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*by William S. Merkin**

Let me begin by saying that I have been out of Washington for two weeks, and when I left Clayton Yeutter had not shown up to talk to the staff on how he was going to run things. So the perspective I am giving is still the Bill Brock perspective. I assume it will still be the general thrust of U.S. trade policy, but I cannot say definitely that this is the way the new U.S. Trade Representative will think.

The United States perspective on enhanced free-trade can be summarized very succinctly—we support it. The U.S. Administration has traditionally felt that the reduction or elimination of trade barriers, whether bilaterally or multilaterally, will lead to greater economic growth, productivity and investment. And I see no reason to believe we are going to be changing that perspective.

What we do need to examine is what the best approach from both the U.S. side and the Canadian side is. How best do we do this on a bilateral perspective without affecting what we have built up over the years through the multilateral process?

An interesting way to approach this initially is to look at the work that we did as a result of the 1983 initiative coming out of the previous government in Ottawa. While it was sectoral in focus (the new government does not embrace that approach) it did give us an insight into a lot of the problems that we are going to have to face no matter what approach we take. There were four work groups established as a result of that 1983 initiative. And while the work has not been moving frantically since the elections last year, we have gotten to the point of identifying many of the problems. I will briefly discuss the four groups and what we found were some of the barriers—and they were not just trade barriers that we found.

Probably the one that was least controversial from our perspective was in the agricultural machinery, implements, and inputs area. There we have essentially had free-trade between the two countries for years; not as a result of any bilateral agreement but from reductions which one side or the other has made over the years. Most recently the United

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States in the Tokyo Round agreed to major elimination of tariffs on a whole range of agricultural equipment.

What has happened, however, is that the customs services in both the United States and Canada have found ingenious ways to define a product as not agricultural. There are provisions, for example, which state something has to be an "active piece of machinery" to be classified as equipment. Something like flooring or siding on a barn, because it is not active, is a "passive piece of equipment." The custom services on one side of the border or the other say it is not equipment and should not come in under the "no tariff" provision. So it gets throw into a miscellaneous manufacture's area, where it may have a 9%-12% tariff, even though it is going to the farm. And the purpose for reducing our tariffs in these areas, to improve the efficiencies of our farming sector, is frustrated.

We were able to define a whole number of these types of products and it is amazing how many there actually were. It was interesting just trying to talk to some of these customs officials. But, even though we had not gone through all our formal consultations, there was pretty strong feeling on both sides of the border that we had a basis for an agreement.

The first stumbling block which you will see throughout the sectoral approach is: What about the GATT? What does the GATT say about all of this? It is one thing to talk about reducing tariffs and giving to everybody most-favored-nation treatment, which is embodied in the GATT. But we are talking bilaterally here, and the GATT basically was set up to provide that concessions given to one country should be provided to others.

Now, there are exceptions. There is Article XXIV of the GATT, which allows free-trade areas. There are about forty of these that have been recognized under the GATT, ranging in trade coverage from as small as 9% up to 90%. The GATT states they should cover substantially all trade. This is not defined— though agricultural equipment is not going to cover substantially all the trade between the United States and Canada.

Article XXV of the GATT is basically a waiver provision, where the GATT contracting parties agree to allow a violation of the GATT. That is what was done with the AutoPact twenty years ago. And we have heard in no uncertain terms from our trading partners in Europe and in Japan that if we go to the GATT for a waiver for a bilateral deal with Canada there would be blood all over the floor in Geneva.

We saw, then, in this one sector where there was not necessarily any bilateral controversy that we had serious problems on the sectoral approach. We did have the option of giving MFN treatment, of reducing tariffs on both sides of the border for everybody. That may still be a possibility in this sector, but it opens up a lot of criticism in Congress.

The next sector we looked at was steel, which was obviously more to the Canadians' interest; and there was a whole range of problems. There are tariffs, but those are not the major impediments. The significant impediments on the U.S. side are "Buy American" restrictions which reach down to the state level. Obviously, the Canadian government was interested in us doing away with "Buy American" provisions. We could do that bilaterally, by doing it on a conditional MFN basis. That is, we would open up our procurement market if others willingly gave us equal treatment. That is what we have done with the Japanese in the NTT Agreement, and that is what one would presume we could do if we wanted to open up our steel.

We came, however, into a tricky question—the political implications of all this. If we are only opening up procurement for the steel sector, where is the support in the United States for that effort? The U.S. steel industry is not basically a free-trade sector. (In fact, while we were examining this whole concept with steel, others were working very hard at another end of our building to get global restrictions in place. Those are now in place, with the exception of Canada.) We needed to expand the review of the procurement sector in order to see if anyone would be in support of opening up the procurement. There was not that big of a market in Canada if we kept it just to steel. In the eyes of our steel industry, however, a completely reciprocal deal would not be supported.

We began to examine these issues in a much broader context and came up with an even worse problem—the disparity in the size of our procurement markets. We know that the U.S. market is ten times the size of Canada. But when you start looking at the Federal procurement market, it is 20 to 1. So there is a separate problem here: how do we deal with our Congress, since they are the ones that ultimately are going to approve whatever agreements we enter into?

We then looked into the informatics sector. It took us about three months to figure out what we were talking about. We came up with a very broad definition that looked at computers, computer parts, telecommunications, and all the connected services. On the goods side there were some of the same questions: procurement policies, tariffs, standards etc. But with services, especially information flow and data exchange, privacy questions enter the picture. There are questions of national security and questions of extra-territoriality. We found that as you broaden the subject area to more than just goods—into the service area—you are getting into difficult, politically sensitive issues that have never been addressed.

Throughout this period we began to hear from other sectors. On the United States side, we heard from the furniture industry, the alcoholic beverages industry, and the paper industry. On the Canadian side, Ottawa was hearing from the petrochemical industry, the beef industry, and the non-ferrous metal industry. Again we ran into serious problems:

how to sell a package where, on one side of the border or the other, there is a perception that there is going to be a winner and a loser.

The furniture industry, for example, has been lobbying as hard as any industry in the United States for either sectoral or comprehensive trade agreements. They do not care what it is called so long as the end result is that Canadian tariffs are brought down to the U.S. level or lower. Obviously, on the Canadian side of the border the furniture industry is absolutely not interested in such agreements. The real difficulty to a sectoral approach is how to get a balance within a sector. One thing that was made very clear from Ottawa: they cannot trade one sector for another. Politically, that would be suicide.

Next the government proposed something called the Trade Enhancement Agreement. This was a framework agreement that set out objectives of voiding protectionism and attempting to reduce barriers over the years. The problem was: this sounded great, but there was no substance to it. By the time one negotiated an agreement, took the time to fight over the language and get the Congress to sign it, there was no change in the trading relationship. That kind of political capital should be spent in real negotiation involving the trade barriers.

We looked at the functional approach also, which has come out of the new discussion paper of the Canadian government. We looked at procurement. One could look at other functional areas such as contingency protectionism (*e.g.* the footwear industry cannot get shoes into Canada because global quotas have been in effect for about seven years). There is nothing illegal about this. These actions are called for in the GATT. There are provisions in the GATT for taking temporary safeguard actions—if seven years is temporary. There are provisions in the GATT for dealing with subsidies and dumping of goods. I do not see these as major problems. I think it would be a major problem if there was an effort made to try to water down those provisions. The U.S. Congress is not prepared to see any such weakening.

Where does this take us? It leaves us the comprehensive option. And, to a trade negotiator in the U.S. government who feels that barriers around the world should come down, this sounds like a good idea. But, we are going to run into some of the same problems that we ran into with the other approaches. There is still going to be opposition from particular sectors. There are going to be the problems of non-tariff barriers. We are going to have to deal with the perception, if not the fact, of contingency protectionism. And, we are going to have to deal with the states and provinces.

There are a lot of procurement restrictions at the state level and the provinces discriminate on procurement practices. We are talking about ten provinces and fifty states. Are we going to get everyone to sign up or do we try to invoke the Constitutional privileges of the Federal government over the States? This Administration is not going to go in that direction.

Then, there is the question of investment. There is concern in Canada about losing investment. We also have a concern in the United States about not being able to invest in Canada when U.S. businesses want to. There is the question of changing ownership. If we look at energy and energy related products, there is the question of pricing feed stock. There are some real tricky questions out there and I am hoping that this conference will help solve some of them.

What is the Congressional part in these problems? It may not be understood well in some places in Canada that on trade policy the U.S. Administration is at the mercy of the U.S. Congress. It is in our Constitution. The ability to control our trade policy rests with the U.S. Congress. From time to time it delegates to the Administration the ability to negotiate reductions in U.S. trade barriers, such as the Tokyo Round. But essentially anything that is as broad as a trade enhancement agreement, or a free-trade area, is going to have to be approved by the Congress.

The frustration with the Japanese is starting to erode the strength that the Administration had in some quarters of the Congress with a group of free-traders. Traditional supporters of trade liberalization are now becoming real hawks. The view is now focused on the Japanese, but people already are looking at the U.S.-Canada trade deficit. It is over $20 billion already. And there is a coalition now forming in Congress, because of the lumber issue, which is out to stop it—whether through a restrictive bill placing quotas on Canadian imports of lumber or by blocking any bill that will be of benefit to Canada.

It is there and it is growing, and we are going to have a real problem when the day comes that we want to go and say "Hey, we want to talk about free-trade with Canada." Those people that are fed up with the system, whether it is over Japan, the EEC, the developing world or with Canada, are going to have to be convinced that there is political capital in it for them. That is, we have to make sure that those in the United States private sector that support freer trade around the world, not just bilaterally, make that view known. The message I am getting is: do not count on overwhelming support.

It was interesting that Mr. Macdonald said events were moving quickly and that we have shifted from the sectoral approach to something more comprehensive. From somebody that has been sitting in the trenches for a couple of years, I think that events have been moving pretty slowly. We still do not have a firm decision out of Ottawa as to which way they want to go, if at all. There is some great language in the Trade Declaration which came from the Quebec Summit, but it still is not a total commitment. This is especially so under our political system, where we have to bring Congress into the game. My personal plea is that the sooner we get going on the nitty-gritty and get into the negotiations and show Congress that there is something happening—that there is support for this—the sooner we can turn around this negativism developing in the Congress.

My basic point, from the U.S. perspective, is that we support freer trade—whether it is with Canada, or with Europe or with Japan; or whether it is through a new GATT Round. I think the point which is important is that we have to move. Standing still will drag us all down eventually. I think a bilateral approach with Canada has great merit on its own right, but beyond that I think it will push other countries in the multilateral process to join with Canada and the United States in liberalizing trade around the world.

Thank you.