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Good fences make good neighbors, Robert Frost teaches us. A month after Prime Minister Mulroney and President Reagan adopted a Declaration on Trade at their Quebec meeting, it is timely to offer a view from the Canadian side of the fence concerning the opportunities and options that lie before us for changing the way the bilateral trading relationship is conducted.

When this Conference was organized, the theme of sectoral integration, and negotiations that lead in that direction, was a well chosen topic for serious public discussion. It still is. Indeed, it is the sectoral approach and the positive response it engendered on both sides which has been the launch pad for a broader and more profound examination of new approaches to govern this most important trading relationship.

In January, the Canadian government published *How to Secure and Enhance Canadian Access to Export Markets: A Discussion Paper*, as the basis for extensive public consultations covering both a new round of multilateral trade negotiations and options for Canada-U.S. trade inclusive of the sectoral approach. The work program and timetables for action established by the Quebec Declaration, and the outcome of consultations on the Discussion Paper, will lead to important decisions in the months ahead. Conferences such as the present one can make a valuable contribution to public debate.

In Canada, serious discussion of trade policy starts with some fundamental factors which, for us, are as enduring as the cold weather which sweeps from the north every year to make headlines on American news. These factors govern our view of the trading world and define our options. The first factor is the size of our home market, 25 million people, that is by far the smallest of all the major industrialized trading countries. Our three principal trading partners: the U.S., the European Community and Japan, have domestic markets of roughly 240, 330 and 100 million or more.

In North American terms, the Canadian market has been, throughout most of its history, one tenth of the U.S. market. For example, in 1911, the last time an agreement providing for the elimination of bilateral

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trade barriers was publicly debated in Canada, our population was some 9 million compared to 90 million in the United States. What this small market means is that for Canada, in contrast to the United States, the options of looking inward for our prosperity or working for a consumer led recovery to lead us out of recessions, are luxuries denied. In the words of the Canadian Government's Trade Policy Review of 1983: "Canada's population will remain too small, and its industrial productive capacity too specialized, to permit a significant reduction in foreign trading activity without severely reducing the Canadian standard of living."

If the smallness of the market relative to the U.S. has been an enduring fact of life, the rapid growth of the share of trade in the national income has brought home to Canadians how important open markets are to production and employment. A few years ago, trade accounted for under 20% of national income; it now approaches one third of the total. This compares with 10% for the U.S. and 15% for Japan.

Every indication, in a world of rapidly changing competitive pressures and comparative advantage, points to a continually rising trend in the share of trade in our national income. There is hardly a sector or region of the country that does not depend upon a strong trade performance for growth and employment. These face major disruption when our competitive edge sags, or markets are restricted or closed. Some three million jobs, more than a quarter of the Canadian work force, depend upon trade. The Economic Council of Canada has calculated that every billion dollars of exports translates into nearly 16,000 jobs.

Canada is, of course, not the only country with a small domestic market and a high dependence upon exports. Economies such as the Netherlands and Norway have smaller markets and reach considerably higher figures of trade dependence. Among larger countries, West Germany's trade dependence at some 32% exceeds that of Canada. However, these countries enjoy relatively unfettered access to export markets either through membership in the European Community or by means of trade agreements with it.

A second factor is the composition of Canadian trade. Economic students of a previous generation broke their teeth on Harold Innis' seminal studies of the fur trade in Canada. Aspiring trade policy officers of 15 to 20 years ago came to grips and attempted to master trade and trade policies in wheat, forest products, metals and minerals.

In the 1980's, Canada retains comparative advantage in world markets for resource based products at various stages of processing. However, world market prospects for resource products are for slow growth with over-capacity and new competition. For example, in agriculture the pursuit of self-sufficiency policies in major importing countries, the entry of new exporters, and the shortages of foreign exchange in developing and centrally-planned economies, may continue to have a dampening effect on world market prospects. In metals and minerals, Canadian producers are, on the one hand, frequently competing against new materials and products. On the other hand they are confronted by competition from developing countries which often have lower costs, receive development assistance and, in some cases, enjoy preferential access to developed country markets. While the Canadian resource endowment retains the potential to provide a solid basis for prosperity in the future, it is no longer the automatic meal ticket that it once appeared to be.

The final factor to underline, in presenting the view from the Canadian side of the fence, is the shift in Canada's export picture in terms of market concentration and market opportunities. The United States has become overwhelmingly our most important export market—almost 75% of total sales. Canadian exports to the U.S., including those under the AutoPact, are fourteen times our exports to our next most important market. The growth in the U.S. market for Canadian exports in 1984 was more than the total of our exports to Europe and Japan. Virtually the whole breadth and range of Canadian production, in all regions of Canada, are involved in exports to the U.S.

We are, at the same time, the U.S.'s most important market, accounting for 20% of U.S. exports. In 1983 U.S. exports to Canada were (Can)$66.3 billion, more than Japan at $55 billion and four times as much as U.S. exports to Germany and the U.K. While Canadian exports to the U.S. have been rapidly rising, there has been a steady decline in our traditional markets in Western Europe. In the early 1960's, Western Europe accounted for 25% of our total exports, concentrated in the agricultural and primary resource industries area. This figure has declined to 8%, and slow economic growth in Europe suggests that this region offers only modest potential.

New markets in Asia and the Pacific have opened for Canada. This region has the fastest economic growth rate in the world and now represents Canada's most rapidly growing export market, second to the U.S. Whatever bilateral options may be adopted in Canada-U.S. trade, the government will attach high priority to the Pacific Rim. Canada, like the U.S., faces the challenge of increasing its competitiveness if the immense opportunities of the Pacific are to be exploited.

It is these considerations which lead Canadians to a continuous preoccupation with the country's trade performance and with devising the best mix of policies and bilateral and multilateral trade relationships to improve that performance. Throughout the course of our history, this preoccupation has led us time and time again to a hard look at our trading relationship with the United States. The proximity, the depth and breadth of our bilateral trade, and the sheer volumes of the cross-border trade, required us to have that trading relationship be the first order of business for Canadian trade policy.

In each of the seven rounds of mutilateral trade negotiations since the General Agreement on Tariffs and Trade was established thirty-eight years ago, the Canada-U.S. dimension has been the largest and the most critical part of the negotiations for Canada. Over this period, both countries have concentrated their efforts on constructing, improving, and shoring up the multilateral trading system. What is new is a disposition to consider whether a bilateral agreement which goes beyond the obligations exchanged in the GATT would serve our mutual interests and can be negotiated in a reasonable time.

When the present Canadian government came to office last September, one of its first decisions was to engage in a broad and intensive series of public consultations on a range of issues including Canadian trade. In its Economic and Fiscal Statement last November, the government undertook to "examine . . . in close consultation with the provinces and the private sector all avenues to secure and enhance market access." The result of that commitment was the Discussion Paper mentioned above.

The preeminent theme of the paper is security of access to world markets. One reason for the choice of such a theme is the success of seven rounds of multilateral trade negotiations. Indeed, tariffs have been reduced to a level where—compared to rapid and unpredictable changes in exchange rates—they are no longer the significant barrier to trade that they were even ten to fifteen years ago. In 1987, when the last of the Tokyo Round of tariff cuts are made, over 80% of Canadian exports to the United States and 65% of U.S. exports to Canada will be free of customs duty. However, Canadian producers of petrochemicals will still face high rates of 15% in the United States and American exporters face significant tariff obstacles in rubber and footwear in Canada. While a bilateral agenda, focused on tariffs alone, would present a challenging task for negotiators, it is clear that there would be little enthusiasm on either side for such an exclusive course of action.

A second and more important reason is the vulnerability of Canadian exports—and the production and employment which depend upon them—to protectionist forces of growing magnitude and effectiveness. There is a proliferating range of non-tariff barriers to trade, an imposing battery of contingency protection remedies, and an increasingly aggressive, sometimes whimsical, involvement of Congress in changing unilaterally the conditions of access to the U.S. market. These protectionist pressures, whether fueled by trade deficits or difficult bilateral relationships with other countries, jeopardize the accomplishments of the past and have led our governments to consider anew their options.

It is an axiom of trade policy that you either go forward or backward. Inertia is no option. This axiom applies not only to trade in goods, where international disciplines embodied in the GATT exist, but also to areas such as services, where such rules have not been formulated or widely accepted in a contractually binding way. Against this background, the Discussion Paper sets out four options for consideration under the heading of Canada-U.S. trade relations.

One is to continue as we have in the past. The Canadian response to the protectionist threats of the last two to three years has been the invocation of Canadian rights under the GATT, combined with a coordinated and integrated effort designed to bring home to U.S. interests our mutual stake in maintaining market access. In one case, specialty steel, Canada availed itself of its GATT rights to take action against U.S. exports to Canada when the U.S., under its emergency safeguard legislation, imposed restrictions on Canadian exports. In other cases, notably the threat against carbon steel in 1984, Canadian efforts emphasized U.S. exports to Canada of coal and iron ore, and we are pleased that Canada has not been asked to accept voluntary export restraints.

The Discussion Paper observes that while there is clearly scope to step up these efforts and buttress them with an improved early warning system, the status quo in bilateral trade relations may not adequately serve Canadian economic interests with the U.S. in a tougher international environment.

A second approach would be to negotiate agreements limited to sectors or non-tariff trade measures. The scope of such arrangements would go beyond existing GATT rules and agreements in terms of secured and enhanced market access. Two agreements of the sectoral type already exist with the U.S.: The Canada-U.S. Defense Production Sharing Arrangement and the AutoPact. The former provides for virtually unrestricted trade in defense products; the latter provides for tariff-free trade for new automobiles and most original parts, subject on the Canadian side to certain production and value-added safeguards and a limitation of rights to duty-free access to designated importers.

The sector initiative, launched by Canada in 1983, was aimed at the careful examination of the scope for agreements in individual sectors. Four were identified initially for study: steel, urban transit equipment, agricultural inputs and equipment, and informatics. The motivation for the first three was improved and more secure access to the U.S. market: in the case of steel, to negotiate not only the removal of U.S. and Canadian tariffs but, more importantly from the Canadian perspective, a contractually binding exclusion from protectionist tariff increases or import quotas; in urban transit, to obtain the removal of "Buy American" preferences; and, in agricultural inputs and equipment, to extend the scope and enhance the security of existing tariff-free trade. A number of other sectors were proposed for examination but the concentration of attention throughout last year was upon these four.

In the non-tariff area, the Discussion Paper suggests that negotiations could specifically address government procurement or contingency protection measures such as emergency safeguards. For example, would it be possible to establish mutual exemptions from measures of general application aimed primarily at disruptive imports from third parties?

Any limited approach presents issues of balance and symmetry. Sectoral arrangements would need to be perceived by the industries of both countries as mutually advantageous. There would be no cross-sectoral tradeoffs, thus limiting the scope of the exercise and the negotiating parameters.

In the non-tariff area, an important question is how an appropriate balance of advantages could be struck between those industries which would benefit from such arrangements and those which would face increased import competition. An important question is whether sufficient political and private sector support could be mustered for individual agreements on a step-by-step basis, or whether a comprehensive approach would better ensure positive results.

Another relevant consideration is an examination of the limited arrangements in the GATT. The most-favored-nation (MFN) obligation of the GATT requires members of the organization to extend the same conditions of access, with respect to duties and non-tariff barriers, to all members of the organization. It is unlikely that limited arrangements in any great number could be negotiated which could be so extended to all GATT members or otherwise made compatible with the GATT. The Discussion Paper makes clear that the GATT is the cornerstone of Canadian trade policy and any bilateral arrangements would need to be brought into conformity with it.

A third approach would be to negotiate a comprehensive arrangement. A comprehensive agreement which provided for the removal of tariffs and non-tariff barriers on substantially all bilateral trade would conform with the GATT requirements. Implementation would require Congressional and Parliamentary approval of the agreement and action to implement the changes in existing legislation ensuing from the arrangement.

This would be a challenging and complex agenda, requiring consideration of the scope for the removal of tariff and non-tariff barriers according to a multi-year schedule on substantially all the trade between Canada and the United States. Among the approaches for Canada-U.S. arrangements outlined in the Discussion Paper, only the comprehensive approach would induce substantial structural adjustment in the Canadian economy—as firms adapted to economies of scale and specialization, to increased production, and to more intense competition from imports.

If it were decided to initiate negotiations for a comprehensive agreement, there would exist considerable flexibility on several issues: the nature and the duration of the transitional period for the removal of trade barriers; the exclusion of certain product categories; contingency protection; the question of domestic subsidization; and the treatment of trade restrictions maintained by provinces and states. In addition, it would be open to Canada and the U.S. to negotiate provisions on matters which do not themselves fall under the GATT, for example, trade in services or rules relating to investment.

An important question would be the manner in which the agreement would be managed. In particular, the principles and procedures for the resolution of disputes on matters covered by the agreement would need to be carefully stipulated, bearing in mind the disparity in the relative bargaining weights of Canada and the U.S.

A comprehensive approach would affect only the barriers maintained on Canada-U.S. trade. It would leave untouched the respective trade barriers maintained against third countries. It would not provide for the free flow of capital and labor as in a common market. Nor would an arrangement necessarily entail changes in other policies which affect trade, such as monetary policies, taxation, labor, regional development, investment or competition. It could, however, accentuate the pressure in Canada that is inherent in the close Canada-U.S. economic relationship—to ensure that Canadian policies in these and other areas did not place Canadian producers at a competitive disadvantage *vis-a-vis* the U.S.

The last approach proposed for public discussion—with the observation that this list of four options is neither exclusive or conclusive—is a framework agreement. By such an agreement the two governments would establish objectives for the improvement and expansion of commercial and economic relations and the reduction and removal of bilateral trade barriers. An institutional mechanism such as a Trade Consultative Committee could be created to address the issues under discussion and negotiation.

A framework agreement would demonstrate the political importance attached by both governments to the trade relationship, through the establishment of principles, procedures, and mechanisms for the management of trade issues. Since there would be no immediate changes to current legislation, a framework agreement could be entered into quickly without reference to Congress. Being essentially declaratory and non-contractual in nature, it would not in itself provide more secure and enhanced access to the Canadian or U.S. market.

The Discussion Paper is careful to point out that a framework agreement could give rise to expectations which could only be realized through substantive negotiations involving reciprocal commitments on market access. The risk is that negotiating of a framework agreement by itself could be time-consuming without yielding concrete measures; and, that time may not be available.

The consultations conducted by the Minister for International Trade take the form of open public meetings, less formal but with the same purpose as the hearing process in the United States. The results of these consultations will be discussed with the Canadian provinces, and a report made to Cabinet. The question of the direction of future Canada-U.S. trade arrangements, and the determination of the best choice among the options available, rests ultimately on an assessment of the importance of barriers to Canadian access identified in the consultations; the advantages and risks of each option; the negotiability of defined objectives; and, the political will of both governments to undertake such negotiations.

Between the Discussion Paper and the Declaration on Trade adopted at Quebec on March 19, there is a clear fit. The Canadian Minister for International Trade and the United States Trade Representative have received a mandate "to chart all possible ways to reduce and eliminate existing barriers to trade and to report (to the Prime Minister and the President) within six months." In addition, special action is being taken on a range of special issues including government procurement, air transport, intellectual property, energy, and cooperation in high technology. On April 19th, Minister Kelleher and the newly nominated Trade Representative Clayton Yeutter met in Chicago for what will be several meetings on how to discharge the Quebec mandate.

Beyond these bilateral initiatives, both governments have repeatedly made clear—most recently in the Quebec Trade Declaration and in the OECD Ministerial meeting—the importance of an early beginning to a new round of multilateral trade negotiations. It needs to be emphasized that what is at issue is not a choice between bilateral and multilateral approaches to trade liberalization. The stakes that both countries have in a strengthened multilateral trading system and multilateral trade liberalization on the broadest possible basis are too great to permit an exclusive focus on the bilateral relationship.

It is not for me on this occasion to predict the results of bilateral initiatives or the date and outcome of multilateral negotiations. It is clear, however, that our two governments have set themselves upon an exciting road which has been traveled before in the long history between us. The priority which both governments attach to strengthening and deepening the bilateral relationship in all fields is recorded in the results of the Quebec meeting. In trade, the options for bringing a new regime to the rules and conditions which govern the most important trading relationship in the world offer a new future. These are interesting times.