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The Canadian Position in the World Economic Context

*Percy T. Eastham**

The title of this session of this conference reminds me of the story of the blind men who encountered an elephant for the first time. If you are familiar with the story you may remember that each individual came into contact with a different part of the animal and based on their necessarily limited knowledge each arrived at a different conclusion as to the nature of the whole beast.

In attempting to define the "world economic context," I think we are all a little bit like one of those blind men trying to describe a very large and complex organism based upon limited information and strongly influenced by the situation in which we happen to find ourselves in relation to the whole. Moreover, in attempting to understand the larger context with which our national economies interact, we must also deal with the fact that the "elephant" in question is constantly and rapidly evolving.

Keeping this general limitation in mind, there are certain features on which most analysts would agree. First, I will outline for you what I believe those features are, then I will go on to look at the Canadian perspective on the position which Canada and the United States currently occupy, in relation to the rest of the international community — our view of the elephant so to speak.

The Conference Board of Canada highlights its view that the world economy appears to be entering a period of retrenchment with the phrase "Growth ain't what it used to be." Rates of growth in most industrialized countries have declined markedly since the first oil shock and we seem to be entering a period in which, for the short-term at least, lackluster growth rates may continue to be the norm. It looks as though the immediate cause of this most recent deceleration in growth is the fact that the U.S. economy has apparently reached the limits of its ability to fuel the world economy by purchasing imports. As U.S. Department of Commerce merchandise trade figures for the last two months of 1987 and January of this year show, the biggest import shopping spree in history is coming to an end.

This will probably mean that the world economy over the next year or two will only grow about 2-2.5%. Some economists refer to this as "the muddling-through scenario." Analysts also put U.S. growth rates in this general range, with the prospect of a possible downturn heighten-

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ing in 1989 or 1990. There is, therefore, the prospect of the continuation of the long-term trend toward moderating growth coupled with recent exchange rate-driven adjustment in the U.S. import/export imbalance. This means that considerable new pressure will be placed on other industrialized countries, notably Japan and the Federal Republic of Germany, to pick up the slack in the short-term. From a Canadian perspective, the need to ensure the careful management of this transition period puts a premium on international economic cooperation at this time so that, as E.M. Forster said, the machine does not stop.

Canadian support for international cooperation in trade and economic relations is a pragmatic response to the situation we find ourselves in as a result of our history and geography. We may lack the panache of latter-day Venetians, but we are decidedly a nation of traders — more than a quarter of our gross national product is derived from international trade. This figure makes trade comparatively more important to us than to the Japanese as a source of national wealth.

Most of Canada's trade in the recent past has followed the natural north-south axis of this continent. Over seventy-five percent of our exports went to the United States in 1987 while almost seventy percent of our imports last year were purchased from the United States. This latter figure represents roughly one fifth of total U.S. exports. Not only are we each others' best customer, but we have the largest bilateral trading relationship in the world. The extent of the relationship was recently highlighted by President Reagan when he pointed out that the province of Ontario buys more from the United States than does Japan.

The Canadian Government's decision to seek a comprehensive bilateral Free Trade Agreement ("FTA") with the United States is the first track in a two track approach to international trade relations. The second track is the Canadian commitment to the Uruguay Round of the General Agreement on Tariffs and Trade ("GATT") negotiations. From Canada's vantage point the FTA and the GATT are complementary and mutually reinforcing. Our goal in the bilateral negotiations was to produce an agreement which was not only fully consistent with our current GATT obligations, but which could also serve as a model and catalyst for the treatment of certain issues in the Uruguay Round.

Despite this, Canada and the United States have been called upon on numerous occasions to assure other countries that the FTA is not and was never intended to be, a protectionist pact. One of the FTA's major advantages is that it should make both Canada and the United States more, not less, open to expanded trade liberalization. There is no real basis for assuming that it could be used to establish a kind of "Fortress North America" into which both countries can retreat. It was clear from the outset that the achievement of the FTA would require us to overcome the strong pull of the parochial interests of those protectionist forces which are so successful in making the front pages. It is always difficult to make the case for long-term, national benefits in the face of

opposition from narrower sectoral interests. The negotiations leading to the FTA were intense and hard fought with neither side getting everything it wanted. Both sides did, however, finally arrive at an Agreement which contains most of their principal objectives.

For our part, Canada has obtained more secure and enhanced access to the U.S. market not only for our goods, but for a wide range of services as well. We have come to agreement on binding dispute settlement procedures which are comprehensive and have effective enforcement mechanisms. They are probably the best procedures ever negotiated and we hope that they will produce results equal to their conception.

The comprehensive nature of the FTA meant that the Canadian and American negotiating teams had to frame an Agreement which took into account the differences between our two societies. Fundamental concerns from the Canadian point of view about our cultural sovereignty, our commitment to comprehensive social welfare programs and our unique approach to the reduction of economic disparities among the various regions of our extraordinarily diverse country meant that certain exceptions were required. Negotiators are not normally fond of exceptions, but they were necessary to achieving the Agreement.

The stimulus that that FTA will provide to the Canadian and the U.S. economies should be a very significant factor in enhancing the ability of a number of sectors in both economies to compete in international markets. This may actually be the most important long-term benefit to come out of the Agreement.

In this context, I do not see the comparative decline in the competitiveness of the U.S. economy in the last few years as signaling the beginning of a permanent eclipse of American economic power. I do not believe that Canada has hitched its trade wagon to a falling star in signing the FTA, as some anti-FTA forces in Canada have contended. The turnaround in the U.S. trade position on a volume basis over the last year and a half, a turnaround which appears now to be having a significant impact on the value of the U.S. trade balance, gives ample proof of the resilience of the U.S. economy.

However, it would be wrong for anyone to assume that the worst is undoubtedly behind us, with October 19, 1987, as the demarcation point, and that the problem is on its way to correcting itself without the need for further governmental action. As previously mentioned, the Canadian Government believes that the need for international coordination of economic policy remains high and the Prime Minister has indicated that he will be pushing hard for progress in this area at the Toronto Summit. The Prime Minister has also recently identified the Toronto Summit as an occasion for giving momentum to the Uruguay Round of the GATT. Canada is particularly hopeful that a commitment by the Summit countries on progress toward agricultural reforms will provide the impetus for the Mid-term Review Conference of the Uruguay Round, which Canada will be hosting later this year in Montreal.

In negotiating the FTA, the Canadian and U.S. negotiators were fully aware of the importance that both governments attach to the need for reform of the international agricultural trading system. The FTA contains significant benefits for Canadian and U.S. producers in the liberalization of bilateral agricultural trade. It also recognizes the fact that the most serious problems go beyond the bilateral sphere and will require multilateral cooperation if they are to be resolved. The FTA acknowledges the need for cooperation between Canada and the United States in addressing issues such as subsidies and import restrictions, while seeking to enhance the competitive balance in the international agricultural marketplace. The agricultural trade chapter in the FTA is just one area where the provisions make clear that further negotiations toward trade liberalization are necessary.

If the FTA is to really represent a win/win situation for both countries, the momentum which it establishes must not be allowed to flag. Special interests in either country cannot be allowed to derail its implementation on the grounds that it does not perfectly satisfy their own narrowly defined needs. The emphasis should be on building on the accomplishment and moving beyond it.

It is interesting to note that similar issues have become contentious in both Canada and the United States. In fact, the manner in which opponents of various elements of the Agreement in each country present their cases sometimes seem to be an ironic reflection of one another. Canadian nationalists have attacked the FTA as a threat to Canadian political sovereignty, arguing that the United States will come to be completely dominant in Canadian economic decision making and the power thus acquired will unduly influence Canadian domestic and foreign policy. This line of argument takes its ultimate inspiration from a tradition of general suspicion in certain segments of the Canadian population with regard to U.S. motives and ambitions. One might call this current manifestation of the phenomenon "patriotic protectionism," the idea being that having an economy more or less closed to U.S. competition is the best way of preventing any evolutionary drift towards continentalism. In the United States, the sovereignty question has been argued on constitutional grounds. U.S. concerns in this country seem to have centered primarily around Canada's insistence that the Agreement's dispute settlement mechanisms be binding and that the determinations of the binational panels should be final and not subject to domestic judicial review. From the Canadian perspective, this seems to be a logical means of ensuring impartiality; to many Americans it appears to be a denial of their right of due process.

A similar ironic mirroring of concerns is evident when one considers the provisions in the FTA which govern trade in energy. In Canada, opponents of the Agreement argue that we are locking ourselves into a continental energy system in which American demand will dictate the development of the Canadian energy sector and add to the cost paid for

energy by Canadian consumers. In the United States, on the other hand, small oil and gas producers object to the FTA because they see enhanced access to Canadian supplies as a disincentive in the short-term to investment in exploration in the United States and a possible threat to current pricing arrangements. Specifically, coal producers object to the FTA, fearing that it will facilitate new exports of Canadian hydroelectric power. Therefore, in the energy field, the situation is one in which Canadian opposition centers on fears regarding the consequences of excessive U.S. demand, while in the United States the special interests are concerned with the problems which may be created for them due to increased availability of alternative energy sources.

Both groups are misconstruing the intent of the FTA's energy provisions which seek first and foremost to promote liberalization of the energy marketplace. The energy provisions recognize that assured access for Canadian exports to the U.S. market must be matched by assurances of the continuity of supplies to be delivered under the terms of freely negotiated contracts. What industry or sector-specific special interests obscure in their zeal to defend their current position in the marketplace is that the implementation of the FTA should ultimately lead to a strengthening of the North American industrial base. It will help to restore the recently lost competitiveness of North American goods against foreign products. It will not limit consumer choices, increase costs or discourage innovation and productivity in any sector.

The FTA is a concrete manifestation of our mutual commitment to general trade liberalization. It is fully consistent with GATT obligations and should serve as a model for the Uruguay Round. The response from Canada's other trading partners has generally been positive, but they will still require some convincing that the Agreement will be trade creating rather than trade diverting.

The Japanese are concerned about the impact of the automotive provision and their general competitive position after all tariffs are removed. Our European trading partners wonder about the impact of enhanced "bilateralism" and trade diversion. They express specific concerns about the possible loss of markets for footwear and automobiles, among other products. The newly industrialized countries in the Far East are concerned that their clothing and textiles may have to compete in a more cost-efficient environment. The international community is keeping a very close watch at this time. They are, for the most part, supportive of the FTA and, I believe, genuinely hopeful that we can clear the final hurdles and implement the Agreement. However, they want assurances that we are not entrenching bilateralism by means of the FTA. They will be looking to both countries to provide evidence of our commitment to multilateral trade liberalization in the Uruguay Round.

The expectations of our other trading partners clearly enhance the downside risks involved should we allow the implementation of the FTA to be derailed by domestic sectoral or political special interests in either

Canada or the United States. There is no doubt that the demise of the FTA would have a chilling effect upon the conduct of the multinational negotiations.

If Canada and the United States cannot finally arrive at a mutually acceptable arrangement it is hard to imagine that the rest of the international trading community will be able to set aside their differences and make the kind of hard choices that everyone will be called upon to confront as the Uruguay Round progresses. Equally important is the fact that if the FTA is not implemented, both Canada and the United States will undoubtedly lose some credibility as participants in the multinational negotiations. How can we reasonably expect others to believe that we will be able to deliver on our commitments to them when we cannot deliver to each other?

The position of Canada and the United States in the economic context will be vitally affected over the course of the next few months, and possibly years, by whether or not we show the necessary political will and recognize that the overall achievement of the FTA must be preserved. The FTA provides a blueprint for the development of our trade and economic relations which could serve us both well into the next century. It also breaks some significant new ground with respect to provisions on trade in services and in agricultural products. Furthermore, it can serve as an example of how cooperation can foster enhanced competitiveness. The implementation of the FTA will perform a function which is not only valuable, but perhaps essential to ensuring the continued orderly development of our national economies and to the larger task of promoting the expansion and liberalization of world trade.