the United States. This deficit diminished during the 1965 to 1969 period and was favourable for the next three years. Since 1973,

Canada's automotive trade has once again been in deficit; in 1975 it reached a record $1.9 billion. The cumulative deficit for Canada over the 13 year life of the agreement is more than $7 billion.

Testimony from government officials indicated that under the agreement, Canada as well as the United States experienced substantial employment growth. In Canada, employment in parts and accessories manufacture rose faster than employment in the assembly sector. In relative terms employment in Canada in this sector increased by 56 per cent between 1964 and 1974 and by 18 per cent in the United States, the higher Canadian percentage reflecting the smaller base of the automotive industry in Canada. Mr. Bennett of Ford of Canada claimed that as a proportion of total employment in the North American automotive industry, Canadian employment rose from 8.4 per cent in 1964 to 11.3 per cent in 1975. Subsequently an Ontario government study questioned whether Canada had received a proportionate share of automotive industry jobs.

The realization of optimal scale levels in Canada has resulted in dramatic increases in productivity and in the wages earned in the industry. Nominal parity of wages for Canadian plant employees of the motor vehicle manufacturers was achieved. For the independent parts suppliers, Canadian average wages are still lower than in the contiguous U.S. regions. This is partly due to the fact that there are some non-unionized and low cost plants in Ontario and partly to the different level of skills required in the parts plants in the two countries. However, even here the gap has been narrowed considerably.

Increases in Canadian rates of investment accompanied the major restructuring of the industry. However, much of this investment by the major motor vehicle manufacturers had been committed prior to the agreement, probably stimulated by the Canadian duty remission plan of 1962 and 1963. Compared to the average annual investment levels for 1961-64, assembly investment in the 1965-69 period rose from $28 million to $50 million (in constant 1961 dollars) and parts investment rose from $26 million to $78 million. The annual averages for the 1971 to 1975 period are lower than those experienced in the period immediately following the conclusion of the agreement but remain substantially higher than pre-1965 levels. Again the increases are greater for parts than for assembly.

In the light of these benefits, the Committee considered that, overall, the agreement has been advantageous to Canada. Nonetheless, problems exist, some the cause of current concern to Canada, some the subject of serious intergovernmental differences and some of lesser seriousness and termed merely "irritants". They have caused a variety of interested parties to question over the years whether the agreement should be renegotiated, amended, even terminated.

At this time the main Canadian uneasiness stems from the persistent overall trade imbalance due to

- the ever-increasing deficit in the trade of automotive parts;
- the lower technological content and less skilled labour component in Canadian industry;
- the almost total concentration of R & D in the United States;

• the price differential;

• the relatively low level of investment in the industry in Canada since 1970.

U.S. concerns have focussed more on employment levels and the price differential. The differences of opinion over whether the safeguard provisions in the agreement are transitional or permanent are discussed in Chapter VII in the context of sectoral free trade arrangements.

Problems Related to Automotive Parts Trade

The thorniest issue arising from this trade relates to the deficit in cross-border trade of parts. As is evident from table 7 on page 95, Canada exports more vehicles (cars and trucks) to the United States than it imports, resulting in a surplus in 1977 of $1.2 billion in these items. However, the trade in automotive parts* is a different story; these imports exceeded exports by a wide margin, leaving a $3.1 billion deficit in 1977. Linked to this problem is the concern that the quality of Canadian jobs in the parts industry is not of the same skill mix as in the United States. At the heart of the debate over the parts deficit is the interpretation put on the agreement's objectives that both parties to the agreement should achieve "a fair and equitable share" of the North American market.

The Committee heard a number of opinions on the subject of the parts deficit. Officials of the Department of Industry, Trade and Commerce expressed concern over the widening gap in parts trade. Mr. Doug Arthur explained that part of the reason lay in the fact that the type of parts produced in Canada are being used mainly in assembly plants in the United States which produced the larger, intermediate and standard model cars. Canadian assembled cars tended to be mainly in the sub-compact range and the increase in the U.S. imported parts was a function of the high demand for these cars.

Mr. Patrick Lavelle of the Canadian Automotive Parts Manufacturers Association told the Committee that the shifting assembly production patterns were only part of the answer to the parts trade deficit. He attributed the trouble to a number of other factors including:

i) the purchasing decisions of the U.S. parent assembly companies which decide where parts are to be sourced;

ii) more favourable competitive conditions in the United States including wage rates which were lower in the southern United States than in Canada;

iii) and to the fact that parts are being imported into Canada by the companies from Mexico, Brazil and Venezuela under the most-favoured-nation application of duty free access granted by Canada at the time of the agreement.

Mr. Dennis McDermott of the United Auto Workers suggested that since the Canadian parts producers were not benefiting as they should under the Auto Pact

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* This discussion concerns original equipment parts (O.E.M.) which trade freely under the agreement as differentiated from the aftermarket (service or replacement) parts which are subject to duty.

"... government intervention may be necessary... to force the auto majors either to introduce more in-house production in Canada or to expand sourcing from independents in Canada." (II, 26:13)

In particular he referred to the need for increased production in Canada of large stampings, transmissions and power train components. He was concerned that the motor vehicle companies should expand their sourcing from independent parts producers in Canada who, were "treated very roughly by the car manufacturers" (II, 26:30). Mr. McDermott also pointed out the negative impact of the parts which come in from low wage countries by virtue of Canada's multilateral application of the free access provisions. At the time of the agreement, the United States had sought and received a waiver from GATT sanctioning the bilateral free trade arrangement whereas Canada had applied the provisions for free access on a multilateral basis.

Both Mr. William Eberle of the U.S. Motor Vehicle Manufacturers Association and Mr. Roy Bennett said that the industry's trade should not be looked at in two segments, parts and assembled vehicles, but should be taken as a whole. Mr. Bennett linked the surplus on vehicle trade to the deficit in automotive parts. He explained:

"The more vehicles we assemble in Canada, the more components are imported and the larger the deficit in the trade balance in this particular segment becomes." (II, 7:13)

Instead of looking at Canada's gross exports of parts, Mr. Bennett preferred to look at the deficit from the point of view of the net parts consumed in the two countries—"those parts exported that stay exported and the parts that are imported that stay imported". Subsequent to the hearing, Mr. Bennett supplied the Committee with a chart (see Appendix 3) based on estimated data calculating that Canada has, in fact, been a net exporter of parts since 1968. Mr. Bennett explained his procedure:

"To arrive at net consumption, we reduced the gross imports of original equipment parts by the estimated amount of parts included in vehicles assembled in Canada and exported. A similar adjustment was made to the gross exports of original equipment parts so as to deduct parts returned to Canada as finished vehicles. The broken line showing net imports on the chart is labelled 'U.S.-made parts consumed in Canada', and the unbroken line for exports is labelled 'Canadian-made parts consumed in the United States'."

Mr. Bennett acknowledged that the vehicle trade figures would also need to be altered with the consequence that the normally reported surplus in vehicle trade would become a deficit.

There is no doubt that the gross balances of the present trade figures provide an imperfect picture of which activities are generating a surplus or a deficit in the balance of payments. Also, because the back-and-forth flows are simply aggregated, a distorted and inflated idea emerges about the amount of real production in this industry. While Mr. Bennett's method gets rid of the double-counting and is useful when only a broad picture of the total trans-border trade is required, it has serious drawbacks if any separate examinations of vehicle and parts trade is attempted. For instance, it deals only with a portion of the parts trade. It ignores the flow of a) parts made in the United States, installed in vehicles in the United States and then exported to Canada and b) parts made in Canada installed in vehicles in Canada and then exported to the United States.

The Committee proposes a better procedure for achieving not only the broad picture but also a dissected viewpoint of the parts and vehicles trade. This is set out in detail in Appendix 4. Again, a large Canadian deficit in original equipment parts is evident, but it is easier to interpret the source of the deficit. During its examination of the statistical argument, the Committee became persuaded that there is considerable merit in having the disaggregated figures as well as the existing statistical measure of the cross-border trade. Therefore, **the Committee recommends that the balance of automotive trade figures be disaggregated to show the net value of original equipment parts balance and the amount of net Canadian value-added in assembly.** This improved statistical measure should reveal the plight of the Canadian auto parts producers more clearly. On a North American basis the Canadian share of the original equipment parts has been less than the consumption of these parts by Canadian manufacturers. Mr. Doug Arthur of Industry, Trade and Commerce told the Committee that while the Canadian parts industry had grown substantially over the period covered by the agreement, the growth had not matched the growth in consumption of original equipment parts.* In 1975 Canada's share in the North American production of these parts was 7 per cent whereas Canada's share of North American consumption had reached 12 per cent. Canadian parts producers appear to be losing their share of the Canadian market, supplying 29% in 1975 and, after an initial period of growth in the post-1965 period, also appear to be losing their United States market as well.

One part of the answer lies in the fact that the parts industry itself is expanding to cheaper non-union plants in the southern United States, so that Canadian parts producers are no longer competing against plants in adjacent areas across the border. Wages in the southern states are as much as 25 per cent lower than the Toronto area, and U.S. state and municipal inducements abound. Serious as this prospect appears for the future, however, the nub of the problem currently seems to lie in the sourcing decisions of the vehicle manufacturers in Detroit. In 1975, 71 per cent of U.S.-made parts were used in the assembly of vehicles in Canada and 29 per cent Canadian-made parts. The four motor vehicle manufacturers dominating the market make many of their own parts and components in in-house or captive plants. In addition there are eight large multinational parts suppliers. The rest are mainly independent parts producers. Of the $3.1 billion worth of imported U.S. parts consumed in Canada annually in 1975, the United States motor vehicle manufacturers or their affiliates accounted for 67 per cent or $2 billion worth and the large multinationals for 22 per cent, leaving only 11 per cent from U.S. independents. However, of the $1.3 billion in parts sourced in Canada, 39 per cent came from Canadian in-house plants, 36 per cent from the eight large multinational producers' subsidiaries in Canada and 25 per cent from other parts producers in Canada.** In the light of these figures, and the additional fact that products of the in-house plants are the high value items, it is evident that the "Big Four" are the only companies which have the financial and technological capability to modify the existing sourcing pattern to any significant degree.

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* His statements were subsequently borne out in a review of the North American automotive industry by a Canadian government task force. The Canadian study was paralleled by a U.S. study; both were set in motion by a December 1974 agreement between Prime Minister Trudeau and President Ford.

** Canadian government task force report, page 144-145.

It is clear that the safeguard provisions of the agreement linking the ratio of production to sales and value-added have influenced the vehicle manufacturers to meet their commitments in Canada largely through assembly, by investment in the labour-intensive vehicle assembly plants. Since the signing of the pact, Canada has had a surplus in assembly trade. While some of the major vehicle manufacturers are apparently close to the minimum commitment levels in relation to production growth, they cannot be accused of failing to honour their undertakings unless it falls below these levels. The main issue would therefore appear to be whether the lagging Canadian parts producers' participation constitutes a valid cause for complaint under the "fair and equitable" objectives of the agreement.

Other Problem Areas

The issue of parts deficit is being aggravated by Canadian concern for the future pattern of production and investment. It is evident that the industry is on the threshold of unprecedented technological change. Whole plants may have to be re-equipped and re-tooled at least once and perhaps twice in the next eight years and some plants will become obsolete. A major shift from steel to aluminum alloys and plastic is foreseen. Radical changes will take place in engines and transmissions after 1980. Mr. Arthur told the Committee:

> "The industry will have to meet the mandatory fuel economy standards on new vehicles, as well as engine emission and safety standards. The influences of the energy situation on the consumer, government action spurred by energy problems and regulations relating to safety and engine emission, will have significant impacts on the configuration of the North American automobile. Although manufacturing methods and materials will not change drastically, the industry will have to shift to the use of lighter weight materials which require different fabricating techniques to meet design, manufacturing, cost and weight requirements. Manufacturing will become more automated.
>
> The cumulative effect of these changes will significantly alter the traditional sourcing pattern of the industry. Many materials and parts suppliers will have to adjust to the changing circumstances in this industry if they hope to continue to compete. The development of new types of vehicles, new technologies and standards will require considerable new investment." (I, 24:18)

But the Canadian industry is ill-equipped to participate in these important changes, both in assembly and parts plants. Compared to the more highly skilled, capital-intensive parts plants in the United States, Canadian plants tend to be labour-intensive but requiring lower skill levels to do more conventional production.

The research and development efforts in Canada by the major vehicle manufacturers have been miniscule and the Committee views them as totally unacceptable. In 1975 the "Big Four" spent over $2 billion on R & D in the United States as opposed to approximately $5 million in Canada. Yet the Canadian manufacturers have contributed at least $230 million annually to the research accounts of their parent companies. The location of the bulk of the research facilities in the United States rather than Canada is seen to have a relationship to the acquisition of sophisticated skills and technology by firms operating on the periphery of the auto industry. While it is important that Canada share in the participation of the technological developments, present trends suggest that the more capital intensive activities and the production of the higher technology products will be increasingly concentrated in the United States.

Another concern relates to the low level of investment in the automotive industry in Canada, a level which has essentially stood still or declined since 1970. According to the Canadian government Task Force report, some of the vehicle manufacturers have been operating at close to the minimum levels of growth to which they are tied by the original commitments made at the time of the Automotive Agreement. This raises the question of what their investment pattern might have been without the safeguards or if they had been in place for only a few years. The Canadian subsidiaries of the three major U.S. auto manufacturers are a source of a much higher profit ratio than the U.S. parents. According to Mr. Dennis McDermott the Canadian rates of return approach twice the Canadian average and almost 1½ times the returns of United States companies.

The pricing policies of the companies have been an irritant particularly to the Canadian government. It has been suggested that higher profits from the Canadian operations are related to the price differential charged in Canada and the United States for the same car model. The cost difference has fallen for Canadians from 16 per cent at the time the pact was signed to 6.4 per cent in 1976. That prices would remain higher in Canada than in the United States for a transitionary period following the signing of the agreement appears to have been understood by the two governments, but the speed with which price differences would be reduced to a gap which reflected only the different costs of distribution in the two countries has been a source of disagreement. Mr. Bennett testified that there were differences in advertising, marketing and distribution costs between Canada and the United States that warranted a 4 per cent price differential.

In fact, the logic of the manufacturers' car pricing is difficult to follow. The Committee heard evidence giving wide fluctuation in prices both within Canada and between Canada and the United States. For some models in some locations Canadian prices were lower than the prices for the same models in a similar U.S. location. An example cited was a Ford Pinto, the suggested price of which was $35 lower in Vancouver than in Seattle (adjusted for tax differences). For the smaller cars, the motor vehicle manufacturers have responded to competition from offshore sources by establishing prices on the Atlantic and Pacific coasts at a level below prices at central locations plus freight. Mr. Bennett testified that the actual cost of moving a Pinto from St. Thomas, where they are produced, to Vancouver was $250 but the prices charged by the company to dealers in the two locations differed by only $50. It is interesting that the coastal regions which have very little production activity have experienced greater price reductions than the central regions of the country.

Mr. McDermott pointed out another anomaly.

"Another interesting point that has not been exploited too much by those who have appeared before your committee is the price differential that exists on cars between the United States and Canada, regardless of where they are manufactured. To give one example, a General Motors Chevelle Malibu coming out of Oshawa costs 6.3 per cent more if it is shipped to a Canadian dealer as opposed to a U.S. dealer, and that is before any taxation or transportation costs, or anything of that nature, are imposed. Similarly, a Ford Pinto from the Ford operation in St. Thomas will cost 4.2 per cent more if shipped to a Canadian dealer as opposed to an American dealer, and a Ford LTD from Oakville will cost 8 per cent more. Canadians get the privilege of paying that extra percentage!

The Chevelle Malibu will cost 6.3 per cent more; the Ford LTD from Oakville will cost 8 per cent more; and the small Pinto, 4.2 per cent more. The reason for the differential is that those who gravitate towards the Pinto are fairly responsive to the competitiveness of imports. The differential, therefore, is consciously and deliberately smaller on the Pinto than it is on the LTD or the Malibu." (II, 26:8)

The United States Treasury Department in 1975 told the U.S. parent companies that it would initiate anti-dumping hearings unless it received assurances that the prices of Canadian cars would be brought into line with those of similar models in the United States within five years. Apparently it has received the commitment it sought from the manufacturers. As this confrontation took place when the Canadian dollar was at par or above, it will be interesting to follow the companies' pricing policies in the light of the present lower Canadian dollar rate of exchange.

In summary, there are a considerable number of issues and irritants under the Pact; the large deficit in the auto parts trade, the failure to create a number of high technology jobs proportionate with that in the United States, the failure to do any meaningful amount of research and development in Canada, the pricing policies of the companies and the relatively low level of investment in Canada leaving the Canadian industry unprepared for imminent and drastic technological changes. From a Canadian point of view, there are no easy answers to these problems. There is very little leverage available to Canada for persuading either the vehicle manufacturers or the U.S. government to modify the situation.

During the hearings, suggestions were made that the 1965 Automotive Agreement should be renegotiated and amended. Although no witness suggested terminating the pact, voices in the United States and Canada have spoken in such terms when issues flared up. The agreement can in fact be terminated on 12 months' notice by either side. The Committee specifically heard suggestions from Mr. Lavelle and Mr. McDermott that the pact be re-opened and amended to include separate safeguard provisions for Canadian parts production similar to those in place for assembly of vehicles. It also heard Mr. Eberle's proposal that the agreement should be expanded to include aftermarkets parts and trucks and buses and, later, used vehicles. He suggested the Canadian "value added" requirements should be changed and put in terms of a running average instead of an annual basis and that there should be some mechanism to discuss grievances, government to government and industry to industry.

The Committee does not recommend the re-opening of the Automotive Agreement. Until very recently the United States has been pressing for removal of certain "value added" commitments on Canadian manufacturers which it considers transitional and Canada considers permanent. In view of the large Canadian balance of payments deficit, this issue is not being pressed at present. However, since the United States is prepared to let market forces determine the North American production pattern in this industry, there is every risk that in a renegotiation, the United States would not agree to continued safeguards for the vehicle producers, let alone for the parts producers. Moreover, the United States would be likely to emphasize the Canadian surplus in finished vehicles.

It is not widely realized in Canada that in the United States there is a more sceptical and critical perception of the agreement than in Canada. The U.S.

International Trade Commission stated cryptically in its 1976 report to Congress that

> "The agreement as implemented by Canada is not a free-trade agreement, and it has primarily benefitted the Canadian economy." (page 43)

and more bluntly

> "Indeed when the agreement is examined in its totality, it is manifest that the only true concessions granted in the agreement are those granted by the government of the United States according duty-free treatment to imports of automotive products manufactured in Canada. Other than the provisions of the agreement providing for consultations between the two governments, the agreement contains no substantive concessions on the part of the Government of Canada except those that are subject to the commitments and obligations to the Government of Canada in Annex A and the letters of undertaking." (page 42)

Given such United States' attitudes as quoted above, termination would be one of the possible U.S. responses to a Canadian initiative to renegotiate. And if the agreement were terminated, many more problems would ensue for Canada than for the United States.

The only immediate answer for the parts producers predicament may be suasion on the Canadian vehicle companies by the Canadian government. The vehicle manufacturers should be pressed to locate high technology in-house parts plants in Canada and encouraged to source more of their parts in Canada including those from independents. By early 1978 the Canadian government appeared ready to embark on domestic measures aimed at stimulating the Canadian parts industry and by mid-year there were indications that vehicle manufacturers were planning new investments in Canada but were bargaining for the most lucrative location inducements. In another move to stimulate Canadian-made parts production, the Canadian government stated it would remit a portion of the 15 per cent import duty now levied against Volkswagen for its imported cars and parts. The portion remitted would be equivalent to the value of Canadian-made parts in the imported cars. Similar agreements are being sought with other offshore manufacturers.

In 1977 each country concluded a two year study of the North American automotive industry from its own point of view. In mid-1978 the Canadian government established the Reisman inquiry to examine the industry with a view to "the development of an internationally competitive Canadian automotive industry". The report is due in the fall. It is expected that general discussions between the two governments could take place in the interval. It is unlikely, however, that these discussions will encompass amendments to the pact. Canada in fact, should take the opportunity to work out a stabilizing mechanism which would reinforce the *permanence* of the general framework of the Automotive Agreement. Since Canada is the smaller market, any uncertainty about the future of the agreement affects negatively the investment decisions of the vehicle and parts companies. The location of large volume engine plants or metal stamping plants in Canada is less attractive to companies because, in the event of dissolution of the pact, their capacity would be large relative to the Canadian market and location in the United States would be far safer. It may be that those voices which are advocating renegotiation of the agreement are contributing to the uncertainties which deter investment in Canada. The Automotive Agreement must provide a stable predictable environment within which long-range investment can be planned.

The Joint Automotive Agreement Monitoring Commission

The Committee recommends the establishment of a Joint Automotive Agreement Monitoring Commission in order to provide a better method for monitoring the agreement and modifying its performance in minor ways.

The overall role of such a Joint Monitoring Commission would be to help clarify the objectives of both governments and examine their mutual compatability. It would be useful to measure the ability of the automotive industry to contribute to the attainment of these various objectives. The Auto Pact has made a considerable contribution to improved economic performance in Canada but it could be destroyed if unrealistic expectations about its potential are created.

Mr. McDermott's reaction to the suggestion for a joint monitoring body was positive.

> "It should be a recommending agency . . . In essence that is what we have been advocating for some time—an agency that would monitor, that would watch and would be open to input from interested parties." (II, 26:51)

Although many aspects of the agreement are not amenable to quantitative measure, a number are, and existing quantitative measures appear inadequate. It is important that better statistical measures be developed to give a longer term viewpoint to the sudden hills and valleys in the trade figures. These temporary fluctuations are the cause of agitation for restructuring the agreement and contribute to uncertainty for the industry.

This report has already suggested that to achieve a more realistic picture of automotive trade, the balance of trade figures be disaggregated to show the balance for "value added" during assembly and a balance for exchanged parts whether or not they are embodied in assembled vehicles. It is important to note that the total balance of trade in automotive parts will not be altered by this method but the Joint Monitoring Commission will be better able to interpret the causes of the balances.

Some additional general responsibilities of the Joint Monitoring Commission would be to ensure a flow of relevant and objective information and to make a broad determination of whether or not compliance with the operative safeguards was being achieved. Under directive from the two governments such a Joint Monitoring Commission would undertake impartial analysis of particular issues.

In addition, there are several particular issues which the Joint Monitoring Commission should monitor. Price differentials is one. Mr. Bennett considered that a 4 per cent differential was required in the price of cars in Canada and the United States to meet the higher Canadian costs in advertising, marketing and distribution. The Joint Monitoring Commission should assess the validity of this cost gap and provide some surveillance that the prices in the two countries do not differ, on a regional basis, by more than that difference. If higher price differentials persist, the Canadian government has a number of possible policy options available. Either the Canadian external tariff on automobiles could be lowered from its present level of 15 per cent to a level equal to the cost differences or the Canadian government grant the right to duty free entry at the retail level from the United States.

Under the present arrangements when Canada has a deficit with the United States, the Canadian external tariff protects U.S. production. If a large U.S. car is priced at 10 per cent higher in Canada than in the United States, that difference accrues to the car producer. If a French car is priced 15 per cent higher in Canada than in France because of the tariff the difference accrues to the government as revenue. The Canadian external tariff on automobiles is substantially higher than that of the United States. If automobile prices in Canada remain higher vis-a-vis U.S. prices than the identifiable and justifiable cost differentials, the Canadian government should consider a unilateral tariff reduction or, preferably, inclusion of an automobile tariff reduction as part of its concessions in the Tokyo Round of GATT negotiations.

There is, of course, no particular reason why Canada should attempt to achieve a zero balance in its balance of trade on automotive products any more than it should for minerals, agricultural trade or forest products. However, there is strong evidence that the volatility of the trade account balance in automotive products has been increased by the post 1965 rationalization of the industry. The balance has become more sensitive to the relative popularity of different models and the relative strength of total demand for automobiles in the two countries. Because of this increased volatility of the automotive trade balance, changes in the balance during one year must be interpreted carefully to avoid short-term policy decisions. Longer term averages of the balance ought to be published at the same time as the annual figures and the Joint Monitoring Commission should provide an interpretation of trends during the year.

There is another aspect of the balance of payments where the Joint Monitoring Commission might be useful. The balance of trade in automotive products reflects only a part of the foreign account impact of the automotive industry. In addition to such merchandise transactions, important transactions in invisibles also occur. A detailed listing of "other service payments" for 1973 was provided by Mr. Bower Carty of Statistics Canada in his testimony before the Committee. In that list, $117 million payment for "special tooling and other automotive charges" is identified for that year. As has been noted, the research and development charges paid to the parent company by Canadian subsidiaries of the motor vehicle manufacturers averaged approximately $230 million dollars during the past five years. The Committee was unable to obtain estimates of the management fees and interest payments paid by motor vehicle manufacturers or parts manufacturers to American parent companies. A complete listing of dividends paid to foreign parents is also not available. However, the International Trade Commission in the United States estimated that the average annual inflow of dividends to the U.S. "Big Four" from Canadian operators was $114.1 million during 1973 and 1974. The Joint Monitoring Commission should obtain the information necessary to publish the automotive balance of payments between Canada and the United States for both merchandise and invisible accounts. It is clear that the overall balance of payments deficit for the automotive industry is over a half billion dollars greater than the frequently reported balance of trade.

There were suggestions by witnesses that the Canadian parts manufacturers should be protected against the flow of off-shore parts which is an additional factor

in eroding their market. As mentioned earlier, Canada allows the importation of parts on a multilateral basis (as distinct from the United States which allows them to come in free only from Canada). If these parts are assembled into a car in Canada which has at least 50 per cent North American content, the car can then be shipped into the United States duty free. Mr. John Moller of the U.S. Motor Vehicle Manufacturers Association told the Committee that the U.S. Auto Workers Union had recommended to the U.S. International Trade Commission that the 50 per cent North American content requirement be raised to 75 per cent. The effect would be to limit the incentive to assemble vehicles in Canada that contained duty free components imported into Canada from third countries.

Data presented to the Committee, however, indicated that the total of such imports remained small and there does not appear to be a strong trend developing. Some of the growth of imports from developing countries such as Brazil represents a deflection from other offshore suppliers (Germany in the case of Pinto engines) and not a diversion from a North American source. However, this question too could be examined and watched by the Joint Monitoring Commission.

The Publication of an Annual Report

In addition to the establishment of the Joint Monitoring Commission, the Committee recommends that an annual report on the operations of the Automotive Agreement be published by the responsible department and submitted to Parliament. In the United States such a report is required to be submitted to Congress annually. There have been complaints by the labour unions and the parts producers in Canada concerning the secrecy of certain operations of the agreement. Both Mr. McDermott and Mr. Lavelle favoured annual publication, Mr. McDermott stating that such a report should be based on reports required from industry. Referring to the Government's 1977 task force study in the automotive industry, Mr. McDermott said:

> "We think it is a little bit amazing that the first comprehensive published review of the Auto Pact had to wait until the 12th year of operation here, because in the U.S. there is an annual report published and there is more public monitoring of what is going on. In the light of the present problems and the even more threatening future problems, we think that a regular annual public review should be instituted." (II, 26:12)

VII FUTURE DIRECTIONS AND CONCLUSIONS

This study, which began as a review of Canadian trade policy with the United States, has led the Committee to examine most elements of Canadian industrial policy. It confirms that in recent years Canadian industry has lost grounds competitively to the United States. But as has been pointed out, the United States has itself declined in relation to several other industrialized nations. In short, Canada has fallen behind the United States, while it in turn has for two decades been steadily losing ground to other industrial nations. This is a dangerous development which Canadians must face up to if they are to take effective corrective action.

The report has demonstrated that the problem does not lie in the resource sector. Reduced tax levels and the depreciation of the dollar can restore Canada's competitiveness in resource production. The problem lies in the area of manufacturing. Its most disturbing symptom has been the shift of manufacturing capacity from Canada to the United States, the result of declining competitiveness and reduced tariff protection. This is a development which, if unchecked, can only lead to the eventual de-industrialization of Canada. But while lower tariffs have intensified the problem, for reasons to be elaborated later in this chapter, the Committee does not regard higher tariffs as offering a solution. What is needed is an increase in Canada's competitive capability.

The decline in competitiveness came about with surprising speed, the result of a national misjudging of our economic prospects. The combination of a favourable turn in the terms of trade in the early 1970s caused by a strong market for Canadian resources plus an over-estimate of Canada's oil reserves (which was not corrected until 1973) contributed to an exaggerated sense of Canada's economic potential. The sentiment was well expressed in the official policy paper on the "Third Option", which was published in the autumn of 1972.

> "Our trading position is strong. We are regarded as a stable and affluent country with a significant market and much to offer to our global customers in the way of resources and other products. Our balance of payments has been improving in relative terms. We are no longer as dependent on large capital inflows as we once were."

Canadians responded to their good fortune by cashing in the benefits. While the United States underwent a sharp depression between 1973 and 1976 with actual declines in real hourly earnings, Canadians' real wages surged ahead. Basing itself on a miscalculation—that the 1973 downturn would be short—the federal government encouraged Canadians in their mistaken self-confidence by suggesting that Canada's economic situation and performance were superior to those of the United States. To support demand it increased the money supply and both senior levels of government borrowed heavily in the United States and elsewhere. The extent of the national binge is shown by the movement of real hourly earnings in Canada and the United States. Between 1970 and 1976, while U.S. real hourly earnings grew from

100 to 105.3 per cent, the growth in Canada was from 100 to 125.8 per cent (Annex A, table 1)

One consequence of living next to the United States is that Canadians have a ready-at-hand standard of comparison by which they can judge their economic performance. Having similar working practices, tastes and currencies which carry the same names for the units of measurement, comparisons are simple and instinctive. This situation has its advantages but it also has disadvantages.

Until the 1960s most Canadians accepted that their wage and salary rates would be at least marginally lower than those in the United States. With the signing of the Auto Pact this general perception was breached. Not surprisingly, the United Auto Workers in Canada set their eyes on wage parity, arguing that as the auto companies moved toward comparable rates of productivity in Canada with that of the United States, the workers in the industry should share in the benefits. Had other Canadian wage rate increases been strictly related to productivity increases, no great problem would have occurred. But, stimulated by the buoyant economic conditions of the early 1970s, workers in industries other than the auto industry, and especially in the public sector, began pressing for wage increases to match the auto workers, even where there were no comparable productivity gains. Their efforts were successful and as a result unit labour costs in Canada got out of alignment with those in the United States.

In the past year the situation has stabilized and even shown improvement. Wage rate settlements are comparable to those in the United States and, given the current economic situation, are not showing signs of rising disproportionately following removal of the AIB. The exchange rate depreciation represents an important adjustment. In 1977 unit labour costs expressed in terms of U.S. dollars actually fell by 2 per cent.

This benefit from the exchange rate depreciation is a one-time gain. Moreover, it will only be effective as long as salary and wage increases do not attempt to recoup the actual fall in Canadian living standards which the exchange rate decline reflects. Even such restraint will not be sufficient to regain fully the lost competitiveness. This will require that unit labour costs increase at a slower rate than in the United States. And since productivity gains will at best come slowly, this must mean that wage rates in Canada should rise a little slower than those in the United States. This is not a prescription which Canadian trade union leaders can be expected to accept unless Canadian business leaders for their part exercise restraint in their salary increases and are prepared to make their contribution to strengthened Canadian competitiveness by investing profits in new equipment and generally improving the efficiency of their plants. Wage restraint can only be accepted if there is a national awareness of the seriousness of Canada's economic perspective and general agreement on the actions which all must take to improve the nation's competitive capacity.

An important conclusion of the Committee's study is that government policy changes alone will not solve Canada's problems. Such an approach is misleading since it removes from the citizen a sense of personal responsibility for the situation in which he finds himself. It is important to note that other industrialized countries have developed that critical ingredient—a consensus between government, business

and labour—which enables the leading elements in the society to work in relative harmony. Those which have succeeded—notably West Germany, Switzerland and Japan—have done so because their populations have concerted their actions, recognizing that the greatest gains come through working together.

It is important that Canadians recognize that the world economy is facing the most serious difficulties of the post war era. The period of rapid increases in living standards is over, at least for the present, and all countries are experiencing high levels of unemployment. In such a situation, each country and each government is scrambling to protect jobs by trying to hold on to its domestic market, while maintaining and expanding exports by every conceivable device. Protectionist measures are being introduced in all industrial countries and each move begets a response despite the high-principled rhetoric at GATT.

Canada lacks natural economic defences; its domestic market is small and it has a high dependency on foreign trade. At a time when many countries are joining trade blocs to achieve access to a market of at least 100,000,000 people, Canada is "odd man out". Its efforts during the decade to pursue the "Third Option" and to expand its economic links with the European Community and Japan have not succeeded. Since 1973 the proportion of Canadian exports to the United States has not fallen below 65 percent, while shipments to the European Community and Japan have amounted to only about 11 percent and 6 percent respectively, with the remaining 18 percent divided among all other countries. Indeed, the most recent quarterly figures show a higher proportion of Canadian exports going to the United States (72.4 percent for the first quarter of 1978) than in any previous quarter. In a period of protectionism, it is surely self-evident that Canada's overriding concern must be to enhance its competitiveness and its access to its principal markets, namely the United States.

1. Multilateral Trade Negotiations

The choices which Canada and Canadians face, as the country attemps to recover its competitive position, would be difficult in almost any circumstance. The coincidence of the final stages of the Multilateral Trade Negotiations (MTN) under the GATT, known as the Tokyo Round, adds a new complication and increases the uncertainties. Canada's stake in these negotiations is high. The tariff and non-tariff arrangements which may be agreed to during the 1978 negotiating sessions could mold Canadian trading patterns and the viability and development of Canadian industry during the 1980s and 1990s.

By early 1978 the objective for tariff reductions agreed among the major negotiators at Geneva stood at an average across-the-board 30 to 40 percent reduction, the so-called Swiss formula. Canada's average tariff level on goods which are dutiable is higher than any of its major trading partners. The proposal is that cuts would be proportionately greater on higher tariffs than on lower tariffs. Thus Canada would lose more in respect to its protected manufacturing industries than it would gain through improved access for the export of its resource-based products. As it is, some Canadian industries are having trouble competing with imports even with

the existing levels of protection. With the tariff substantially lower, a significant number of companies in Canada would have great difficulty withstanding the pressure of products from the new, low-wage, growth centres such as Hong Kong, Brazil, Taiwan or South Korea, let alone from the United States, Europe and Japan where existing scale and specialization give them an established edge. The nearby U.S. secondary manufacturing industry is in a position to take advantage of this opening-up of markets whereas much of Canadian industry is geared mainly to the small domestic market. There is little doubt that a 30 to 40 percent tariff reduction would be a devastating blow for some Canadian companies. Others would face enormous challenges and be required to make major adjustments.

As the negotiations reach the critical stage, business and trade union leaders in Canada are expressing deep concern over the possible effect of tariff reductions for the industries with which they are associated and are questioning the government's announced policy favouring tariff liberalization. But can Canada prudently reject the Geneva goals? If Canada retained or increased its present tariff barriers when other participating countries had lowered theirs, it would face retaliation from its trading partners, including the United States. Canadian consumers would pay more for imported products and Canadian manufactured exports would meet new difficulties in penetrating even traditional markets.

In a protected environment the technical competence of Canadian industry would diminish farther, isolated as it would be from the necessity of competitive performance. With little import competition, incentives for better productivity rates, superior technology or increased efficiency would be lacking. Although some segments of Canadian industry might feel greater certainty behind a protective barrier, the Canadian standard of living would decline with Canadians facing higher prices, reduced incomes and a restricted choice of goods. Such a course would be costly and harmful to Canada.

The Committee concludes that Canada as a major trading nation has no alternative to participating in the GATT negotiations and to making the best deal possible. The failure of the multilateral trade negotiations could adversely affect the level of world trade and Canada, as a major trader and supplier of commodities, would be one of the first to suffer.

On the other hand, if the GATT negotiations were successful, non-tariff barriers would assume a proportionately greater significance in international trade. Having depended heavily on tariffs to protect domestic industry, Canada has relied less than most industrialized countries on limiting imports by means of non-tariff measures. Past experience with other countries' NTBs should lead Canadians to be sceptical that they can be policed effectively on a multilateral basis even if the MTN succeeds in evolving international codes of behaviour to try to standardize and regulate them. Surveillance would be difficult. To deter violation of the codes, tough hard-to-achieve sanctions would be required.

Nevertheless, the Committee supports the government's insistence on linking across-the-board tariff reductions with solid progress in lowering the barriers constituted by non-tariff measures; otherwise Canada would be giving up more than it gained.

2. Alternative Policies

It is against this background that the report reviews the major trading options which Canada now faces:

a) modified tariff protection with a program of domestic remedies,

b) sectoral free trade arrangements with the United States,

c) multilateral free trade or unilateral free trade,

d) bilateral free trade with the United States.

a) Modified Tariff Protection with a Program of Domestic Remedies

This report has already examined various proposals for strengthening Canadian industry through domestic action (Chapter IV). Specifically it has looked at programs designed to encourage industrial rationalization, to promote R & D, to support the manufacture of promising products through government procurement and to assist exporters by remitting duties on imported components intended for re-export. The Committee has made recommendations in these areas:

- that competition policy be modified to provide a conducive climate for the rationalization of Canadian manufacturing production and that the government offer some inducements to rationalization.
- that the Department of Finance consider the possibility of offering a Duty Remission Program to individual Canadian machinery equipment producers for particular lines of machinery in which they might seek to specialize.
- that, to encourage increased R & D in Canada, it may be necessary to offer even greater tax incentives than those announced in October 1977 and in the April 1978 budget.
- that the federal government seek, in selected fields of particular Canadian competence, to coordinate its purchasing decisions and those of provincial departments, local governments and crown corporations.

In each instance, the Committee has assessed the limits of what might be achieved by such measures. It is already more than a decade since the attempt was last begun to revise competition policy. Speedy action is therefore unlikely, and the results at best would be felt slowly. A Duty Remission Program for the machinery industry, while it might promote some rationalization, would likely have only a marginal impact, and it would be most effective only as an interim measure. Increased R & D in Canada, even if it can be stimulated, will produce results only in the longer term. Finally, the Committee has found that there was, practically speaking, not much margin for increasing procurement in Canada by the federal government and so many obstacles to the effective coordination of provincial procurement with that of the federal government that the benefits would at best be limited. In sum, the Committee concluded that even the most vigorous application of these policies would have comparatively little effect on the competitive position of Canadian industry.

b) Sectoral Free Trade Arrangements with the United States.

A remedy which has received support in recent years is a form of sectoral free trade, sometimes proposed in a multilateral form, but more frequently bilaterally with the United States. The Automotive Agreement stands as an instance of limited free trade between Canada and the United States in a particular industry. Trade under the Defence Production Sharing arrangement is another example. The question is, can this pattern be extended to other industries?

In both these cases, the Canadian objective in negotiating the arrangement was the strengthening of the industries involved through providing opportunities for economies of scale — exactly what is needed in so many Canadian industries. In both cases, negotiations succeeded in gaining free access to the U.S. market for Canadian producers of a number of highly processed goods. In both cases certain safeguarding mechanisms were put in place; in the Auto Pact minimum production levels were safeguarded for the Canadian producer and in the defence production area the 1963 "understanding" provided for "a rough balance" of trade.

U.S. objectives in these arrangements, it is important to note, were not exclusively economic. The United States agreed to the Defence Production Sharing arrangement largely as a gesture of continental defence solidarity, after the failure of the Arrow project made it clear that Canada would have to look abroad for all major military procurement. In the case of the Auto Pact, U.S. motives were more strictly economic; rationalization offered some benefits to the United States as well as Canada. But the U.S. government was also anxious, for political reasons, to avoid the kind of trade war which the Canadian duty remission scheme on car exports threatened to precipitate. Despite the undeniable benefits which the Auto Pact has bestowed, it must be recognized that it has also aroused considerable criticism and debate on both side during the 13-year period of its existence. Periodically there have been strong pressures for change and even, on the U.S. side, for termination of the agreement.

The automotive industry has some unique characteristics which facilitated the development of a bilateral free trade arrangement. Mr. Roy Bennett of the Ford Motor Company of Canada told the Committee that few other industries have the same very small number of companies and the clearly identifiable product which made it easy to establish guidelines in the automotive sector. He might have added that the parent-subsidiary relationship in the industry across the border was also an asset, perhaps an indispensable one, in the structuring of the agreement. A common international union in plants on both sides was undoubtedly helpful, as was the concentration of Canadian and U.S. production facilities in fairly contiguous regions.

The defence industries of the two countries have very different characteristics—an enormous range of firms, both large and small, some national, others multinational, producing a virtually limitless range of products from clothing to items of the highest technology. The factor which homogenizes the industry and makes the Defence Production Sharing arrangement possible is that there is a single buyer in each country, the respective defence departments. This is an element which makes it possible for the two governments to maintain a "rough balance" in their defence trade.

In looking at other possible areas for sectoral free trade, a difficult problem is the delineation of which dependent or associated industries should be encompassed in any such agreement. GATT objections to an exclusive bilateral trading concession could also present a problem. However, as the United States overcame this latter difficulty at the time of the Automotive Agreement by obtaining a waiver, presumably similar exemptions could be obtained again, even though the two countries would not, strictly speaking, be participating in a regional free trade arrangement as permitted under GATT.

A major hurdle in applying the sectoral free trade formula to another industry, however, would be the problem of safeguards. Unless there were full bilateral free trade, in which case the exchange rate would become the principal equilibrating mechanism, Canadian safeguards would be a prerequisite to any new sectoral free trade arrangement. Because of superior size and strength and certain built-in advantages on the United States side, specific guarantees would be essential to ensure the Canadian industry a proportionate share of production. This may be needed particularly to protect Canadian branch plants from either overzealous rationalization or a phasing out of Canadian operations by the U.S. parent company or from possible policy initiatives of the U.S. government in the field of repatriation of foreign investment or returns. The United States might want similar safeguards in respect to Canadian multinationals operating in the United States.

The president of Ford (Canada) told the Committee that it would be "dangerous" for Canada if there were totally free access to the Canadian market from the United States in automotive products, and he agreed that safeguards were required to maintain the Canadian production share. In non-production areas such as advertising, marketing and distribution, he explained, there is an additional cost amounting to about 3 to 4 per cent of doing business in Canada as compared to the United States.

It is noteworthy that while these automotive safeguards appear fundamental to Canada, the U.S. government contends that the safeguards were meant to be transitional. It apparently continues to argue thus, even though it has had a favourable automotive trade balance for several years and a cumulative balance of $7 billion over the first 13 years of the pact. The United States' position is that it is prepared to accept whatever trade pattern results from a completely free market operation of the agreement unimpeded by safeguards. Hence Canada has resisted pressure to remove the production safeguards, the more so since in recent years it has had a substantial trade deficit position in automotive products. In fact, these deficits have caused Canada to look for an *extension* of safeguards to protect and expand its automotive parts industry.

The stalemate in the automotive sector over safeguards can only serve as a warning of the difficulties which could be expected in any other sector. This will be particularly so in arriving at an agreed definition of how to assess the benefits and costs of an agreement to each country and how to ensure a fair sharing of the total market by both sides without putting too many constraints on the free working of the market place. For Canada, therefore, the question is whether the United States is likely to agree to production safeguards satisfactory to Canada in a free trade

arrangement in any other industrial sector. At this moment, it seems doubtful. Even recognizing the fact that specific safeguarding details would vary, depending on the industry selected, the basic goal for Canada would remain the same—to maintain a fair and equitable share of production. If the United States were to agree on safeguards initially, it seems likely that it would insist on their transitional nature, with a clearly enunciated cut-off date. Or alternatively, the United States might write a mechanism into the agreement for amending or revising the agreement as conditions warrant. This would expose Canada to bargaining from a very vulnerable position.

No attempt has been made here to assess the industries which might be most suited to such initiatives, but from time to time academic and other studies have mentioned the chemical industry, the computer industry, the major appliance industry, the non-ferrous metals industry, the specialty steel industry and the forest industry as possible candidates. While a number of these industries possess some of the characteristics described above and would clearly benefit from economies of scale, it is difficult to find one which could risk the plunge into bilateral free trade without fairly specific production safeguards. These, in the light of the Auto Pact experience, the United States seems unlikely to grant.

In any case, it is far from clear how the United States would react to an initiative to sectoral free trade arrangements with Canada. While the U.S. Trade Act of 1974 included a provision authorizing the Administration to negotiate a bilateral free trade agreement with Canada, limited sectoral arrangements do not offer the United States attractive benefits. Nor are there obvious non-economic factors of the kind which influenced the United States' decision to agree to the two existing sectoral free trade arrangments.

U.S. attitudes might be quite different, however, if sectoral free trade arrangements were to be proposed as transitional steps toward complete bilateral free trade. This would put the issue in a larger context and could prove to be more acceptable in the United States.

Mr. William Eberle, a former senior U.S. trade official told the Committee that he thought it was time that Canada and the United States worked toward common solutions in certain industrial areas by means of joint fact-finding groups or commissions which would include industry and labour and senior government officials. While Mr. Eberle did not specifically link this suggestion with sectoral free trade arrangements, elsewhere in his testimony he expressed the opinion that the chemical industry and the forest products industry might be potential areas for the application of an Auto Pact type of arrangement. This suggestion of joint fact-finding commissions appears to be an effective way to examine the problems, if it were decided to move in this direction.

c) Multilateral Free Trade or Unilateral Free Trade

The argument in the Economic Council's report "Looking Outward" in favour of multilateral free trade is prefaced by an emphasis on the undeniably important fact that Canada and Australia are the only industrialized countries without free access to a market of 100 or 200 million people and that scale and specialization in

industry is of critical importance in cost competitiveness and technological innovativeness. With tariffs eliminated, that report argued, companies would be forced to rationalize their production in order to compete internationally. Lower unit costs would be realized through product specialization and economies of scale.

It is evident that in general the present high levels of tariffs are proving to be self-defeating for Canadian secondary manufacturing. The tariff combined with foreign ownership—which is itself a product of earlier tariff policy—has produced or maintained a basically inefficient industrial structure with truncated branch plants producing too large a range of goods with too short production runs for too small a market. Nor has the high tariff actually been able to protect many of these industries once their competitiveness had slipped.

Yet in the contemporary economic situation, multilateral free trade is not a realistic prospect. No country is advocating it. Despite their support of trade liberalization in the Geneva talks, many industrialized countries are actually taking protective measures when vital products such as steel are threatened. In the present international climate it is difficult to treat the idea very seriously.

Nor should Canada under any circumstances consider offering free entry unilaterally as mentioned as another possibility by the Council. Such a course would unfairly expose Canadian industry to a flood of imports from foreign, including U.S., industries, which benefit from the production efficiencies obtainable in large markets. At the same time, Canada would be giving away, with no return, all its bargaining chips.

d) Bilateral Free Trade with the United States

Using much the same argument as it used in favour of multilateral free trade, the Economic Council's report "Looking Outward" espoused a Canada-United States free trade arrangement as "the only other option offering economic benefits roughly commensurate with the gains that would accrue from multisided free trade". This option was the one the Committee examined most closely as a possible course for Canada.

The Committee's evidence relating to thise issue was taken principally during the year 1976, at a time when Canadian wage rates were rising faster than those in the United States, when days lost through strikes were unusually high and when the Canadian dollar was above par. In these circumstances it was hardly surprising that most comments by Canadian businessmen reflected either a negative or a cautionary note on the bilateral free trade proposition. While this support for tariff protection was predictable, it is important to identify the variety of their reasons against free trade with the United States.

Mr. Walter Ward of Canadian General Electric acknowledged that Canada needed the discipline of international competition to maintain competitive industries, but he advocated only a reduction of tariffs rather than elimination, and then on a very selective basis, "to be sure we keep competitive pressure on Canadian industry". (I, 38:12) Mr. Bruce Sully of Dominion Road Machinery maintained that Canada

must have tariff protection because of inequalities in the cost of money, the rate of inflation and the lack of economies of scale in Canada. Canadian multinational manufacturing companies such as ATCO warned that if Canadian tariffs were eliminated, their companies would be better off exporting back into Canada from their U.S.-based plants instead of manufacturing in Canada. While the Chemical Producers Association favoured trade liberalization and selective tariff reductions for its industry, they considered that some form of protection was necessary for certain of their products which provided an essential link between the resources industries on one hand and a very wide spectrum of industrial and manufacturing activities on the other. Mr. A. J. Foote, Chairman of the Association, thought "Canada would be at a serious disadvantage in a free trade environment" because of its lower labour productivity, higher construction costs, higher financing charges and climatic factors.

> "It is our view that the Canadian tariff should be high enough but no higher than what is required to offset these cost penalties for operating in Canada which are virtually beyond our control." (II, 11:12, 13)

Mr. McCarthy of Du Pont of Canada judged that free trade would result in a tendency to locate new facilities in the United States in order to be nearer the centre of the market and predicted it would mean an "inevitable slow death" to the company in Canada. (II, 11:50) Mr. R. W. Chorlton of Wajax asserted that any further reduction in the tariff on machinery would lead to a slowing down and eventual closing of many U.S.-owned machinery plants in Canada.

Mr. William Mounfield of Massey-Ferguson was one of the few manufacturers who spoke positively of bilateral free trade. As far as his Canadian farm machinery company was concerned, it had benefitted from the essentially free trade atmosphere. He attached importance to the early start and strong position of the company historically in Canada and cited the acquisition of a U.S. tractor company as a factor in Massey-Ferguson's successful operation in the free trade environment. Mr. Mounfield warned, however, that the same situation would not necessarily apply to other Canadian industries; each one would have to be examined individually to assess its capacity to compete in the North American setting. Even the Canadian steel industry which is generally considered to be among the most competitive in the world was cautious. Stelco's president, Mr. J. D. Allan, said that for a number of reasons related to population and geography, bilateral free trade would give greater advantage to the U.S. industry than to the Canadian industry. Mr. A. V. Ohlson of Atlas Steels said that while his company, a maker of specialty steel, would welcome bilateral free trade with the easier access to the U.S. market, much would depend on whether their Canadian customers could survive competitively in such a situation. If not, the market would tend to move south of the border, leaving Atlas less freight competitive.

Two major national organizations were concerned about the timeliness of moving toward free trade. In addition to its concern that Canada might not get its share of the action in a free trade situation with the United States, the Canadian Manufacturers Association felt that Canadian industry had to get its "house in order" before it could contemplate such a move. (II, 4:57, 80) The Canadian Importers Association considered that the benefits of free trade would be enormous,

but judged that the Canadian manufacturing industry was "unready" for it at the present time. (II, 1:42)

Benefits and Risks

The Committee's problem is to judge how much the depreciation of the Canadian dollar, the improvement in the ratio of time lost through strikes and the moderation of wage settlements will have affected the perspective of Canadian producers and manufacturers. Mr. Robert Scrivener of Northern Telecom asserted when he appeared before the Committee that tariff-free access could result in his company supplying the Canadian market from the United States. However, his warning was linked to the hypothesis that high Canadian labour rates and other unfavourable factors related to competitiveness would persist. These conditions have now improved. In particular, the dollar depreciation has largely compensated for the relative growth of Canadian wage rates during this decade. And Mr. Scrivener, in a speech in March 1978 to the Ontario Economic Council, twice urged Canadians to "start thinking of *a North American alliance* as the prime position for our national industrial objectives and strategies . . . to prepare ourselves for the onset of the international and intercontinental trade battles of the Eighties." (italics added). While the formulation is ambiguous, it sounds like an appeal to Canadians to think seriously about some form of bilateral trade arrangement with the United States.

Under bilateral free trade, U.S. tariffs would be removed providing easier access for Canadian exports. The protection now afforded domestic industry by specific Canadian tariffs would be replaced by a general protection provided by a depreciated dollar. Unlike the tariff, however, the benefit would be two-fold; apart from a discouragement to imports equivalent to a tariff, a depreciated currency also offers an advantage akin to a subsidy to exports. So a devalued dollar would compensate for some of the inescapable higher costs of doing business in Canada.

The critical question is whether companies would make investment decisions on the assumption that the Canadian dollar under bilateral free trade would remain devalued. The experience of recent years when large capital borrowings sustained the dollar above par would be reason for scepticism. However, with tariff protection against U.S. imports removed, to the extent that Canadian manufacturing was not competitive, there would be downward pressure on the Canadian dollar. The exchange rate would adjust to reflect the relative competitive conditions in the two countries.

A move toward bilateral free trade with the United States would, of course, significantly change the competitive position of many industries. Some Canadian industries would be placed in a strong competitive position; others would suffer a sharp decline in output and employment. Even with a movement toward free trade phased in over a number of years, the temporary dislocation would be considerable and a major program of industrial assistance would be needed.

The regional impact would of course vary. It has been argued for a hundred years that protectionism has weakened the Maritimes, inhibited growth in the West and unfairly strengthened central Canada. While the western and Atlantic provinces would benefit from having access to lower cost manufactured goods and the opportunity to process their natural produce to higher levels, many smaller producers

in those areas would suffer from the stronger, cross-border U.S. competition. The initial dislocation to Ontario and Quebec could be difficult and certainly some industries would be forced to close. But the Economic Council has suggested that the gains from free trade for Ontario and Quebec might eventually be greater than the Maritimes or the western provinces since, in any rationalization, it is likely that plants closer to the major domestic market would be the ones chosen by industry to adapt to larger scale and more specialized production.

There is reason to believe that certain industries, including textiles, would be in an improved position operating within the large Canada-U.S. market with continued tariff protection against low-cost third country producers.

The peculiar characteristics of branch plants in Canada of U.S. multinationals add an additional uncertainty. How would they react in a free trade situation? The optimum would be if companies were to opt for specialization on a North American basis with the Canadian plants supplying particular products to the combined market of the two countries. However, there are a number of factors—over-capacity in U.S. plants in low periods of the business cycle, the pull of the larger, i.e. U.S. market, a perceived change in the reliability or stability of the Canadian political base and a natural tendency to reinvest at home rather than in a foreign jurisdiction—all of which might cause repatriation of production to the United States. This is the most serious risk of bilateral free trade. In responding to a question on general free trade, Mr. Walter Ward of CGE pointed to the danger that

> "To invest in a plant in Canada whose output . . . would be up to 90 per cent dependent on free access to the U.S.A. or other markets would or could possibly be providing hostages to a whole range of factors affecting our relationship with those countries". (I, 38:11)

Multinational companies, no matter where their headquarters are located, seek the best rate of return. Providing that costs of production, adjusted by the prevailing rate of exchange, are lower than those of the United States, companies will have an incentive under free trade to locate production facilities in Canada and even to supply northern parts of the United States from them.

Mr. Ward's response raises the question whether a company making a decision to invest in the smaller country assumes a risk that the export of its product to the larger market might be blocked by a non-tariff barrier (NTB). This concern points to a potential benefit from bilateral free trade on which none of the witnesses focussed—a possible resolution of the problem of non-tariff barriers. This report has stressed that NTBs in general are likely to dislocate trade in a period of reduced tariff protection even if the GATT negotiations agree on the means of monitoring them. In addition, it has considered a series of non-tariff measures which now limit trade between Canada and the United States and has drawn attention to new obstacles being proposed to protect U.S. industry which would further inhibit the export of Canadian manufactured goods to the United States.

One of the principal advantages of a free trade agreement is that it provides an opportunity for negotiating mutual exemptions to the provisions of non-tariff protec-

tive measures. While there are certain limitations to achieving a complete absence of non-tariff measures, the free trade agreements negotiated by individual European states such as Sweden and Finland with the European Community illustrate the potential of such a negotiation. If Canada were to propose to the United States that the two countries form a bilaterial free trade area, it would be essential to include as part of the negotiations mutual exemption from the provisions of U.S. non-tariff protective measures. Two examples will illustrate the potential of this approach. The zinc producers of the United States appealed to the International Trade Commission for a high tariff on refined zinc imports beyond a specified volume. The U.S. industry acknowledges that they are seeking protection against European custom smelters which are dumping surplus production rather than against Canadian producers which have always sold fairly at the New York price, no matter how tight supplies were. The copper producers are also seeking protection by means of a quota on imports. Under GATT rules Canada could be exempted from such U.S. devices if it formed part of a regional free trade area.

The success of the Defence Production Sharing arrangement derives from the exemption of Canada from the provisions of the Buy American Act. Under a bilateral free trade arrangement, Canadian companies should be free to quote on all U.S. federal government procurement and vice versa of course. Even existing limitations such as the specialty steels reservation on defence contracts would be opened up for Canadian bidding. Providing therefore that Canada was exempted from the major U.S. non-tariff barriers, the benefits to Canada from bilateral free trade would be much greater than they are generally perceived. If each member country exempted the other from its NTBs and there was truly a North American market, companies could then decide to invest on the basis of the relative costs of production as adjusted by the rate of exchange.

3. Conclusion

Starting from the perception that serious measures have to be taken to improve Canada's competitive capacity, the Committee has considered each of Canada's principal options.

- It rejects increased protection as leading inevitably to diminished competitiveness and a declining standard of living.
- It supports general tariff reductions under the GATT, on condition that non-tariff measures are equally and effectively dismantled, but is sceptical regarding the effectiveness of the results expected to emerge from the multilateral trade talks.
- It makes recommendations for strengthening the competitive capacity of Canadian industry, but concludes that these measures by themselves are insufficient to achieve the rationalization needed by Canadian manufacturing.
- It sees no prospect for general free trade and counsels strongly against any suggestion of moving toward unilateral free trade. The preferred arrangement for Canada would be to negotiate sectoral free trade arrangements with the United States where there would be a benefit to Canada in doing so, but it is

unlikely that such an approach would be of interest to the United States unless it were as a first step toward bilateral free trade.

It was against this background that the Committee has concluded that, in order to resist the gradual shift of Canadian manufacturing capacity to the United States and to strengthen potentially competitive firms and industries in Cananda, Canadians should seriously examine the benefits to be derived from free trade with the United States. It is not a policy without risk, but the Committee is convinced that the balance of advantage from bilateral free trade with the United States is greater than most witnesses perceived for the following reasons:

a) An exchange rate differential can provide a more general and efficient protection than the tariff, one which also encourages adjustment to changing economic conditions and opportunities. The 15 per cent depreciation of the Canadian dollar vis-à-vis the U.S. dollar in the past two years represents a greater measure of protection than most Canadian tariffs now offer and in addition provides a form of subsidy to Canadian exports to the United States larger than most U.S. tariffs now in place.

b) Without unimpeded access to the United States market, it will be difficult — even with government encouragement — to rationalize industrial production and for Canada to become more competitive. As tariffs decline, the pressure from abroad, including the United States, for more effective non-tariff barriers may grow and Canada may find itself increasingly squeezed out of the U.S. market. Only a blanket exemption for Canada, which should be negotiated as part of a free trade arrangement, could avoid this risk, and reverse the trend for U.S. companies to close their Canadian subsidiaries and for Canadian companies to move southward.

c) It used to be argued that bilateral free trade would be risky because it would encourage labour in Canada to seek parity with U.S. workers. However average wage rates in Canada have in the last few years grown to the point where they equal or exceed those in the United States. Bilateral free trade should now be perceived as a discipline to hold Canadian wage rates in line.

d) A normal feature of all free trade arrangements is a phased implementation. A bilateral free trade agreement with the United States should be entered into in stages over a minimum of ten years. If the United States agreed to the principle of free trade with Canada, it is reasonable to expect that it would also agree to negotiate interim free trade arrangements in sectors to make the process of adjustment less difficult.

Any move toward bilateral free trade would have to be carefully prepared domestically. The political uncertainties resulting from the Quebec situation make this a difficult step to take at this moment, and the Canadian public may not be ready for a policy change of this magnitude. On the economic side the weak competitive position of the Canadian economy would result, even with extensive adjustment schemes, in serious dislocation of Canadian secondary manufacturing. But bilateral free trade with the United States appears to offer in the long run the most effective approach to overcome the economic problems which Canada is facing.

Furthermore, in geographic, economic and cultural terms the United States is the only obvious trading bloc partner for Canada.

Simultaneously, the United States appreciation of the benefits to be gained from the larger market of North America may grow. Mr. John Shepherd of the Science Council maintained that the United States was the only industrialized country which experienced a reduction in the proportion of its exports accounted for by finished manufactures in the period between 1955 and 1970. There is support in Congress for free trade with Canada; it was a Congressional initiative which led to the inclusion of the authority to negotiate a regional free trade agreement with Canada in the U.S. Trade Act of 1974. Thus, there are reasonable prospects of an interested United States response, making this a viable option.

Limited sectoral free trade would, from Canada's point of view, involve fewer risks and ensure that a market would only be opened when benefits were to be gained. But these same considerations render improbable United States interest in such arrangements, and as a minimum, the U.S. would oppose any significant safeguard provisions. Under a bilateral free trade agreement, safeguards would not be needed by Canada because movements of the exchange rates would serve as a balancing mechanism.

Bilateral free trade in North America has often been presented as heading inevitably to the economic and cultural assimilation of Canada by the United States. Only half a dozen years ago the government espoused this viewpoint when it advocated what it called the "Third Option". In discarding option number two — "Canada can move deliberately into closer integration with the United States" — the then Secretary of State for External Affairs, Mitchell Sharp, argued that the process was irreversible, leading progressively from free trade to a customs union to political union.

The Committee disagrees. Having presented reports in 1973 on the necessity of developing more intensive Canadian relations with the European Community and in 1972 on the need to expand relations with Japan, the Committee is fully aware of the importance of these extra-continental relationships. But an effort to expand these connections is not inconsistent with pursuit of the long-term goal of free trade with the United States. An economically strong Canada is in a much better situation to maintain political and cultural independence than an economically weak Canada.

The European Community was first formed in 1957 by France, Germany, Italy, Belgium, Luxembourg and the Netherlands as a common market providing for a free flow of capital, labour and goods, and for a Common Agricultural Policy and common external tariffs. In response, most of the remaining countries of Western Europe—initially the United Kingdom, Sweden, Norway, Denmark, Iceland, Portugal and Switzerland and subsequently Austria and Finland—formed a European Free Trade Area (EFTA) which involved free trade in industrial goods but none of the other characteristics of a common market or customs union. This situation continued until the United Kingdom and some other members of EFTA decided to seek membership in the European Community. The success of these negotiations effectively terminated EFTA, whereupon the remaining small countries of Europe such as Switzerland (6,000,000 inhabitants), Portugal (9,199,000 inhabitants),

Sweden (7,730,000 inhabitants), Austria (7,250,000 inhabitants), Finland (4,640,000 inhabitants) and Norway (3,723,000 inhabitants) all decided to make industrial free trade arrangements with the Community. If their populations are compared with the Community's 225,000,000, in every instance, the disproportion is substantially greater than Canada's population relationship with the United States.

Finland's case is particularly interesting. During its association with EFTA, Finland monitored its exports of industrial goods. It found that such exports expanded more rapidly with the United Kingdom under free trade, even though the U.K. then had a sluggish economy, than with Germany, whose economy was booming and which had traditionally been Finland's closest trading partner, but to which Finland did not have free access. This experience persuaded Finland to enter into a free trade agreement with the Community upon the disbanding of EFTA. Even Norway, which narrowly voted against joining the expanded Community, immediately thereupon entered into a free trade arrangement with it.

The free trade agreements entered into by these European countries with the EC have certain common characteristics which must be kept in mind when considering such an arrangement between Canada and the United States. Each involved a transitional period of 10 years or more, and left both parties free to set their own external tariffs and NTB's, all in accordance with the rules of GATT.

The European parallel might suggest that it would be wise to proceed from the first to establish a North American free trade agreement to include Mexico and the countries of Central America. The Committee disagrees. It will be difficult enough to negotiate a free trade arrangement with the United States, without further complicating the task. However, it should be understood that any agreement reached should be open to accession subsequently by third countries, just as the European common market provided for expansion.

Canadian political and economic sovereignty will be protected providing certain conditions are maintained. It has already been suggested that under free trade, exchange rates between Canada and the United States should move freely. Indeed this would be the main equilibrating mechanism between the two economies. Only a free trade arrangement is being proposed, not a customs union, so that while trade barriers for industrial commodities would be eliminated each country would remain free to set the conditions of its trade with third countries. Agricultural trade would also be excluded as was the case with the EFTA countries. Each country would continue to control the rate of development of its own resources, which would involve the right to limit exports. It would probably also be necessary for internal political reasons to work out mutually acceptable systems for assisting the less developed regions of both countries.

It has been suggested that in the short term the Quebec political situation precludes an immediate initiative. But the prospect of a free trade arrangement between Canada and the United States raises an interesting perspective. On the one hand, Quebec would have little economically to offer to Canada which had access to the entire U.S. market; on the other hand, the cost to Quebec of being outside such an arrangement would be enormous, and not only in economic terms. From the point of view of both Canada and the United States, a policy which would lead to a

strengthening of Canadian unity would be an important non-economic benefit to be derived from pursuit of the bilateral free trade objective.

The Committee recognizes that major governmental assistance to industry would be required during the transitional period, but this report has not attempted an examination of this important issue. The Committee decided that this difficulty has been successfully resolved in many other countries. There was no reason why it could not be as effectively solved in Canada as elsewhere.

No government would proceed to adopt the goal of free trade with the United States without intense internal debate and public discussion which would extend over several years. Negotiations with the United States would take some time as well, so that the earliest that an agreement could be concluded might be five years. Transitional arrangements might extend over a further 10 or 15 year period. Full bilateral free trade would therefore not be fully effective until almost the turn of the century.

The outcome of the GATT negotiations will significantly affect the context in which the recommendations in this report will be considered. Even if the negotiations are largely successful, it will still be important for Canada seriously to consider a free trade arrangement with the Unites States. But should negotiations collapse or produce minimal results, bilateral free trade with the United States may suddenly be the only possible solution.

The Committee is aware it is prescribing strong medicine. But just because the patient is too weak at this moment to take the full medication, it does not follow that bilateral free trade is not a desirable objective in the long term.

The Committee urges governments in Canada, as well as the business and labour communities, to assess without prejudice Canada's present economic prospects, the alternative solutions and their consequences. The Committee recommends that they consider seriously the option of bilateral free trade with the United States.

ANNEXES
and
APPENDICES

ANNEX A

Comparative Wage Rates between Canada and the United States

No single factor was mentioned more frequently during the Committee hearings as contributing to declining Canadian competitiveness than wage levels. Mr. R. D. Southern of ATCO, expressed the overall concern this way:

> "For the manufacturing industry, of which ATCO is a part, labour is the primary cost factor of production. Employee compensation accounts for 75 per cent of our value added in the manufacturing sector in Canada. There has been a growing concern that our products are being priced out of world markets because of exceptionally large increases in costs and prices attributable to large wage settlements. It is a widely publicized fact that wage settlements during 1974 and 1975 in Canada were double those in the United States. From June, 1974 to June, 1975 average weekly wages in Canadian manufacturing increased by 18 per cent, while the United States the increase was less than 9 per cent. This had a resultant detrimental effect on our unit labour cost. The large wage and salary increases, in concert with the higher exchange value of the Canadian dollar, beginning in 1970, gave the result that unit labour costs in Canadian manufacturing industries increased faster than in the United States between 1970 and 1974." (II, 2:17)

Mr. R. W. Chorlton of Wajax compared the wage rates in his equipment company with his U.S. partners' wages.

> "Five years ago our wage rate was $.60 an hour lower than our U.S. partner. Today we pay $.60 an hour or 10 per cent more in direct labour rates than our U.S. counterpart and by virtue of the lower volume probably do not obtain the same level of productivity." (II, 9:21)

While the average level of Canadian wages moved higher than the U.S. wage levels, witnesses reported significant differences in individual industries. In forest products, electrical machinery, business forms, telecommunication equipment, Canadian wages were substantially higher than U.S.; in carbon steel and automotive assembly approximate parity exists; in a number of other areas such as auto parts, farm machinery and specialty steels, Canada retains a diminished wage advantage.

Simple hourly wage differentials (Table 1) may present a somewhat biased picture of comparative labour costs in the two countries, as there are some basic differences in the base employed by the two countries in calculating wage increases. Further, testimony by witnesses indicated that in some industries fringe benefits were more generous in the United States as compared to Canada. For example, Du Pont's management reported that in a similar fibre plant, Canadian wages were 109 per cent of American but the total remuneration *including benefits* to a Canadian worker was 98 per cent of the U.S. level. The figures for a similar petrochemical plant were 106 per cent and 95 per cent respectively. Some social programs paid, in part, by contributions from employers in the United States are provided by the state in Canada. At least some of the higher wages paid to workers in Canada is taxed to help finance these programs.

Despite this caveat, money wages increased so much faster in Canada than in the United States that an unusual combination of forces must have been at work. No

thoroughly convincing rationale of why Canadian manufacturing wage rates rose so dramatically was presented to the Committee, but several contributing factors were suggested. These factors fall into two broad categories: those related to the "tightness" of labour markets, i.e., the balance between aggregate demand for and supply of labour, and those related to changes in the structure of labour markets such as social security, minimum wages, unionization, etc. Because of the central importance of wage rates and the emphasis put on them by witnesses, the Committee decided it was important to examine the causes in some detail.

Table 1

Indexes of Output, Compensation, Unit Labour Costs & Hourly Earnings in Manufacturing: Canada & United States. 1970 - 1976

Item	Canada	U.S.	Item	Canada	U.S.
Output Per Hour			Unit Labour Costs (U.S. dollar basis)[3]		
1970	100.0	100.0	1970	100.0	100.0
1973	114.8	114.5	1973	113.5	105.7
1974	114.8	109.8	1974	130.4	120.9
1975	116.7	109.9	1975	143.6	134.2
1976[2]	119.4	117.1	1976[2]	161.4	135.5
Compensation Per Hour (national currency)			Average Hourly Earnings[1] (national currency)		
1970	100.0	100.0	1970	100.0	100.0
1973	124.8	120.7	1973	127.9	121.4
1974	140.3	132.8	1974	145.2	131.2
1975	163.3	147.7	1975	168.1	143.2
1976[2]	182.1	158.7	1976[2]	192.7	154.5
Unit Labour Costs (national currency)			Real Hourly Earnings[1,4]		
1970	100.0	100.0	1970	100.0	100.0
1973	108.8	105.7	1973	110.3	106.0
1974	122.1	120.9	1974	112.9	103.3
1975	140.0	134.2	1975	118.0	103.3
1976[2]	152.4	135.5	1976[2]	125.8	105.3

1. Wage earners only
2. Preliminary
3. Indexes in national currency adjusted for changes in prevailing exchange rates
4. Index of average hourly earnings divided by the index of consumer prices to adjust for changes in purchasing power

Source: U.S. Bureau of Labour Statistics

1. *Aggregate Demand Factors*

Canadian labour markets appear to have been relatively "tighter" during the 1970-1975 period than those in the United States so that wages in Canada were being pulled up by the competition between employers for labour.

Output and employment grew more than twice as fast in Canada throughout the period as Table 2 shows.

Table 2

Average Annual Rates of Change
1970 — 1975

	Canada	U.S.
Total Gross Domestic Product	4.7	2.5
Per Capita GDP	3.2	1.6
Industrial Activity		
Total	4.4	1.7
Manufacturing	4.3	1.8
Manufacturing Employment	0.5	— 0.9
Private Sector Employment	3.2	1.2
Public Administration (civil)	5.3	2.7

Source: U.S. Statistical Abstract, 1977 Statistics Canada

The divergence was particularly marked in the years 1973-75. Surprisingly the "tightness" of the labour markets was not commented upon by either business or labour leaders who appeared as witnesses, but the Committee is convinced it had a significant impact.

Some of the differences in output and employment growth in the two countries can undoubtedly be attributed to the especially favourable world market conditions for Canadian products from 1972 to 1974. World demand for industrial materials, especially grains, base metals and mineral fuels, was very strong during these years. While both countries produce these materials, they occupy a much more central place in the Canadian economy than in the U.S. economy. Indeed, the United States is Canada's major customer for many of these products. Terms of trade turned sharply in favour of Canada from 1972 to 1974 and exports grew rapidly. This sharp growth in the primary sector induced a high level of investment and consumption expenditure which in turn resulted in a strong demand for manufactures and services. This demand would probably have generated some upward pressure on wages in Canada relative to those in the U.S., even in the absence of any structural changes and even if monetary and fiscal policies had been the same in both countries. However, throughout the period, monetary policy was much more expansionary in Canada than in the U.S. Fiscal policy, especially from mid 1974 on, was also more expansionary in Canada.

From Table 3 it can be seen that the Bank of Canada expanded the Canadian money supply much more rapidly than the U.S. authorities expanded their money supply. By 1975 and 1976 this growth undoubtedly contributed to the relatively better Canadian performance in terms of real growth, but also resulted in somewhat more rapid price increases in Canada. These accelerated price increases had a marked effect on wages by 1975 and would continue to exert upward pressure on them thereafter.

Table 3
Annual Percentage Money Supply Growth Canada and United States
1966 — 1976

	M1—Currency & Demand Deposits			M2—Currency and Demand & Time Deposits		
	(1) CAN.	(2) U.S.	(3) (1) - (2)	(4) CAN.	(5) U.S.	(6) (4) - (5)
1966	6.9	2.2	4.7	8.1	4.9	3.2
1967	9.7	6.6	3.1	12.2	11.1	1.1
1968	4.3	7.2	— 2.9	13.4	9.4	4.0
1969	7.5	2.6	4.9	9.7	— 1.5	11.2
1970	2.3	5.2	— 2.9	5.5	7.1	— 1.6
1971	12.8	6.4	6.4	14.4	11.3	3.1
1972	14.0	9.0	5.0	17.6	11.2	6.4
1973	14.5	6.3	8.2	13.4	8.8	4.6
1974	9.7	4.4	5.3	19.9	7.2	12.7
1975	13.7	4.2	9.5	17.5	8.5	9.0
1976	8.0	6.8	1.2	17.0	11.4	5.6
Avg. 1970-75	11.2	5.9	5.3	14.7	9.0	5.7

Source: May 1977 Economic Annual Review, Dept. of Finance, Canada. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin (monthly)

Fiscal policy (as measured by the size of government deficits) was also more expansionary in Canada than in the U.S., especially in 1974 and 1975. This fiscal stimulus was partly responsible for the better performance of the Canadian economy over this period and thus also for the greater upward pressure on wages in Canada. But the size of deficits does not tell the whole story. The public sector expanded much more rapidly in Canada than in the U.S. and this rapid expansion in turn generated considerable upward pressure on Canadian wages.

Public sector employment grew especially rapidly from 1970 to 1975. Employment in "public administration" in Canada expanded by a phenomenal 30 per cent between 1970 and 1975 compared to approximately 18 per cent for private sector employment. Thus, as it had been doing throughout most of the 1960s, the public sector was competing aggressively for many types of labour and in the process was exerting upward pressures on wage rates.

Faced with this strong demand for labour by the public sector, private sector employers have been forced to increase wages to retain labour. The Canadian labour market is not segmented. Employees will move to government jobs if the terms in industry employment are not commensurate. The point was well put by M. Ian Barclay of British Columbia Forest Products Ltd..

"... we have a real dilemma because the public sector and the service sector have extraordinary wages compared to ours and we are looking at things where we want a qualified person to run a very expensive piece of machinery 150 miles from nowhere ... " (II, 6:34)

In contrast, in the United States, while civilian public sector employment grew somewhat more rapidly than private sector employment during this period (18 per cent as compared with 12 per cent), military employment *fell* by 33 per cent so that total public sector employment (military plus civilian) rose by only 8 per cent.

In the overall, between 1970 and 1975, the number employed in Canada increased by 19.5 per cent compared to 8.5 per cent in the U.S. In the manufacturing sector Canadian employment increased by 3 per cent compared to a 5 per cent decline in the U.S. Unemployment rates, which had averaged one-half percentage point higher in Canada during the late 1960s, were about the same as the United States over the period 1970-75 and about one percentage point lower in 1974-75. While the impact that relatively stronger demand for labour in Canada has had on Canadian wages cannot be precisely assessed, the Committee concludes that at least part of the more rapid rise in Canadian wages during the 1970s was attributable to the stronger demand for labour.

2. *Structural Factors*

Changes in the structure of labour markets during this period also contributed significantly to the more rapid escalation of wage costs in Canada. While many changes contributed to rapid wage increases during this period, in the opinion of the Committee, the most important of these structural changes were:

(i) Changes in public sector wage policies and the increased role of collective bargaining in public sector wage determination;

(ii) Changes in many social security benefits and unemployment insurance benefits in particular;

(iii) Rapid increases in minimum wages; and

(iv) Increased expectations of workers for a progressively higher standard of living leading to deteriorating labour relations in the private sector.

Each of these will be discussed below in some detail.

(a) Public Sector Wage Policies. The rapid growth in the demand for labour by the public sector contributed during the period 1970-76 to sharp increases in wage rates. In the opinion of Mr. Robert Scrivener of Northern Telecom:

> "... labour and benefits costs and productivity levels are being established, and will continue to be established, by the public sector in Canada, while in our principal competitor, the U.S., they are being established by the private sector; the further downstream we look, the wider the Canada-U.S. wage-productivity gap will develop in favour of the U.S." (II, 3:12)

This opinion was echoed by Mr. Walter Ward of Canadian General Electric who stated that one factor explaining the wage explosion in Canada was:

> "the settlements in the public and quasi-public area which were significantly higher than they had been historically and higher than increases taking place in the private sector." (I, 38:9)

Because of the shift in relative employment between the private and public sectors it is surprising to find that the actual increase in public sector wages between 1970 and 1975 was not substantially higher than the increase in wages in manufacturing and in the service sector. According to Statistics Canada, the average

percentage increase in average gross wages in the public sector was 62.3 per cent between 1971 and 1975 (provincial 63.6 per cent, federal 58.2 per cent and municipal was 58.2 per cent). In the private sector, the percentage increase for the manufacturing sector was 60.7 per cent and for the service industries 58.5 per cent.

But a strong demand for labour by the public sector is only one of the reasons for rapidly rising wages in the public sector. A second and perhaps equally important factor has been the spread of collective bargaining in the public sector. The number of employees in the public sector covered by collective agreements rose dramatically during the last ten years, as can be seen from Table 4.

Table 4

Per Cent of Employees Covered by Collective Agreement by Major Industry Group, 1968 — 1975

	Non-Office Employees		Office Employees	
	1968	1975	1968	1975
Mining	77	83	5	11
Manufacturing	72	76	9	10
Transport, Comm., Util.	85	88	46	44
Service	34	46	12	25
Public Administration	46	97	24	92

Source: Labour Canada : *Working Conditions in Canadian Industry*.

Academic research has established that initial agreements usually result in above average settlements, and this rapid growth in unionization is likely to be reflected in larger-than-normal pay increases in the public sector.*

As the percentage of public sector employees covered by agreements stabilizes, the impact of this initial agreement effect should diminish. Mr. Lynn Williams of the United Steelworkers and Mr. Dennis McDermott of the United Auto Workers pointed in their testimony to certain necessary but one-time developments which accounted for the particularly rapid growth in provincial and municipal wage settlements. They noted that before the increases of the early 1970s hospital and municipal workers' wages had been very much out of line with other Canadian workers. They did not expect the trend to persist.

While this "initial agreement effect" may be temporary, the bargaining environment for public sector wage settlements does differ from that of the private sector. The government lacks a single measure of performance, such as profit, which would indicate when "excessive" wage settlements were being offered. In addition, the public sector is often involved in the production of services, some of them of vital importance to the country as a whole. Customers of services cannot dull the impact of a possible strike by stockpiling to the same extent that customers of goods producing industries can. Many health services, police protection, communications, etc. have to be consumed when needed. There is little scope for rescheduling

* Cousineau & Lacroix, *Wage Determination in Collective Agreements in the Public & Private Sectors*, Economic Council of Canada, 1977.

consumption of these services. Labour providing vital services has, as a group, much greater power than labour in other sectors.

There are, then, two major reasons why public sector wage settlements differ from private: the different disciplining forces acting on the negotiating parties and the larger proportion of vital services provided. Historical differences between the private and public sector in negotiating practices have been eroded in the last two decades. Public sector employees have gained the right to unionize and to strike. Their right to participate in political activity has also been liberalized. There are obvious social benefits from extending such valuable rights, but the dangers of a dramatic or steady exercise of power by public employees on the competitiveness of the private sector and eventually on their own well-being have been enhanced by these changes.

(b) Social Security. A second structural factor which has contributed to upward pressure on wages in Canada relative to the U.S., is the relative improvement of the Canadian income security programs, particularly unemployment insurance. During the 1970s, the duration, level, and qualifying periods for benefits in Canada were liberalized much more rapidly than was the case in the U.S. These more liberal U.I. provisions in Canada have greatly increased frictions in the labour market and placed upward pressure on Canadian wage rates.

This phenomenon is now well documented in economic literature. Although this analysis concentrates mainly on the effect of Canadian U.I. revisions on unemployment rates rather than the effect on wage rates, the effect on wages can be inferred. These studies indicate that the 1971 U.I. revisions increased Canadian unemployment rates by one to two percentage points. This implies that at any given level of unemployment in the mid 1970s, wages could be expected to increase 0.5% to 1.0% per year faster than at the same level of unemployment in the mid 1960s.

Several witnesses mentioned unemployment insurance as one of the reasons they were having some trouble attracting and retaining employees. For example, Mr. R. K. Groome, President of Hilton, Canada, testified:

> "we have had many experiences where people have refused jobs. I can give you one example: Not too long ago we had to lay off a few cocktail lounge people because business was too slow. We offered them food waiter jobs instead. They declined, saying that they would prefer to be laid off so they could draw their unemployment insurance in that manner, because they did not wish to do the heavier work or the more complicated work of serving food as against serving beverages." (II, 21:25)

The Committee does not question the necessity of maintaining an adequate unemployment insurance system to protect workers from serious hardships during recessions. Nevertheless, the upward pressure which the present unemployment insurance system exerts on wages in Canada should be recognized.

(c) Minimum Wages. Over the decade from 1967 to 1976, the U.S. Federal minimum wage was increased by about 65 per cent while the average Canadian minimum wage was increased by 180 per cent. During this period the average Canadian minimum wage increased from about 75 per cent of the U.S. federal minimum wage to 120 per cent of the U.S. minimum wage. (See Table 6 on page 75 of the report) In mid-1977, the average minimum wage in the Canadian provinces

was $2.85 an hour, much higher than in the many contiguous U.S. states and 15 per cent higher than the U.S. federal minimum of $2.50 an hour. Moreover, there are many more exemptions under the U.S. minimum wage legislation than under Canadian statutes, so that the effective differences are even greater than is indicated by the difference in rates.

Increases in mimimum wage rates have two important impacts. First, they put great pressure on wages just above the minimum and, through time, on all wage rates as higher rates are adjusted to maintain long established differentials. Second, increases in minimum wages directly increase costs and reduce employment in low wage manufacturing and service industries. (One industry that is particularly adversely affected is the hotel and restaurant industry as discussed in Chapter IV:3 of the report.)

The original rationale for minimum wage legislation was to better the lot of lower paid employees. Witnesses questioned that the anticipated benefits of this legislation have been realized and whether this approach is the best means of pursuing this objective. Mr. John Bulloch of the Canadian Federation of Independent Business argued that the minimum wage has reduced the number of jobs available to this group and in particular, many apprentice-style jobs which were low paying, but where the employee was receiving training in a skill that would generate income later, disappeared. The high unemployment rates among teenagers appears to be, in part, a result of the incidence of minimum wage laws.

(d) Labour Relations. It would appear that the industrial relations climate underwent a major change in the 1970s. Increasing acrimony, protracted negotiations and a marked increase in time lost due to strikes and lockouts characterized the labour relations scene from 1970 to 1976. According to U.K. statistics,* Canada had the dubious distinction of having more days lost per thousand people employed than any other developed country. Canada's average over the decade 1966-1975 was 38 per cent higher than that of the United States, 138 per cent higher than that of the U.K. and 345 per cent higher than West Germany. The bulk of time lost was in the private sector but the proportion of man-days lost to strikes and lockouts in the federal public service and federal industry grew to 11.3 per cent by 1975. This dismal record was maintained in 1976 when Canada edged out Italy as losing more days in strikes than the listed 54 other countries; Canada lost 2.27 working days for each worker, Italy 2.2 days. The United States, by contrast, lost only about one day. Fortunately, by 1977 the situation had improved dramatically with 70 per cent less man days lost than in 1976.

While there can be no doubt that Canadian competitiveness suffered because of increased time lost to strikes and strike-related activity and because of the accompanying reduction in cooperation between labour and management, the reasons for this deteriorating climate are far from clear. Factors suggested to the Committee to explain the situation, at least in part, included: (a) the behaviour of wages in the public sector; (b) increased uncertainty due to rapid inflation; (c) increased expectations of manufacturing and service employees because of the buoyant state of output and exports from 1972 to 1975; (d) an increasingly political orientation of unions.

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* *Department of Employment Gazette*, United Kingdom, December 1976

The major impact of the public sector on private sector wages is through competition for labour in the market and rising wage rates. These have been treated in detail above. Other effects may also be important, however.

One such effect is in the area of fringe benefits. Industry was particularly concerned about the benchmarks being set by the public sector as far as fringe benefits were concerned. Mr. Walter Light, President of Northern Telecom, pointed out that his company was paying more in Canada than in the United States for labour and of the average Canadian wage, 72 cents was for benefits including pension plans, holidays etc. The company was apprehensive that the "tendency is for unions to want to match the fully-indexed pension plans that the government has." (II, 3:17)

There can be little doubt that the rapid inflation from 1973 caused greatly increased difficulties for parties at the bargaining table. Long established underpinnings for wage relationships were destroyed. Labour felt that they had been cheated out of real wages negotiated in the previous contract, especially when that contract had a duration of more than two years. Determined to "catch up" for these perceived losses, labour was wary of signing long contracts unless awarded high wage increases or cost of living allowances (COLA) clauses as insurance against future inflation. On the other hand, after 1974 businesses perceived themselves to be faced with softening world and domestic markets and to be exposed to intensified import competition. These sharp differences in perceptions made bargaining very difficult and undoubtedly resulted in more strikes and in increased length of strikes when they did occur.

While the foregoing reason explains in part the long duration of strikes in the last three years, it is but one contributing factor, and other useful suggestions were made in testimony. Mr. Lynn Williams of the United Steelworkers noted that it was extremely difficult under Canadian law to modify an agreement, once negotiated, while it was in force. Consequently, both parties took great care and time in ensuring that they could live with all the clauses of the agreement over its full term. Different patterns of industrial specialization, historical and legal differences and the complexity of collective bargaining agreements may provide partial explanations for the phenomenon. As well, in Canada, there is a fairly widespread tradition of plant-by-plant bargaining as opposed to the industry-wide bargaining in the U.S. which may contribute to the Canadian total of days lost due to strikes.

In addition to the impact of inflation on expectations, the buoyant state of the economy from 1972 to 1974 undoubtedly led to greater expectations about the increase in real wages than was appropriate. Large increases in resource and agricultural prices led to increasing expectations and wage rates in this sector. Strong revenues of government made it easy for the public sector to increase wages of all public employees, and made governments particularly vulnerable to claims of those involved in the provision of services to export industries. Employees in other sectors also perceived the economy to be "strong" and felt entitled to receive increases similar to those being paid in the resource sector. While it is extremely difficult to quantify the impact of these rising expectations on industrial relations after 1972, there can be no doubt that they did make bargaining more difficult.

It was also suggested that Canadian unions had become more "political" in their orientation and were less aware of the economic realities than their U.S. counterparts. Although there was a predictable tendency for management witnesses to argue that a more constructive approach by labour would help in improving labour relations, the Committee was impressed by the competence and awareness of both business and labour leaders of their common problems and their mutual interest in remaining competitive. The specific issues raised by industry leaders were that: the labour movement in the United States was better informed about the situation of each industry and therefore more aware of the consequences of their demands on job opportunities in the future; the labour movement in Canada was more politically involved than in the United States and therefore more likely to be influenced by other than economic considerations.

Mr. Laurent Thibault, an economist with the Canadian Manufacturers Association, stated:

> "... it is a generally accepted fact in Canada that many of our unions have in fact a different approach to how society should be run than, say, in most unions in the United States, which are generally recognized as business unions." (II, 4:64)

Despite these assertions, the Canadian labour leaders who testified before the Committee were well briefed on their industry's situation. Like the management witnesses, they buttressed their arguments with statistical information, although they understandably selected different aspects of their industry's prospects and experience than chosen by management. Mr. McDermott agreed that the direct political involvement of Canadian unions was more marked than that of U.S. labour. However, some European countries with far greater involvement by labour in the political process, have experienced much less industrial strife than Canada, at least as measured by man hours lost per thousand employees. Both Messrs. McDermott and Williams commented unfavourably on the lack of acceptance by business leaders in Canada of the legitimate role of labour leaders, a factor which they believed contributed to bad labour relations.

The most important criterion for improved labour relations is greater awareness of the reduced capability of Canadian industry to compete. The testimony indicated that labour and management had both learned from recent experience and were aware of each others' concerns and the country's deteriorating position. For example, Mr. Henri Lorrain of the Canadian Paperworkers Union said, in July 1977:

> "I think the membership by and large recognizes the problem of the industry. I think I can make that as a general statement at this time... Usually the employees of paper companies base their demands on what they believe is their employers' ability to pay. In 1974 the employers in Ontario gave a large settlement to the woodworkers. They had second thoughts about it by the spring of 1975, and it was not extended to the employees of the manufacturing sector of the pulp and paper industry. At that time, of course, the workers were perhaps less concerned about ability to pay than about maintaining—not maintaining the higher rates than those of woodworkers, which they had had for decades—but at least maintaining some measure of parity with the employees of the same companies in Ontario. This is one instance where we forgot a little bit about their ability to pay. We wanted justice. Traditionally, I think our people have bargained on what they have assumed to be the employers' ability to pay." (II, 27:17, 21)

There are encouraging signs that this increased awareness is bearing fruit. According to Ontario's labour minister, in the first three months of 1977, man-days

lost in that province were 82 per cent lower than in the comparable period during 1976. It is noteworthy that the most successful Western industrial economy—the Federal Republic of Germany—is a society in which there is a broad sense of national purpose and a high level of mutual acceptance by business and labour leaders.

ANNEX B

Comparative Taxation Levels

(i) *Comparative Personal Income and Social Security Tax Levels*

Personal income taxes and social security taxes can have an impact on costs to the extent that they "push up" wages and payroll costs of regular employees, and through the effect they can have in the movement of bright young managers, professionals, and middle executives between companies in Canada and the United States.

While there is considerable variation in the rate of income and social security taxes across states and provinces, as of 1977 employees earning roughly $20,000 and over faced higher rates of tax in Canada than in almost all states in the U.S., while those earning $10,000 to $20,000 paid about the same or somewhat less in most provinces compared to most states in the U.S. The married taxpayer earning $20,000 and up who is the sole earner in the family is treated more harshly in Canada compared to his U.S. counterpart, while single taxpayers and those with working spouses in Canada in this income range are at only a very mild disadvantage compared with their U.S. counterparts in most states. It should also be noted that the U.S. tax system places great emphasis on itemized deductions compared to Canada. In aggregate itemized deductions represent about 16 per cent of the comprehensive tax base in the U.S. compared to 9 per cent for Canada. For this reason, tax burdens of individuals with similar incomes may differ widely.

It should be noted that average tax rates do not tell the whole story, however. For individuals with above average earnings transfer payments may go a long way to offset higher personal income tax burdens in Canada. Payments received via family allowances and hospital and medical insurance have no U.S. counterpart. Moreover, the combined old age security/Canada Pension Plan benefits in Canada are likely to be higher upon retirement than U.S. social security payments. Thus the net tax position (taxes minus transfers) of most middle income employees in Canada is likely to be about the same or lower than their U.S. counterparts in states with average tax levels.

Because of the wide variation in tax levels across states and provinces and because of the greater reliance on itemized deductions in the U.S. tax system, it is not surprising that the Committee received conflicting testimony as to the impact of the personal income tax on salaries of managers in Canada. On the one hand, the Committee heard testimony from the heads of some Canadian companies who found it difficult to bring people from the United States because of the tax situation. For example, Mr. David Barr of Moore Corporation said that a manager would have to be paid a 33½% increase to bring a $25,000 U.S. salary to the break-even point in Canada. Mr. Alfred Powis of Noranda testified that Canadian personal income taxes

were much higher than those in the United States and told the Committee his company had to pay someone who was making $20,000 in the United States $34,000 to give him the same take home pay in Canada. On the other hand, Mr. R. D. Brown of Price Waterhouse & Co. suggested that there is not much difference in Canadian and U.S. personal tax rates.

(ii) *Corporation Income Tax*

Corporation income tax structures in both Canada and the U.S. are exceedingly complex with the result that effective rates of tax paid in both countries vary greatly across industries and companies. On average, however, the corporate tax burden is somewhat lower in Canada than in the United States. The Department of Finance calculates that the average rate of tax on book profits in Canada was 35 per cent in the period from 1970 to 1976 compared to 39 per cent in the United States.

Canadian corporate tax rates are, in general, a little lower than the U.S. rates. Combining federal and provincial levies, the rates vary between 46 and 51 per cent in Canada, whereas the comparable figure in the United States is about 50 per cent. For manufacturing and processing industries, the Canadian rates are substantially lower, running between 40 and 45 per cent. While Canadian treatment of losses is slightly less advantageous than that in the United States, this is more than offset by the more favourable treatment accorded to intercorporate dividend payments.

In general, the United States provides stronger incentives to new investment through the investment tax credit than does Canada. Mr. Brown of Price Waterhouse reported that in the United States:

> "Depending on certain factors, 10 or 11 per cent of the cost of new capital investment in plant and equipment is allowed as a tax credit. In Canada, we have an investment tax credit, but it is only 5 per cent. Furthermore, that 5 per cent must be used to reduce the basis of the asset for further depreciation purposes. This is not true in the United States." (I, 28:6)

While the Canadian credit can be as much as 10 per cent on certain investments in depressed areas of the country, the generally lower credit combined with the reduction of value of the asset for depreciation purposes means that the Canadian tax credit is usually less than half as valuable as the U.S. one. On the other hand, Canada permits very much faster write-offs for capital cost allowances (CCA) than does the U.S. In Canada, new manufacturing and processing equipment can be written off in two years whereas in the U.S. many types of machinery have to be depreciated over 10 to 15 years for tax purposes. This gives a very great cash flow advantage to capital intensive firms in Canada, especially in periods of high inflation and high interest rates, and more than offsets the effect on cash flow of the higher tax credit in the U.S.

In spite of investment tax credits and accelerated CCA, industry in Canada, as in the United States, is exposed to the risk of overtaxation in periods of rapid inflation. As Mr. John Stenason of Canadian Pacific Investments explained:

> "... income tax payments are based on earnings calculated on the basis of historic costs and do not make allowance for the much higher costs of replacing plant and equipment during an inflationary period. This means that corporate earnings and corporate taxes are overstated and this has the effect of shrinking funds available for re-investment in plant and machinery."*

* In a letter of December 7, 1977 to the Committee following his testimony.

As an assistance in capital formation, Mr. Walter Ward of CGE pointed out that the Swedish system allows tax-free reserves of up to 40 per cent of pre-tax profits for future investment and 60 per cent of inventories to be written down immediately. He judged that this system would be a tremendous help in the availability of cash flow for re-investment in industry.

The Committee did not examine this complex issue in detail. It would seem appropriate however that the government should work with the Canadian Institute of Chartered Accountants to try to devise a satisfactory system of coping with this problem. While inflation continues, a company under the traditional accounting system, will be forced to delay investment and neglect to refurbish its plant. Inevitably there will be unfortunate production and trade consequences.

Canadian producers, especially those who carry large inventories, are at a tax disadvantage relative to their U.S. counterparts in periods of inflation because inventory profits in Canada must be calculated on a "first-in-first-out" (FIFO) basis while American producers have the option—which most have taken—of calculating these profits on a last-in-first-out basis (LIFO) for tax purposes. Under the LIFO system, the most recent (and generally more expensive) acquisition is charged against current income, thus reducing taxable income to the advantage of U.S. companies. This advantage has been partially offset (at least at current rates of inflation) by the introduction in Canada in April, 1977 of a 3 per cent inventory valuation credit. Such a credit is only a partial response to the problem however.

In the United States, the DISC (Domestic International Sales Corporation) also provides a considerably reduced rate for profits earned on exports. The provisions of DISC are complicated but the effect is roughly to reduce federal taxes on income earned from exports to three quarters of the level that would otherwise be paid. The effects of DISC on Canadian-American trade are difficult to assess. The tax concessions would only be expected to lower costs of American export goods by one to two per cent. However, one to two per cent on gross revenue can make a considerable difference to profit levels. Mr. Tom Burns of Industry, Trade and Commerce believed

> "that the principal benefit taken by U.S. exporters has been in terms of the capacity to dispose of greater resources financially, either in profits, expanded production, investment or what-have-you, rather than on the price side." (I, 27:17)

A U.S. Treasury Report summarized the operations of DISC for 1972. Of $16 billion of exports through DISC, 22.1 per cent were destined for the Canadian market. The U.S. Treasury estimated that DISC involved a loss of revenue of approximately $250 million. Prorating this loss, a rough estimate of an annual $50 million subsidy to U.S. exports to Canada can be derived. A specially established panel of GATT ruled in 1976 that DISC was an export-subsidy scheme and therefore counter to the GATT rules. Canada could take retaliatory countervail action, if injury has occurred. The testimony of Canadian industry witnesses, however, indicated that DISC had not contributed markedly to their problems. The DISC legislation was recently altered by the U.S. Tax Reform Act and will in future only apply to income earned on exports above those in a base period. From data on

DISC imports gathered under the Canadian Import Surveillance program, the Department of National Revenue estimates that $4 billion of U.S. exports to Canada will no longer be subsidized under DISC. The U.S. is also on record that it would remove DISC as part of a general agreement, under GATT, for the restriction of export subsidies.

(iii) *Resource Taxation*

While corporations in general face lower rates of income taxation in Canada than in the U.S., resource based industries in Canada must pay heavy additional fees, taxes and royalties which leaves them in a disadvantageous position vis-a-vis their American counterparts. The Department of Finance calculates that while the effective rate of tax on income for all taxes is six percentage points lower in Canada than in the U.S. for all industries, it is 12 and 24 percentage points higher in Canada for the mining and forestry industries respectively.

A major problem for the Canadian resource industries, and particularly the mining industry in recent years relates to the jurisdictional disputes between the federal and provincial levels of government over the right to tax. The mining industry's tax incentive structure was substantially altered in 1971 by changes in federal tax policy which removed some of the advantages which the industry had traditionally enjoyed. However, the impact of this change was compounded by steps taken within a couple of years by the provinces to tax away the profit generated in the prosperous 1973-74 period, which, it is now apparent, was due to cyclical factors.

Mr. Alfred Powis, President of Noranda, termed as "devastating" the overall impact of the federal governments' 1971 tax reform coupled with the punitive taxes and royalties of the provinces which the federal government disallowed as expenses. In terms of competitive position, he said, Canadian taxes were more than double those in parts of the United States. As evidence of this his company prepared for the Committee some tables of comparable mining operations in its Brenda Mine concern in B.C., in Ontario and in Nevada. (Tables 1 and 2 on following page)

Both Mr. Stenason and Mr. Powis considered that the interaction of federal and provincial taxation measures were constraining new mine developments. Mr. Powis stated:

> "It is our conviction that unless you discover something extraordinarily rich in Canada, it cannot be developed under today's tax circumstances. You cannot finance it; you do not have the prospect of making a reasonable rate of return. We are still looking for mines in Canada as well. We are doing it as an act of faith, I suppose . . . sooner or later some common sense will prevail in this federal-provincial battle over taxing." (I, 36:12)

A recent study by Ontario's Ministry of Natural Resources indicates a heightened awareness by some provinces of the impact from the double tax burden. The study found that tax changes in recent years have resulted in a 17 to 20 per cent reduction in mining investment in Ontario and 21 per cent in Canada as a whole. While the federal government made some modifications, effective January 1, 1976, reducing the corporate tax rate on production profits from 50 per cent to 46 per cent, the speed in imposing the original increased taxes was dazzling compared to the slowness in removing them to alleviate the difficulty.

Table 1

Brenda Mines Limited Tax Comparison — Recent Conditions

Thousands of Dollars	In B.C. (A)	In Ont. (B)	In Nevada (B)
Earnings before Taxes	$5,818	$5,818	$5,818
Provincial/State Taxes	2,645	1,389	291
Federal Taxes	1,455	1,455	1,327
Earnings After Taxes	$1,718	$2,974	$4,200
Effective Tax Rate	71%	49%	28%

(A) Results shown are actual results for 1975.
(B) Assumes that, if the mine happened to be in Ontario or Nevada, exactly the same revenues and costs would apply.

Table 2

Brenda Mines Limited Tax Comparison — Prices Doubled

Thousands of Dollars	In B.C. (A)	In Ontario. (B)	In Nevada (B)
Earnings before Taxes	$45,789	$45,789	$45,789
Provincial/State Taxes	26,687	14,220	2,289
Federal Taxes	11,447	11,447	14,596
Earnings After Taxes	$ 7,655	$20,121	$28,904
Effective Tax Rate	83%	56%	37%

(A) Assumes that costs are at the same level as in 1975 but that prices of copper and molybdenum are doubled.
(B) Assumes that, if the mine happened to be in Ontario or Nevada, exactly the same revenues and costs would apply.

It is the Committee's opinion that the Canadian resource industry, particularly the non-fuel mineral industry and the forest industry have suffered in recent years from over-taxation relative to the United States, mainly as a result of federal and provincial jurisdictional disputes. This is in the two industries which are the greatest "net" earners of foreign exchange for Canada. The non-fuel mining industries face enough serious challenges from slumping prices, large inventories and precarious markets without punitive taxes. The same is true in the forest industry which is being faced with serious competition from the fast-growing tree plantations in the southern United States. When asked how the federal-provincial resource tax conflict could be resolved, Mr. Powis said:

> "a nice simple solution would be for various governments to decide that 50 per cent is a high enough tax rate and maybe they should split that 50-50." (I, 36:13)

(iv) *Indirect Taxation*

Perhaps the most important difference in the structure of Canadian and U.S. taxes on business relates to taxes other than corporate income taxes, in particular to the much heavier indirect taxes in Canada. Mr. R. D. Brown, a tax expert, explained that these hidden taxes—sales taxes on equipment and supplies, capital taxes, business and franchise taxes—were applied to business whether they had profits or not. The general manufacturing sales tax of 12 per cent had no equivalent south of the border.

Mr. Brown commented:

> "The impact of these other taxes is, therefore, a "front-end load" on Canadian industry. This is particularly important in years of high capital investment, or the initial years of a new company. There is also this heavy burden of other taxes, basically of a fixed character unrelated to profits, which means that the Canadian tax system can be particularly harmful in loss years or years of low profits, and tends to accentuate the business cycle in Canada since the tax burden is particularly heavy when industry is not doing well." (I, 28:6)

Mr. Brown considered the Canadian tax structure as inefficient. After a detailed comparative study of the tax systems in Canada, United States and Northern Europe for one industry, he concluded that the Canadian system imposed more burdens on its industry than the tax systems of other countries. As to its effect on competitiveness, Mr. Brown said:

> "our tax system does not help and indeed hinders the aggregate level of productivity in Canada and tends to make our products have a more difficult time in world markets." (I, 28:14)

He concluded that the same revenue could be raised in Canada with greater emphasis on taxing profits and less emphasis on indirect taxes.

While it is difficult to obtain a precise estimate of the amount of sales taxes paid on intermediate goods, it appears that $750 to $1000 million of federal manufacturers sales tax is paid at this level. A small amount of provincial sales tax is also paid at this level. Thus the burden of these inefficient taxes constitutes about one fifth of the burden of the corporate income tax and for many industries may more than offset the benefits of the lower Canadian corporate tax described above. This additional burden increases the difficulties of Canadian firms in competing with U.S. and European firms which face no such tax.

Several witnesses suggested that this burden could be eliminated by switching to a value added tax (VAT). Mr. Walter Ward of Canadian General Electric pointed out that European tax policies assist manufacturers through their VAT procedure. They effectively subsidize exports since the value-added tax does not apply to exports thereby allowing the manufacturer to get a better export price. The VAT does apply to imported products, however, which helps to pay high social service costs and at the same time makes European manufacturers more competitive. Mr. Brown agreed that a VAT system would make Canadian industry more competitive both at home and abroad. While he noted that it might shift a larger percentage of the sales tax burden directly to the consumer, he underlined the VAT's positive effect of exempting industry from all sales tax costs on inputs of production.

While the VAT system has many attractions, the Committee recognizes that the introduction of such a system would be very difficult in Canada where the sales tax field is shared between provincial and federal governments.

Therefore, even if the VAT does not appear to be a practicable way to deal with the problem of taxation of producers' goods at the present time, the Committee considers it important to find some solution to this problem in order to improve Canadian competitiveness. Several possibilities have been suggested. The exemption from manufacturers and provincial sales taxes of a broad range of producers' goods would certainly alleviate, though not eliminate this problem. This method would

cause a minimum amount of administrative problems under existing tax structures, but could involve a significant revenue loss. A second method would be to rebate to producers the sales tax which has been levied on inputs which they purchase. While this solution is administratively more difficult than the first, it would probably provide the maximum of benefit to producers with a minimum of loss of revenue. Since proposals recently advanced by the Minister of Finance for the replacement of the manufacturers sales tax with a wholesale tax are to be re-examined, the Committee recommends that the above proposals or other methods designed to reduce the "front-end load" tax on producers be given urgent consideration.

Statistical Appendix

TABLE 1

CANADIAN TRADE BALANCE WITH UNITED STATES BY MAIN CATEGORIES, 1965-1977

(millions of dollars)

		1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
Live Animals, Food, Feed, Beverages and Tobacco	Exports	488	507	476	549	620	689	672	757	979	918	952	1069	1290
	Imports	385	414	450	469	526	516	540	655	992	1241	1320	1553	1705
	Trade Balance	103	93	26	80	94	173	132	102	87	-323	-368	-484	-415
Crude Materials	Exports	1,019	1,130	1,192	1,378	1,379	1633	1740	2008	2735	5062	5248	5363	5476
	Imports	491	506	512	536	452	535	578	644	780	1078	1432	1407	1788
	Trade Balance	528	624	680	842	927	1098	1162	1364	1955	3984	3816	3956	3688
Fabricated Materials, Inedible	Exports	2,533	2,806	2,871	3,403	3,642	3672	4013	4759	5695	7250	6690	8527	10964
	Imports	1,350	1,482	1,495	1,581	1,912	1915	1981	2233	2824	4209	4044	4394	4968
	Trade Balance	1,183	1,324	1,376	1,822	1,730	1757	2032	2526	2871	3041	2646	4133	5996
End Products	Exports	969	1,769	2,771	3,864	4,943	4987	5571	6354	7158	8235	8881	10738	13103
	Imports	3,578	4,452	5,329	6,244	7,207	6832	7730	9193	11714	14597	16496	17944	20782
	Trade Balance	-2,609	-2,683	-2,558	-2,380	-2,264	-1845	-2159	-2839	-4556	-6362	-7615	-7206	-7679
Special Transaction Trade	Exports	24	23	23	37	31	27	26	43	40	72	63	100	59
	Imports	241	281	236	220	148	119	120	151	192	232	266	364	299
	Trade Balance	-271	-258	-213	-183	-117	-92	-94	-108	-152	-160	-203	-264	-240
Total Trade with U.S.	Exports	5,033	6,235	7,333	9,230	10,614	10987	12023	13922	17129	21433	21870	25953	30893
	Imports	6,045	7,136	8,022	9,048	10,243	9917	10949	12878	16502	21357	23559	25662	29543
	Trade Balance	-1,012	-901	-689	182	371	1070	1074	1044	627	76	-1689	291	1350

Source: Statistics Canada Trade Data, May 1978.

Table 2

Canadian Trade in Energy with the United States

	1974		1977	
	Quantity	Value	Quantity	Value
		($ millions)		($ millions)
Crude Petroleum (10^6 bbls)				
Exports to U.S.	332.2	3,407	120.9	1,752
Imports from U.S.	—	—	19.6	284
Net Exports	332.2	3,407	101.3	1,468
Natural Gas (tcf)				
Exports to U.S.	959.0	494	993.8	2,028
Imports from U.S.	13.3	6	—	—
Net Exports	945.7	488	993.8	2,028
Coal (10^6 tons)				
Exports to U.S.	0.7	20	0.2	11
Imports from U.S.	14.4	344	15.6	652
Net Imports	13.7	324	15.4	641
Electricity (10^9 kWh)				
Exports to U.S.	15.4	175	16.7	377
Imports from U.S.	13.0	170	1.2	15
Net Exports	2.4	5	15.7	362
TOTALS OF ABOVE				
EXPORTS		4,095		4,168
IMPORTS		519		951
EXPORT BALANCE		3,575		3,217
Miscellaneous				
Liquified Petroleum Gases				
Refined Products and				
Radioactive Ores — Net Exports		308		509
TOTAL ENERGY EXPORT BALANCE		3,883		3,726

Compiled by Department of Energy, Mines and Resources, July, 1978

Appendix 2

NON-TARIFF MEASURES NOTIFIED BY THE UNITED STATES AND CANADA AGAINST EACH OTHER

United States Notifications vis-à-vis Canada

I Government Participation in Trade

Category: Government aids, procurement, monopoly practices, etc.

1. Subsidies to film producers
2. Domestic subsidies to stimulate exports (Michelin)
3. Monopolies operated by Canadian Provincial Liquor Boards
4. Government procurement including provinces.

II Customs and Administrative Entry Procedure

Category: Valuation procedures

1. Arbitrary valuation and surtax

III Standards Involving Imports and Domestic Goods

Category: Requirements Concerning Marketing; Industrial Standards

1. Imports permitted only in can sizes established by the Canadian Government
2. Canadian Standards Association for Electrical Equipment

IV Specific Limitations

Category: Screen time quotas and other mixing regulations; embargoes and other restrictions of similar effect

1. Restrictions on trade in recorded television programmes
2. Prohibitions, with exceptions, on imports of used aircraft and automobiles
3. Quotas on imported footwear

Canadian Notifications vis-à-vis United States

I Government Participation in Trade

Category: Government Aids, Countervailing duties; Restrictive practices tolerated by governments

1. Concessional Export Financing
2. Western hemisphere trading corporations

3. Domestic International Sales Corporation (DISC)
4. Countervailing duties
5. Activity by United States labour unions to restrict imports
6. Multinational corporations

II Customs and Administrative Entry Procedure

Category: Anti-dumping and valuation

1. Anti-dumping
2. American Selling Price
3. "Final list" valuation

Category: Customs classifications; Consular formalities and documentation

1. Special valuations
2. Uncertainty of TSUS classification
3. Customs Invoice Form 5515
4. Delays in customs services
5. Ports of entry for furs and fur products

III Standards Involving Imports and Domestic Goods

Category: Industrial standards; health and safety standards

1. Standards (plumbing and heating equipment, lumber, fire fighting equipment and electrical equipment)
2. Coast Guard inspection of safety equipment for use on United States Flag vessels

Category: Health and safety standards; requirements concerning marketing

1. Consumer product Safety Act
2. Fair Packing and Labelling Act, 1966
3. Marks of origin

IV Specific Limitations

Category: Embargoes and other restrictions of similar effect; quantitive restrictions

1. De facto prohibitions on imports of:
   - foreign-built dredges and other work vessels for use in United States territorial waters
   - foreign-built air-cushioned vehicles for use in coast-wide trade over water
   - containers of foreign manufacture on United States flag vessels
   - denatured industrial alcohol
2. Quotas on cotton textiles, butter substitutes, milk powder
3. Restrictions on use of imported nuclear materials
4. Copyright legislation "manufacturing clause"

V Charges on Imports

Category: Border tax adjustments

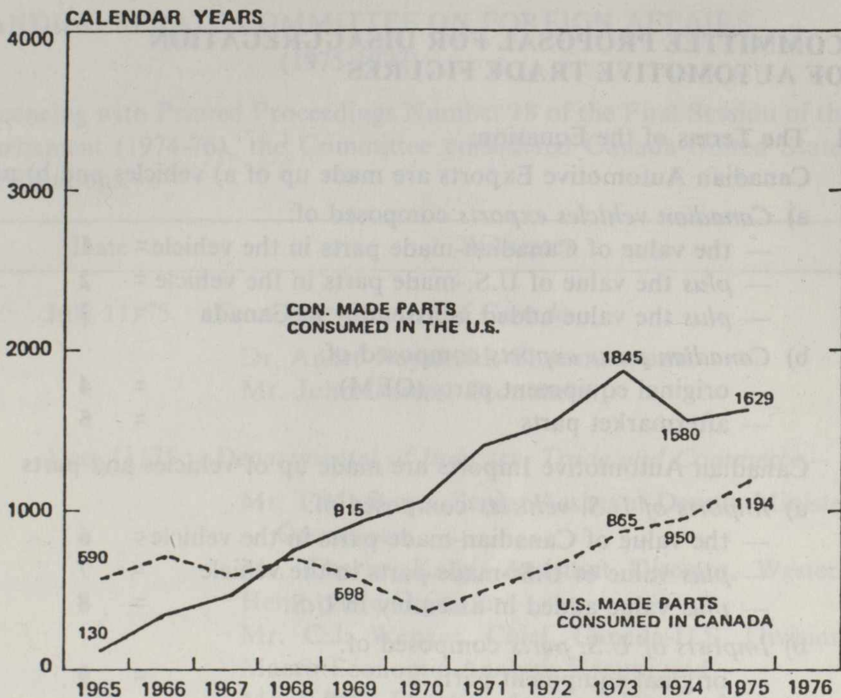
1. Excise Tax System
2. Measurement of alcoholic content of spirits
3. Escape clause tariff action

Source: Extracts from the Inventory of Non-Tariff Measures General Agreement on Tariff and Trade (GATT), Revised as of January 1974.

Appendix 3

NET AUTOMOTIVE PARTS
FOR ORIGINAL EQUIPMENT VEHICLE PRODUCTION

CANADA/U.S.A. TRADE
(NET OF PARTS USED IN VEHICLE EXPORTS/IMPORTS)
(MILLIONS OF DOLLARS)



SURPLUS/(DEFICIT)

	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
• GROSS O.E. TRADE	(534)	(700)	(808)	(1050)	(1109)	(643)	(607)	(970)	(1234)	(1584)	(2104)	N/A
ADJUSTMENTS:												
IMPORTS RE-EXPORTED	75	338	687	1085	1458	1359	1556	1924	2305	2324	2683	N/A
EXPORTS RE-IMPORTED	(1)	(5)	(15)	(24)	(32)	(41)	(57)	(67)	(91)	(110)	(144)	N/A
• NET O.E. TRADE	(460)	(367)	(136)	11	317	675	892	887	980	630	435	N/A

SOURCE: FORD OF CANADA ESTIMATE

Appendix 4

COMMITTEE PROPOSAL FOR DISAGGREGATION OF AUTOMOTIVE TRADE FIGURES

I The Terms of the Equation:

Canadian Automotive Exports are made up of a) vehicles and b) parts

a) *Canadian vehicles exports* composed of:

— the value of Canadian-made parts in the vehicle = **1**
— *plus* the value of U.S.-made parts in the vehicle = **2**
— *plus* the value added in assembly in Canada = **3**

b) *Canadian parts exports* composed of:

— original equipment parts (OEM) = **4**
— aftermarket parts = **5**

Canadian Automotive Imports are made up of vehicles and parts

a) *Imports of U.S. vehicles* composed of:

— the value of Canadian-made parts in the vehicle = **6**
— *plus* value of U.S.-made parts in the vehicle = **7**
— *plus* value added in assembly in U.S. = **8**

b) *Imports of U.S. parts* composed of:

— original equipment parts = **9**
— aftermarket parts = **10**

II The Calculations:

A *To show the net value of original equipment parts (OEM):*

Exports = **4** – **6** + **1**

Imports = **9** – **2** + **7**

Trade Balance = (**4** – **6** + **1**) – (**9** – **2** + **7**)

Mr. Bennett estimated that (**4** – **6**) – (**9** – **2**) = $435 million

Industry, Trade & Commerce estimated that **1** = approx. $350 million

and **7** = approx. $2400 million

Therefore 1975 OEM parts trade balance would be $435 m + $350 m – $2400 m = $1615 million *deficit* in parts

B *To show the amount of new Canadian value-added in assembly operations (vehicles):*

Exports **3** less Imports **8** = no figures available

Trade balance in vehicles = **3** – **8**

Appendix 5

STANDING SENATE COMMITTEE ON FOREIGN AFFAIRS
(1975-1977)

Note: Commencing with Printed Proceedings Number 18 of the First Session of the 30 Parliament (1974-76), the Committee considered Canada-United States Trade Relations.

Issue No.	Date	Witnesses
18	July 11/75	*Economic Council of Canada—* Dr. André Raynauld, Chairman; and Mr. John Downs, Economist.
19	Dec. 11/75	*Departmental of Industry, Trade and Commerce—* Mr. T.M. Burns, Senior Assistant Deputy Minister — Operations; Mr. Charles Kelly, Assistant Director, Western Hemisphere Division; Mr. C.J. Wenaas, Chief, Canada-U.S. Division, Macro-Economic Analysis Group; and Mr. T.R.G. Fletcher, Assistant Deputy Minister — Tourism.
20	Dec. 18/75	Mr. E.B. Carty, Senior Adviers, Balance of Payments, Statistics Canada; and Mr. M.G. Kelly, Chief, Balance of Payments, International Division, Department of Finance.
21	Dec. 2/75 Dec. 9/75 Dec. 16/75	Report of Committee on First Phase of Study — entitled CANADA — UNITED STATES RELATIONS "Volume I — The Institutional Framework for the Relationship."
22	Feb. 10/76	*Department of Industry, Trade and Commerce—* Mr. T.M. Burns, Senior Assistant Deputy Minister — Operations; Mrs. Eileen A. Mahoney, GATT Division, Office of General Relations; Mr. Carl J. Wenaas, Chief, Canada-U.S. Division, Macro-Economic Analysis Group; and Mr. Charles J. Kelly, Assistant Director, U.S.A. Division, Western Hemisphere Bureau.

Issue No.	Date	Witnesses
23	Feb. 24/76	*Department of Industry, Trade and Commerce*— Mr. T.M. Burns, Senior Assistant Deputy Minister — Operations; Mrs. Eileen A. Mahoney, GATT Division, Office of General Relations; Mr. James Taylor, General Director, Western Hemisphere Branch; and Mr. Carl J. Wenaas, Chief, Canada-U.S. Division, Macro-Economic Analysis Group.
24	Feb. 26/76	*Department of Industry, Trade and Commerce*— Mr. T.M. Burns, Senior Assistant Deputy Minister — Operations; and Mr. C. Douglas Arthur, Special Adviser (Automotive), Trade Policy and Planning Group.
25	Mar. 9/76 Mar. 11/76	*
26	Mar. 16/76	Dr. E.P. Neufeld, Director, International Finance Division, Department of Finance.
27	Mar. 18/76	*Department of Industry, Trade and Commerce*— Mr. T.M. Burns, Senior Assistant Deputy Minister — Operations; Mr. C.J. Kelly, Assistant Director, Western Hemisphere Bureau; Mr. G. Elliot, Acting Director, General Trade Policy Branch; and Mr. John Donaghy, Chief of the GATT Division.
28	Mar. 23/76	Mr. R.D. Brown, Senior Tax Partner, Price Waterhouse & Co., Toronto, Ontario.
29	Mar. 25/76	Mr. Carl Beigie from the C.D. Howe Research Institute, Montreal, Quebec.
30	Apr. 6/76	*Department of Industry, Trade and Commerce*— Mr. F.T. Jackman, General Director, Office of International Projects; Mr. William Grant, Director, Defence Programs; and Mr. O.W. Bennett, Chief, Market Research and Administration Division.

Issue No.	Date	Witnesses
31	Apr. 8/76	Mr. Patrick J. Lavelle, President, Automotive Parts Manufacturers' Association of Canada, Toronto, Ontario.
32	Apr. 29/76	*Department of Industry, Trade and Commerce—* Mr. T.M. Burns, Senior Assistant Deputy Minister — Operations; and Mr. C.D. Arthur, Special Advisor (Automotive), Trade Policy and Planning Group.
33	May 11/76	Mr. J.M. McAvity, President, Canadian Export Association, Montreal, Quebec.
34	May 13/76 May 18/76	*
35	May 25/76	Mr. David Culver, President and Chief Executive Officer, Aluminum Company of Canada, Ltd., Montreal, Quebec.
36	May 27/76	Mr. Alfred Powis, President of the Mining Association of Canada, Toronto, Ontario; and also President and Chief Executive Officer, Noranda Mines Limited; and Mr. Keith C. Hendrick, President, Noranda Sales Corporation Ltd.
37	June 8/76 June 22/76	*
38	June 10/76	*Canadian General Electric Company Limited—* Mr. Walter Ward, Chairman of the Board and Chief Executive Officer, Peterborough, Ontario; and Mr. V.L. Clarke, Vice-President in charge of Strategic Planning, Toronto, Ontario.

*Note: Issues numbered 25, 34 and 37 dealt with matters not related to the study of Canda — United States Relations.

Issue No.	Date	Witnesses
1	Nov. 2/76	*Canadian Importers Association:* Mr. C.F. Sayers, President, Toronto, Ontario; and Mr. Keith G. Dixon, Executive Vice-President.
2	Nov. 4/76	Mr. R.D. Southern, President and Chief Executive Officer, ATCO Industries Ltd., Calgary, Alberta.
3	Nov. 16/76	*Northern Telecom Limited:* Mr. Robert C. Scrivener, Chairman and Chief Executive Officer, Montreal, Quebec; Mr. Walter F. Light, President; and Mr. Derek M. Davies, Vice-President — Marketing.
4	Nov. 18/76	*Canadian Manufacturers' Association:* Mr. Rod J. Bilodeau, President, Toronto, Ontario; Mr. Roy Phillips, Executive Director; and Mr. J. Laurent Thibault, Director of Communications and Economics.
5	Nov. 30/76	Mr. W. John Stenason, Executive Vice-President, Canadian Pacific Investments Ltd., Montreal, Quebec; and Mr. N.E. Wale, Research Department, Canadian Pacific Ltd.
6	Dec. 2/76	Mr. Ian A. Barclay, Chairman and Chief Executive Officer, British Columbia Forest Products Limited, Vancouver, British Columbia.
7	Dec. 14/76	*Ford Motor Company of Canada, Limited:* Mr. Roy Bennett, President and Chief Executive Officer, Oakville, Ontario; and Mr. W. Mitchell, Vice President, Finance.
8	Dec. 16/76	*The Steel Company of Canada, Limited (Stelco):* Mr. J.D. Allan, President, Toronto, Ontario; Mr. G.L. Waters, General Manager, Marketing and Commercial Planning; Mr. W.A. Darby, General Accountant — Taxation; and Mr. R.E. Heneault, Vice-President — Administration.

Issue No.	Date	Witnesses
8 (cont.)	Jan 27/77	*Atlas Steels:* Mr. Allan V. Orr, Vice-President and General Manager, Welland, Ontario; and Mr. Carl Ohlson, Vice-President — Marketing.
9	Jan. 27/77	*Canadian Association of Equipment Distributors:* Mr. J.S. Thorp, Executive Director, Ottawa, Ontario. *Dominion Road Machinery Co. Ltd.:* Mr. B. Sully, President; and Mr. J.C. Freeman, Vice-President — Finance. *Wajax Limited:* Mr. R.W. Chorlton, President; and Mr. R.G. Willox, Vice-President.
10	Feb. 8/77	Mr. William Mounfield, President, Massey-Ferguson Industries Ltd., Toronto, Ontario. Mr. R.W. Main, Vice-President — Administration, Massey-Ferguson Ltd.; and Mr. Robert Snelgrove, Vice-President and Legal Counsel Massey-Ferguson Industries Ltd.
Not printed (in camera)	Feb. 10/77	*Department of Consumer & Corporate Affairs—* Mr. David French, Bureau of Intellectual Property *Department of Industry, Trade & Commerce—* Mr. N.R. Cumming; and Mr. S.D. Berneche, both from the United States Division.
11	Feb. 22/77	*Canadian Chemical Producers Association—* Mr. A.J. Foote, Chairman of the Board, Ottawa, Ont.; Major-General Bruce Macdonald, President; and Mr. Chris Conradi, GATT co-ordinator for the Association *Polysar Limited—* Mr. Ian Rush, President and Chief Executive Officer; and Mr. Charles McKenzie, Vice-President — Chemicals

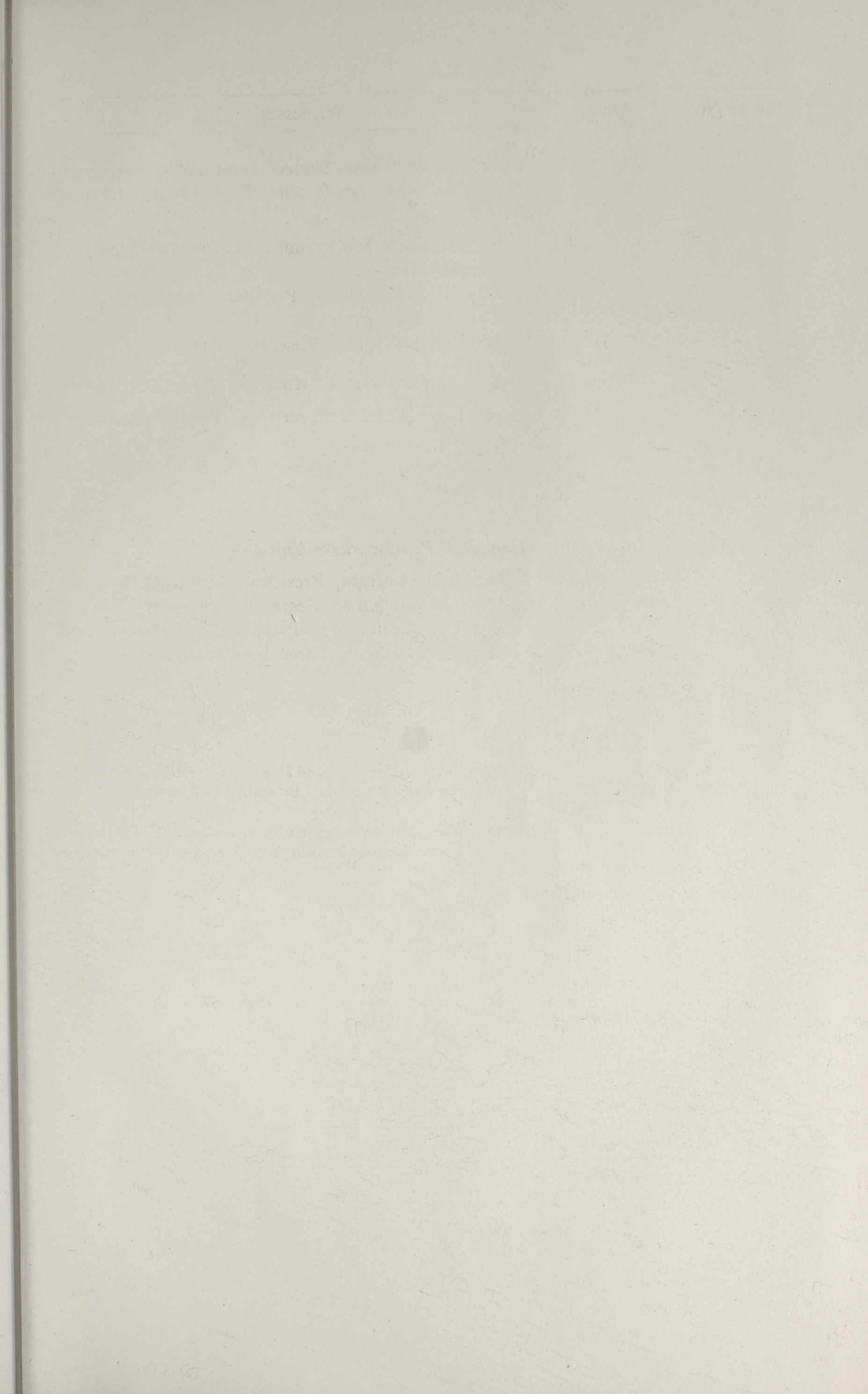
Issue No.	Date	Witnesses
11 (cont.)	Feb. 22/77	*Du Pont of Canada Ltd.*— Mr. Franklin McCarthy, President; Mr. J.H. Childs, Vice-President — Corporate Development; and Mr. A.D. Amery, Senior Economist.
12	Feb. 24/77	Professor Ray Vernon, Director of Centre of International Affairs, Harvard University, U.S.A.
13	Mar. 8/77	*Department of External Affairs*— The Hon. Donald C. Jamieson, Secretary of State for External Affairs; Mr. Peter Towe, Assistant Under-Secretary of State for External Affairs; and Mr. Patrick Reid, Director General, Bureau of Public Affairs.
14	Mar. 10/77	The Honourable Edward M. Lawson, National Director of Canadian Conference of Teamsters, International Vice-President of the Teamsters Union and the President of the British Columbia Joint Council of Teamsters.
15	Mar. 22/77	*Moore Corporation Limited*— Mr. David W. Barr, Chairman, Toronto, Ontario; and Mr. Donald S. Dunlop, Treasurer.
16	Mar. 24/77	Professor Lawrence Skeoch, Glenburnie, Ont.
17	Apr. 26/77	*Motor Vehicle Manufacturers Association of the United States, Inc.*— Mr. William D. Eberle, President and Chief Executive Officer, Washington, D.C.; and Mr. John V. Moller, Manager, International Affairs Department.
18	Apr. 28/77	*Science Council of Canada*— Mr. John Shepherd, Executive Director; and Mr. Mark Murphy, Researcher.
19	May 10/77	*Metric Commission — Canada*— Mr. C.M. Bolger, Chairman; and Mr. P.C. Boire, Executive Director.

Issue No.	Date	Witnesses
20	May 12/77	Professor Abraham Rotstein, Massey College, University of Toronto, Toronto, Ontario
21	May 24/77	*Travel Industry Association of Canada—* Mr. F.G. Brander, President & Chief Executive Officer, Ottawa, Ontario; Mr. Garth C. Campbell, Chairman; and Mr. R.K. Groome, a TIAC Director.
22	May 26/77	*Canadian Federation of Independent Business—* Mr. John F. Bulloch, President, Toronto, Ontario; and Mr. James R. Conrad, Director, Legislative Affairs.
23	June 7/77	*Department of Finance—* Mr. Alec Mac Pherson, Director International Economic Relations Division; and Mr. Lyle Russell, Assistant Director, Tariffs Division. *Department of National Revenue—* Mr. T.C. Greig, Assistant Deputy Minister, Customs Program Branch; Mr. A.T. Wickham, Director General, Assessment Directorate; and Mr. Earl Warren, Director General, Anti-Dumping Directorate. *Department of Supply and Services—* Mr. Craig Oliver, Director General, Supply Planning Sector.
24	June 9/77	*Michelin Tires (Canada) Ltd.—* Mr. A. Voya Peters, Vice-President, New York City, New York, U.S.A.
25	June 16/77	*

Issue No.	Date	Witnesses
26	July 5/77	*International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW)* Mr. Dennis McDermott, Canadian Director, Toronto, Ont. Mr. John Moynahan, President, Canadian UAW Council; and Mr. Samuel Gindin, Research Director. *United Steelworkers of America, AFL-CIO, CLC—* Mr. Lynn Williams, Secretary, Pittsburgh, Penn., U.S.A. Mr. Gordon Milling, Canadian Director of Research.
27	July 7/77	*Canadian Paperworkers Union—* Mr. L.H. Lorrain, President, Montreal, Quebec; Mr. J.M. Buchanan, Secretary Treasurer; Mr. T.H. Curley, Vice-President of Region 3; and Mr. F.J. Dunberry, Director of Research
28	Aug. 3/77	*

*Note: Issues numbered 25 and 28 dealt with matters not related to the study of Canada - United States Relations.

**Note: This appendix lists the witnesses who testified before the Committee together with the position they held at that time.



Issue No.	Date	Witnesses
[illegible]	July 5/72	*International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW)*—
		Mr. Dennis McDermott, Canadian Director, Toronto, Ont.;
		Mr. [illegible], President, Canadian UAW Council; and
		Mr. [illegible], Research Director.
		United Steelworkers of America, AFL-CIO, CLC—
		Mr. [illegible], Secretary, Pittsburgh, Penn., U.S.A.;
		Mr. [illegible], Canadian Director of Research.
22	July 7/72	*[illegible] Union*—
		Mr. J.H. Lorimer, President, Montreal, Quebec;
		Mr. J.G. Buchanan, Secretary-Treasurer;
		Mr. J.H. Curley, Vice-President of Region 3; and
		Mr. J.J. Dunberry, Director of Research.
29	Aug. 3/72	

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