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The Case for a U.S.-Canadian Free Trade Agreement**

*by Alan Wm. Wolff**

I. INTRODUCTION

Elimination of trade barriers has been a central theme of U.S. trade policy since World War II. During this period, Congressional review of trade policy has closely followed the cycle of multilateral negotiations under the General Agreement on Tariffs and Trade (GATT). As international trade has assumed an increasing share of the U.S. gross national product, Congressional oversight of the agreement formulation process has increased in intensity.

The need to satisfy the Congress that trade liberalization agreements are in the national interest presents both challenges and opportunities. Paradoxically, the increasing involvement of the Congress enhances the feasibility of reaching a comprehensive agreement where sector-specific agreements are unattainable because of entrenched opposition. This is because Congressional oversight during negotiations forces U.S. negotiators to consider the effect of any agreement on all constituent groups. If problems can be isolated at an early stage and creatively overcome, those who might have appeared to be potential opponents of bilateral trade liberalization can be turned into allies at the implementation stage.

II. IMPLEMENTATION UNDER THE TRADE & TARIFF ACT OF 1984

In order to participate in each round of the GATT multilateral trade negotiations (MTN), the President has requested authority from Congress to negotiate. In the last two rounds he has returned to Congress in order that the resulting nontariff agreements could be implemented. In the last round, Congress granted the authority in the form of major trade legislation. In the Trade Law of 1974, Congress gave the President authority to participate in the Tokyo Round of MTN and, in the Trade Agreements Act of 1979, the authority to implement the resultant accord.

If negotiations were to be initiated between Canada and the U.S. for the purpose of developing a free-trade agreement or a series of agreements, the implementation process would be carried out by the United States under procedures established by the Trade and Tariff Act of 1984.

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In that Act, the Congress approved a process under which free-trade agreements with other nations could be negotiated and implemented in a relatively rapid manner. The legislative history of the bill indicates that (with the exception of Israel, for which special arrangements were made) Canada was the primary nation under consideration for the negotiation of future agreements.[1]

Under the terms of the Trade and Tariff Act of 1984, the process of developing and implementing a free-trade area with Canada would have to be initiated through a request from the government of Canada. If the United States government were interested in pursuing this course, it could then enter into preliminary negotiations for an agreement. Once the Administration had made the basic decision to proceed with the development of an agreement, and negotiations had been initiated, the law requires that the President provide the Senate Finance Committee and the House Ways and Means Committee with written notice that negotiations are underway. In addition, the President must consult with these two Congressional committees at this time.[2]

To ensure that Congress has sufficient time to consider the desirability of such an agreement, the law requires the President not make the determination that he intends to enter into a free-trade agreement until at least sixty days after the date on which he provides Congress with this initial notification. After that sixty day period has expired, and neither the Ways and Means nor the Finance Committee has objected to the President's plan, the President may inform the House of Representatives and the Senate that he intends to enter into a free-trade area agreement with Canada. He must also promptly publish a notice to this effect in the *Federal Register*, the official U.S. Government journal. If he has not already done so by this time, he must also consult with any Congressional committee which has jurisdiction over matters to be covered by the Agreement.

Ninety days following his report to the Congress that he intends to enter into an agreement—assuming no Congressional directive to the contrary—the President may enter into the agreement with Canada. At this time, he is required to submit to both Houses of Congress a copy of the document he negotiated plus a statement which discloses the nature of any Administrative action proposed to implement the agreement and how the implementing bill and Administrative actions will affect existing law. The President must also submit an implementing bill and a statement of the reasons why he believes the agreement serves the interest of U.S. commerce.

The Congress must then enact the implementing legislation in order for the agreement to become effective. This consideration would occur within sixty legislative days under a "fast track" procedure, which pre-

1 S. REP. No. 510, 98th Cong., 2nd Sess. 1 (1984).

2 Trade and Tariff Act of 1984 §401, 19 U.S.C. 2112(b) (1984).

vents any committee from keeping the implementing legislation from reaching the floor for a vote, and under which no amendments are permitted. This point is the key. Legislation which the President wishes, if opposed by a willful minority, is defeated most often either through delay or the addition of contentious or unacceptable amendments.

During its consideration of the bill, Congress would hold public hearings, at which point interested parties would have the opportunity to testify. Final implementation would occur upon an exchange of letters between the two governments after completion of all internal arrangements.

The extensive opportunities for public comment and Congressional review of any free-trade area agreements with Canada, as required in the Trade and Tariff Act, would make it very difficult, if not impossible, for a President to implement such an accord without making a great effort to achieve public support for the proposal. This effort would likely require the President to include in the agreement appropriate safeguards, exclusions, and other provisions necessary to avoid causing serious opposition from any U.S. industrial or agricultural interest.

III. Prospects and Progress

The United States and Canada have already made remarkable progress in carrying the idea of free-trade directly into their bilateral relationship. The two nations act as each other's largest trading partner. In 1984, the United States supplied Canada with US$52.9 billion—71% of the total Canadian imports of $73.9 billion. This represented 24% of total U.S. exports. During this same period the United States' imports from Canada totaled $63.9 billion—72% of total Canadian exports of $87.5 billion.

As these figures indicate, trade between the two nations is a very significant element in the total international trade of both. Canada, however, depends on trade with the United States to a greater extent than the U.S. depends on trade with Canada. Overall, Canada is generally more trade-dependent than is the U.S.; imports and exports of merchandise account for over 40% of the Canadian gross national product.[3]

By 1987, when the tariff reductions of the Tokyo Round will be fully phased in by both nations, 80% of Canadian exports to the United States will be shipped duty-free and 65% of U.S. exports to Canada will enjoy similar privileges.[4] Most of this trade will be duty free on a most-favored-nation (MFN) basis, although some will still be covered by a special bilateral preferential arrangement under the *1965 Canada-United*

[3] Office of North America, Dep't of Commerce, OBR 83-09 Overseas Business Reports: Marketing in Canada 3 (1983) [hereinafter cited as OBR].

[4] Trade Policy in Goods and Resources Committee, International Business Council of Canada, Discussion Paper on Canada-U.S. Trade Liberalization 3 (1984) [hereinafter cited as IBCC].

States Automotive Agreement (the AutoPact).[5] In short, the U.S. and Canada have traveled most of the way towards a complete free-trade arrangement. Nonetheless, much remains to be done.

In the absence of further agreements, the list of U.S. tariffs which will remain at 4% or greater after 1987 includes a number of products in which the volume of trade in both directions can be expected to increase in coming years. These include certain electrical equipment and machinery, certain metal products, and many chemicals, chemical products and petrochemical feedstocks. On the Canadian side, tariff barriers averaging 10% will be maintained on a range of products including some electrical products, footwear, furniture, certain metal manufactured products and alcoholic beverages.[6] There is a wide range of duty levels in the Canadian tariff schedule, but the general pattern is one of free rates in raw materials, with progressively increasing duties as goods become more highly processed.[7] These more highly processed goods are the ones in which trading opportunities are the greatest between the two nations.[8]

It is the U.S. government's instinctive position that both countries have much to gain from eliminating these residual barriers. Moreover, if the two nations were to develop a free-trade area, rather than *ad hoc* sectoral free-trade agreements, those concerned with foreign relations in the United States believe that frictions caused by differing government policies that transcend sectoral concerns could also be addressed. As recently as January of this year, the new Canadian government of Prime Minister Mulroney tabled an options paper outlining various approaches to liberalizing trade with the U.S. The options reviewed in the paper ranged from sectoral agreements to a more comprehensive agreement.[9] The Quebec Declaration, issued by President Reagan and Prime Minister Mulroney, indicates continued Canadian and U.S. interest in exploring possible trade liberalizing avenues.[10]

Although the Canadian government has not indicated how it would like to proceed, the concern of being adversely affected by U.S. trade restrictions is a substantial motivation in seeking a system to ensure free access to the U.S. market. The concern is justified: a bill recently introduced in Congress would limit U.S. imports of Canadian lumber to their historic level of 25% of the U.S. market, a 5% drop from the current 30% level. Simultaneously, the domestic lumber industry has been con-

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[5] Agreement Concerning Automotive Products, Jan. 16, 1965, United States-Canada, 17 U.S.T. 1372, T.I.A.S. No. 6093.

[6] IBCC, *supra* note 4, at 17.

[7] OBR, *supra* note 3, at 18.

[8] AMERICAN EMBASSY OTTAWA, DEPARTMENT OF COMMERCE, FET 85-04 FOREIGN ECONOMIC TRENDS AND THEIR IMPLICATIONS FOR THE UNITED STATES 9 (1985).

[9] *See* DEP'T OF INTERNATIONAL TRADE (CANADA), HOW TO SECURE AND ENHANCE CANADIAN ACCESS TO EXPORT MARKETS: DISCUSSION PAPER (1984).

[10] Declaration by the Prime Minister of Canada and the President of the United States Regarding Trade in Goods and Services (Quebec, March 18, 1985).

sidering whether to utilize Section 201 of the Trade Act of 1974 as a temporary safeguard mechanism, while Canada phases out what the U.S. industry views as substantial subsidization of its forest products industry. U.S. and Canadian trade officials have been meeting in an effort to develop compromises on this issue,[11] although the U.S. Administration does not necessarily agree the complaints are justified.[12]

IV. Incentives to Reduce Barriers

Given that significant trade barriers and points of trade friction remain between the United States and Canada, what are the incentives to eliminate those remaining barriers and points of friction? What is the optimal way in which to structure their elimination?

From the U.S. perspective, the primary benefit of bilateral free-trade with Canada is based on the philosophic proposition that expanded market access will be mutually beneficial. The reduction in bilateral trade barriers would thus be seen as useful in itself, although the fact that the entire Canadian economy is the size of the economy of California would limit the economic importance of this objective from a U.S. point of view. The idea is also attractive, however, because of the precedent such an agreement with Canada might have for the development of multilateral or bilateral free-trade arrangements with other nations as well. U.S. Trade Representative William Brock expressed these sentiments in comments at the United States Chamber of Commerce in early March of this year.[13] The U.S. Trade Representative designate, Clayton Yeutter, has not expressed himself on this point.[14]

Another incentive the U.S. has to develop a new free-trade agreement with Canada is to generally improve and solidify the economic relationship between the two nations. A third would be to develop principles, such as the need to establish international rules for trade in services, which could be expanded to apply on a multilateral basis through a new round of multilateral negotiations.

From a Canadian perspective, Rowland C. Frazee, Chairman and Chief Executive Officer of the Royal Bank of Canada, points out that free-trade between the U.S. and Canada can yield ready access for Canadian companies not only to the vast U.S. market, but to "methods of improving productivity and efficiency." This could come in terms of newly developed technology, the transfer of which would be unhindered by tariff barriers, investment restrictions, or standards intended to limit the access of foreign companies to the Canadian market.

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[11] Wall St. J., February 26, 1985, at 51.

[12] *See* 47 Fed. Reg. 49,878 (1982).

[13] W. Brock (United States Trade Representative), Remarks before the International Division of the Chamber of Commerce (February 20, 1985).

[14] Telephone interview with Jon Rosenbaum, Office of the United States Trade Representative (April 18, 1985).

Frazee argues that Canada would gain from a general strengthening of the economic relationship with the United States and would also have an incentive to take a leadership role in the development of a new set of general principles for international trade. Finally, he believes that both countries would benefit from the development of a new system for the resolution of economic disputes such as antidumping and countervailing duty cases.[15]

Thus, there are clear incentives for both the United States and Canada to move toward a free-trade area. Furthermore, the basic elements which make a free-trade area attractive are present with respect to both. The two nations are already linked geographically. To a large extent, they are linked economically as well: by the volume of trade between them, by the relatively similar demographic characteristics of the two markets, and by a high degree of transnational investment of each nation in the other. The two countries trade in complimentary products as well as in directly competing products. While some period of adjustment can be expected, given the degree of openness already present between the two economies there is little prospect that one nation's economy will overwhelm the other's.

V. FREE TRADE OPTIONS

To the extent any progress has been made toward the development of freer trade between the United States and Canada, it has been largely through the consideration of specific sectoral free-trade agreements. The International Trade Commission and the Administration's Trade Policy Staff Committee held public hearings on January 15-16, 1985, as part of a section 332 investigation into the possible effects of establishment of sectoral free-trade agreements with Canada.[16]

During these hearings, few of those testifying argued with the proposition that sectoral free-trade agreements would be to the benefit of the firms in that sector on both sides of the border. The benefits are particularly evident in such sectors as electronics (or informatics) and cosmetics, in which a large portion of bilateral trade is carried on between different divisions of individual corporations rather than through intercompany transfers. In the informatics industry, it is clear that the imposition of national barriers to trade results only in a long-term reduction of the competitiveness of the firms in the nation which imposes such restrictions. On balance, the testimony which was offered favored reduction of tariff barriers.

Sectoral free-trade, however, for all its potential benefits, is a second-best choice. Sectoral agreements, by their very nature, would not result in the overall economic benefits which are possible in an economy-wide agreement. An economy-wide agreement would provide all of the

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[15] R. Frazee, Remarks before the Canadian Club of Toronto (November 7, 1983).

[16] 49 Fed. Reg. 44,959 (1984); 49 Fed. Reg. 40,109 (1984).

benefits of a sectoral agreement with the additional advantages resulting from a more rapid rate of overall economic growth, which would further benefit the specific sectors. Such an agreement would also provide the ability to establish procedures for addressing non-tariff trade issues in an orderly manner. Moreover, problems that may first appear to be sector-specific often flow from broader government policies, and may not easily be resolved with reference to the sector alone.

In addition to reducing tariffs on trade between the two nations, a range of additional bilateral trade issues exists for which solutions must be found in the negotiation of any free-trade agreement. A Presidential report to Congress in 1981 noted that although significant progress has been made between Canada and the U.S. toward removal of tariffs, Canadian non-tariff protection has increased.[17]

From the U.S. perspective, such Canadian intervention results in distortions of international trade through non-tariff barriers. These barriers range from Customs and Administrative entry procedures, which often act to keep out imports,[18] to the Canadian pharmaceutical patent policy whereby any Canadian pharmaceutical company may request the Canadian Commissioner of Patents to provide a compulsory license for foreign pharmaceutical patents with the payment of only a nominal royalty of 4%.[19] Under Section 301 of the Trade Act of 1974, a petition is now pending under the GATT rules alleging that Canadian remission of customs duty and sales tax in front-end wheel loader trade violates the Subsidies Code and is an unreasonable and discriminatory burden on U.S. commerce.[20] The Canadians have repeatedly voiced objections to U.S. "Buy American" procurement practices and trade law mechanisms which operate against them.

A solution will not be easy. The free-trade area idea has met with considerable political resistance on both sides of the border. In the United States, it is opposed by those who feel free-trade would result in a loss of jobs, as Canadian firms gained a far larger duty-free market than would U.S. firms. In Canada, objections to the move have come primarily from those who fear that a free-trade area would result in a reduction of Canadian sovereignty and the domination of Canadian business by U.S. companies. This paper has identified several sectors in which such sensitivity exists and specific solutions will need to be adopted for those sectors. Unless the concerns of these major sectors are accommodated, it is unlikely an agreement would receive Congressional approval.

The U.S. bilateral deficit with Canada reached $20.4 billion in 1984, the United States' largest bilateral trade deficit after the U.S.-Japan defi-

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17 THE WHITE HOUSE, NORTH AMERICAN TRADE AGREEMENTS: A STUDY MANDATED IN SECTION 1104 OF THE TRADE AGREEMENTS ACT OF 1979 14 (July 26, 1981).

18 *Id.* at 14.

19 ANNUAL REPORT OF THE PRESIDENT OF THE UNITED STATES ON THE TRADE AGREEMENTS PROGRAM 73 (1983).

20 47 Fed. Reg. 51,029 (1982).

cit.[21] The high value of the dollar has been the principal contributing factor to the deficit and has exacerbated many trade problems. With the high value of the American dollar reducing U.S. exports, it is possible the way may be opened for Canada to consider reversing restrictive policies intended to offset the earlier reductions in Canadian tariff levels.

VI. RESOLUTION

The best way the U.S. and Canada can resolve all these issues surrounding tariff and non-tariff barriers alike is to bring all trade complaints to the negotiating table and seek to address them. The benefit of this approach is that problems seen as sectoral by those directly affected can sometimes be addressed by a change in government policy. Cross-border advertising restrictions and compulsory pharmaceutical patent licensing are seen by U.S. negotiators as sectoral impediments to free-trade. They might be viewed more usefully as manifestations of Canadian government policy of insuring autonomy. If the obvious benefits of free-trade in many other sectors are weighed in the balance, the possibilities for broad exchanges of concessions may be easier to achieve. An overall solution can avoid sectoral impasses.

Whether the approach is sectoral or general, the President and his trade negotiators would have to work very closely with the Congress throughout the negotiating process, even if such close collaboration were not required under the implementation procedures. Such collaboration has at times been regarded by U.S. trade negotiators as adding excessive burden to the negotiating process. Instead of negotiating only with representatives of Canada, the U.S. negotiators must also negotiate the significant American points simultaneously with their own Congress. The degree to which Congressional involvement in trade negotiations has increased in recent years further complicates this process.

In the mid-1960's, the Ways and Means Committee in the House and the Finance Committee in the Senate were regarded as the sole trade committees. Other members of Congress looked to these two committees for guidance on virtually all trade issues. Today, however, trade has taken an increasingly important position in the range of U.S. commercial, economic, and foreign relations interests. As a result, the major trade issues, or elements of these issues, are now regularly considered by the Banking Committees, the Foreign Affairs and Foreign Relations Committees, the Commerce Committees and other committees which find an area of their jurisdiction to be related to international trade. To the extent that a U.S.-Canada free-trade area must address non-tariff as well as tariff barriers, many of these other committees will, of necessity, be brought into the negotiating process.

Furthermore, the Congress today is a more democratic institution

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21 Telephone conversation with Kenneth Fernandez, Office of North America, Department of Commerce (April 17, 1985).

than it was ten years ago. Individual members of Congress are more likely to develop independent positions on trade issues because those issues are now more politically important. At the same time, the leadership in the Congress is able to exercise less control over voting patterns than previously. These changes have resulted in a general slow-down in the rate of progress of any negotiations. U.S. negotiators must now work to develop positions which match the interests of Congress as well as those of the Canadian negotiators.

Nevertheless, there are many advantages to this approach. It minimizes the possibility that the agreement which is eventually developed will ignore the interests of any U.S. sector. Further, because the members of Congress are already aware of its content and have had the opportunity to participate in its creation, the process of enacting the implementing legislation should ultimately be faster and far more certain.

The process may be long and progress slow, but the potential benefits of a free-trade area are great. The United States and Canada should take this opportunity to work seriously toward freeing trade in goods, services, and investment, from self-defeating restrictions. This would increase the rate of economic growth of both nations while providing a mechanism to reduce the causes of trade conflicts. Instead of settling for small gains in some sectors only, the two nations can now further cement their overall relationship and set an example which other nations may follow.