Canada-US Trade Relations:

An Ontario Perspective

This extract is from the Report of the Select Committee on Economic Affairs of the Ontario Legislative Assembly. It was tabled by the Chairman of the Committee, David R. Cooke (Kitchener) on September 25, 1986. Copies of the document, which includes a dissenting report from the two NDP members of the Committee, are available from the Ontario Government Book Store.

The bilateral free trade negotiations between Canada and the United States are part of a long history of close relations. Occasional problems have arisen to strain these relations but, considering the length of our border and the magnitude of interrelationship, these have been infrequent. . . .

The mutual dependence that exists between our two nations is unique. It cuts across regions, provinces and states. Recent protectionist sentiment in the United States may jeopardize some parts of our trade with them. Wherever governments take actions to restrict trade flows, it is likely that the economies on both sides of the border would be harmed. Similarly, anything that governments do to ease the political tension that spring up and to improve the climate for trade is likely to improve the performance of both economies. For this reason, the Committee believes that efforts must be made to respond to concerns expressed in the United States over the fairness of Canada's trading relations.

There are two principal goals of the bilateral trade negotiations. The first is to remove the few tariff barriers that still exist between the two countries and to try to remove as many non-tariff barriers as possible. The second has two components: to secure access to each other's market by obtaining exemption from potential protectionist actions and by establishing some framework for dealing with the harassment which may result from various contingency protection actions. The Committee is particularly concerned that the atmosphere of the trade negotiations be one of neighbours seeking to improve their relationship in a mutually beneficial manner. Unfortunately, recent events have the potential to sour the negotiations. A number of contingency protection actions are currently underway in the United States. There is the potential for more. Some contingency protection actions against U.S products are also possible in Canada.

Because these actions can damage the cordiality that is a prerequisite to any negotiations, some efforts should be made by both governments to prevent them from becoming serious. The Committee recognizes that governments alone are not responsible for using the legislative means and the quasi-judicial tribunals in place which can restrict trade. Individuals, companies and industry groups have the right to initiate these contingency protection actions. Governments can endeavour to prevent these actions from being used as harassment. . . .

The two countries have many similarities but they also have some fundamental differences. Government involvement in the economy is a fundamental part of Canadian history from the building of our railroads to the development of advanced technologies. United States government activity in its economy has taken forms that reflect the distinct history of that country. The trade irritants that do result are often the product of a misunderstanding on how the other country operates. A clear illustration of this is the frequent statements made in the United States that some particular program in Canada, be it a social, cultural or regional development program, is an unfair subsidy to trade. Unfortunately these statements can turn into initiatives under the contingency protection provisions of U.S. trade legislation.

The Committee does not wish to dispute the right of the U.S. Congress to ensure viable industries and a strong economy. Contingency protection is one way of doing so in the face of dynamic international markets. However, there is an unnecessary threat and provocation when contingency protection actions are brought against trade on the basis of Canadian programs or policies that have legitimate social, cultural or economic goals.

As the process operates in the United States, contingency protection actions against Canada can be easily initiated. There is ample opportunity for Canadian companies and the government to defend themselves by presenting their case. Despite this, the rules under the U.S. trade laws do not permit the body which makes the ultimate ruling to consider the purposes or makeup of the Canadian program. What is at issue in these procedures is the effect upon the relevant U.S. industry and whether some form of subsidization or dumping is taking place. Both are legitimate concerns. What may be ignored is the question of whether conditions in Canada are sufficiently different that a subsidy may have a

purpose – legitimate even under U.S. laws – that is not intended to provide a trade subsidy. It may be intended to compensate for some particular disadvantage due to geography, climate or institutional makeup resulting from Canada's limited population. Furthermore, the U.S. procedures fail to weigh whether U.S. producers of a similar product are also subsidized in their domestic market. Canada and the United States may both subsidize a product or industry but in different fashions.

The Committee strongly believes that these bilateral trade negotiations must come to grips with this problem so neither country is disadvantaged. It is, in fact, fundamental to the success of the negotiations. If Canadian companies cannot build markets in the United States without fear that some contingency protection actions will be brought against them when they are successful, then the elimination of trade barriers will be without effect. Any agreement must do more than simply arrive at a common understanding of terminology, it must do more than define what are acceptable and unacceptable subsidies. These are important to avoid misunderstanding and to improve the predictability for government and for business. They are only a starting point because the problems are those of substantial differences in approach and not simply differences in understanding. Each country subsidizes industry. The tools and programs that each uses are quite different. The intended results are different.

The Question of Sovereignty

A solution that has been put forward frequently is the establishment of an international dispute resolution tribunal. This tribunal should supersede the contingency protection laws on both sides of the border in arbitrating bilateral trade disputes if it is to be effective. The particular advantage to such a tribunal is the fact that it could examine information from both countries, determine the facts at issue and provide conclusions or recommendations in a manner agreed upon by both parties. The Committee believes that it is important that this tribunal be removed from any possibility of undue pressure to affect its conclusion, that the tribunal be removed from the political process while it arbitrates the dispute. One cannot use this tribunal to force either government to abide by results the governments are not prepared to accept. But is should be possible to set up some process whereby it is to the advantage of both governments to accept the conclusions and recommendations. The tribunal should play a role in enhancing public information on bilateral trade issues and undertake studies on important subjects of trade. Governments will not and cannot surrender their ultimate decision-making powers. They can agree to limit their discretion in implementing tribunal recommendations to matters of fundamental importance.

The successful conclusion of these bilateral trade negotiations is of interest to many in Canada and the United States. Numerous witnesses before the Select Committee on Economic Affairs expressed serious reservations about these negotiations. At the heart of many of these reservations was the question of whether Canada would lose its rights and powers as a sovereign, independent country as a result of a bilateral free trade agreement. Any treaty or agreement between countries that sets some limits on their behaviour is a restriction on their sovereign rights. A bilateral trade agreement in principle need not be any more limiting than any other international agreement. In the case of a bilateral free trade agreement between Canada and the United States, the issue is not so simple. Canada is a large country with a small population. Its nearest neighbour is the wealthiest, most powerful country in the world. Trade between the two is important to both but disproportionately important to Canada. Finally, in spite of the numerous similarities, there are basic differences in heritage, societies, cultures, economies and governments.

The intention of the bilateral free trade negotiations is to reach an agreement that will permit both countries to expand their mutual trade in order to gain income and improve the operation of their economies. The intention is also to secure this trade from arbitrary action. As the economies become more interdependent, it may become difficult for Canada to make decisions or implement policies that do not conform with policies in the United States. This may be part of the price of the growing interdependence of the world. There is no need for this interdependence to limit Canada's sovereignty in those areas that are fundamental to the rights and requirements of the Canadian people. A similarity of interests between Canada and the United States does not have to result in the homogenization of our two countries. With sufficient scope for independent action and independent policies, there is no reason that a bilateral trade agreement would harm Canada's rights. The difficulty is in establishing the proper basis for achieving the goals of such an agreement while ensuring that each country can continue to do things in the manner most appropriate for it.

While the Committee is of the opinion that a bilateral trade agreement, in itself, need not reduce Canada's sovereign rights, there are some areas of particular concern. Canada has extensive programs and policies in place to meet the needs of Canadians. They have evolved through the course of one hundred and nineteen years of our history as an independent country. Federal and provincial governments regularly change these policies and programs in order to pursue goals important to their citizens. With due care, a bilateral trade agreement can assist in achieving these goals. The difficulty presented is one that will require particular attentiveness.

As mentioned previously, trade disputes have arisen over differences in social, cultural or economic programs and policies. Canada's medicare system and its unemployment insurance system have been attacked as providing unfair subsidies to Canadian industries. Many of our cultural programs have been criticized as being a form of protectionism disguised as cultural programs. Regional development programs have been attacked as trade subsidies. In most cases, Canadians have been able to defend themselves in any contingency protection actions on these matters in the United States. The Committee is concerned that this may not always be the result. A bilateral dispute resolution tribunal must be able to deal with most of these problems, but it can only do so if these problems are clarified before the tribunal is established. By their nature, tribunals can only solve the issues they are explicitly empowered to deal with.

Unfortunately, this is not the only manner in which social, cultural, regional or linguistic policies and programs could be affected. Among the goals that U.S. negotiators have in achieving a bilateral free trade agreement is the establishment of rules on regional subsidies; solving some disputes stemming from Canada's policies in broadcasting, publishing and intellectual property rights; and reaching some agreement on trade services. None of these goals are a direct attack on Canada's right to have distinct social, cultural or regional policies or programs. They are efforts to deal with what might be considered trade disputes about strictly commercial problems. For Canada, however, social, cultural, regional and linguistic policy has often taken the form of policies and programs that determine the economic viability of particular industries. This is the case with fishing, broadcasting, publishing, telecommunications, regional incentive grants and support for specific industries located in depressed regions.

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The purpose of these policies and programs is often not to provide export subsidies. Social policy in Canada commonly provides universal or particular assistance to cover recognized needs. Our medicare system operate to ensure everyone has adequate health care. Unemployment insurance is available for those who meet the requirements. Neither has been set up to subsidize industry. Cultural policy has recognized that for a country to build a distinct cultural identity it is necessary to be able to communicate with one another. Government programs support both the creators of culture and those who communicate it. Regional development programs have the goal of alleviating some of the disparities that characterize our country. They recognize there is a value in preserving communities. None of these policies and programs can be separated from economic institutions. It would not be possible to achieve any of these goals without also supporting individuals, businesses and industries. Therefore, the Committee believes that the bilateral trade negotiations cannot surrender or restrict Canada's rights to provide policies and programs in these areas in the manner that we deem most appropriate. . . .

Provincial Involvement

The broad nature of these negotiations, covering as they do all tariff and non-tariff barriers, with the intention – frequently stated by the United States – of including the service industries, means that areas of both federal and provincial jurisdiction are being discussed. Unlike the situation in the United States where the federal government can bind state governments in international agreements, the situation in Canada is undefined. Considerable precedent exists that the provinces are supreme in areas of their sole jurisdiction, just as the Canadian government is supreme in areas of its jurisdiction. Knowledgeable witnesses have argued both that provinces cannot be bound by federal agreements in trade matters and that provinces are subject to such agreements.

Provinces have interests in the results of the bilateral negotiations that go beyond the pure jurisdictional question. Provincial governments want to ensure that their citizens have the best opportunities for building strong, viable economies. Their interests extend to wanting to secure and develop markets in the United States for their products, as well as to maintain the industries that serve domestic markets. Clearly, not every industry nor every region will be affected in the same way by bilateral free trade. Some will benefit and some will have difficulties. If the balance is not on the benefits, there is little point to an agreement. Even a successful agreement will cause some problems. The best assurance that the provincial governments can have that the interest of their people have been represented as is they are closely involved in the process. Any agreement that disproportionately benefits one region at the expense of others will not be acceptable. In order to provide the mutual benefit that a bilateral trade agreement must, the Canadian government and the provinces must cooperate.

The Committee is of the opinion that this cooperation must extend even to the bilateral dispute resolution tribunal which it hopes will result from the negotiations. A tribunal would be dealing with problems of provincial concern and would have some authority to solve bilateral trade disputes. Therefore, a provincial role in the dispute resolution process is important if the tribunal is to actually perform its function of solving these disputes.

The problem of jurisdiction is particularly sensitive for the provinces. The Committee does not wish to suggest that provincial governments can restrict the Canadian government in those areas of sole federal jurisdiction. Witnesses who have discussed the issue have made it clear that the federal authority is paramount in international relations. What is not clear is the extent to which this paramountcy can bind provincial governments in areas of sole provincial jurisdiction. There are two opposing viewpoints.

The argument for provincial authority in matters of provincial jurisdiction is based on section 92 of the *Constitution Act*. The claim is that a strong constitutional argument exists that a free trade agreement could not impose legal obligations on the provinces nor constrain their existing jurisdiction under this section. The ratification of treaties is a prerogative of the Canadian Governor-in-Council. But this prerogative power does not extend to the implementation of treaties. The power of implementation lies with both the federal and provincial governments in areas of their respective jurisdictions. When trade issues deal with non-tariff barriers, covering such things as purchasing policies, subsidies, regulations and taxing resources, then the subjects of provincial jurisdiction are matters of international negotiation. if a bilateral free trade agreement is to have any effect – and if it is to be successfully negotiated – then provincial involvement is necessary in order to bind the provinces in their jurisdiction. An agreement that binds only the federal government would not be acceptable to the United States.

The opposing argument is that both the making and ratification of treaties is the prerogative power of the executive. Where implementation requires legislation, the matter would be determined by either the ordinary division of powers or a special treaty implementation power of Parliament. Although all appeal rulings have been that there is no special treaty implementation power, the Supreme Court could look at the fact that some piece of legislation was designed to implement a treaty and was, therefore, a federal matter. Difficulties are compounded by the question of whether the legislation deals with trade in goods and commodities, or in capital and services. Federal jurisdiction over the former is clearer than over the latter. Section 15 of the Charter of Rights supports the federal jurisdiction to remove barriers to the licensing of professions. It is possible that the general power of the federal government to control the economy as a whole will be used to sustain its power more broadly. This leads to the conclusion that the legal tools are in place to build a strong federal initiative on non-tariff barriers and to get it implemented in legislation.

The Select Committee on Economic Affairs is not capable of determining which argument would be sustained by the Supreme Court. It has been argued further, by a knowledgeable witness, that there would be a constitutional challenge on a bilateral free trade agreement simply because only a court decision would assure the United States that the provinces are bound by the terms of an agreement.

In fact, provincial commitment without Court backing may be insufficient since a Supreme Court challenge could originate from any source. The Committee feels that any bilateral trade agreement should not be permitted to precipitate a constitutional crisis. Only the full and complete involvement of all the provincial governments in the negotiations and in the ratification of an agreement could prevent it. The provinces have the right and the duty to safeguard their jurisdiction and to legislate in their jurisdiction. Bilateral trade negotiations should not become an opportunity to encroach upon their powers.

Agriculture

Witnesses representing the agricultural sector felt that the U.S. *Food Security Act of 1985* was causing serious harm to farm income in this country. The Act sets U.S. agricultural policy until the end of the decade for most farm commodities except horticultural crops and livestock, although dairy is included. Among its objectives are to increase U.S. agricultural exports; to reduce surpluses and productive capacity; to free up access to world markets and combat agricultural subsidies; and to isolate U.S. producers from the ill effects of world market conditions. Unfortunately, the results for Ontario farmers are serious. Prices are lower for commodities whose price is largely set in the United States. An increasingly competitive buyers' market has ensued which is dominated by subsidies. Farmers' cash flows are being reduced so that government income stabilization programs are becoming a significant portion of farm income. Land prices will probably decline. Chemical, fertilizer and farm machinery producers will be affected by the lower farm income.

The possibility of a bilateral free trade agreement which includes agriculture has been viewed with alarm. Agriculture tariffs are not a great issue for the agricultural industry. There are few of them and they are often designed to be in effect during peak seasons. Completely free trade without any subsidies would have the result that those with the greatest advantage would be those with the best growing conditions; the worse the growing conditions the greater the disadvantage. Canadian farmers have developed a strong agricultural sector but the disadvantages of geography have added significant costs. In addition, Canadians have set up specific market arrangements to keep farm income up while providing agricultural products to consumers at reasonable prices. Milk, eggs and poultry products are produced under quota with prices set administratively in the province. Disruption of these marketing boards and arrangements would result in serious harm. Viable, diversified agricultural production and processing sectors are not possible without major supporting national policies.

Canada is not alone in its special provisions for agriculture. The U.S. *Food Security Act* is one example of policies in the United States designed to maintain farm income and preserve the economic viability of agriculture. Trade is restrained in numerous ways. For these reasons, the Committee is of the opinion that solving the questions of agricultural trade in these bilateral free trade negotiations is an intractable problem. There are too many diverse interests to accommodate and too many difficult problems to solve.

The Autopact

Although the General Agreement on Tariffs and Trade is the principal agreement governing trade between Canada and the United States, there are two others which have had particular success. The Automotive Products Agreement (the Autopact) and the Defence Production Sharing Arrangement have been in effect for some time. They both have features which are incompatible with a bilateral free trade arrangement because they provide for safeguards to ensure that a defined portion of production in automotive vehicles and defence related manufacturing occur in Canada. In effect, they provide for tariff-free trade in these products in return for managing the rules of the trade relationship.

Representatives from the automobile industry – the domestic vehicle assembly companies, the automotive parts producers and the labour union – expressed serious concerns that bilateral free trade negotiations might jeopardize existing trade arrangements. They fear that the United States administration would ask that the Autopact be renegotiated as a condition for holding more extensive trade discussions. Inclusion of the automobile industry in a bilateral free trade arrangement in a manner that leaves the safeguard provisions ineffective would have serious consequences for the industry.

These safeguards guarantee that at least as much automotive vehicle production take place in Canada as the domestic, North American producers sell here. These guarantees have permitted the automobile industry to become a significant exporter to the United States in a rationalized North American automotive production system. The Autopact does not guarantee that Canada will have a surplus in automotive vehicle trade. A large persistent deficit exists in automotive parts trade. For many years during the life of the Autopact, Canada had a deficit in automotive trade. In fact, over the entire period since it was implemented in 1965, automotive vehicle trade is almost precisely in balance between the two countries. The advantage to Canada is that the Autopact provides a means of maintaining a viable automotive industry. The advantage for the United States is that it has permitted U.S.-owned automobile assembly companies to rationalize their production and maintain profitability in a tariff-free North American automobile market.

The terms of the Autopact are complex. It is not one arrangement that establishes the rules for automobile production in both countries. In the United States, it is a bilateral agreement that permits duty-free access for automobiles and their component parts when imported from Canada by a domestic automobile assembly company. In Canada, the Autopact is an arrangement available to all automobile producers. These producers can import tariff-free so long as Canadian production of a particular class of vehicle – automobiles, buses or commercial vehicles – exceeds Canadian imports of that class of vehicle in the year and do not fall below seventy-five percent at any time in the year. The Canadian value added must equal or exceed the Canadian value added the manufacturer produced in the year ending July 31, 1964. In addition, the North American automobile producers have exchanged letters of understanding with the Canadian government where they undertake to ensure that the Canadian value added in their production will be at least sixty percent of their cost of sales. The implications are that the elimination of the established tariffs on automobiles – which the producers avoid by meeting the terms of the Autopact – would remove any incentive for meeting those terms. An across-the-board elimination of tariffs, in fact, prejudices the Autopact even if it were not explicitly included in a bilateral free trade agreement. Explicit exclusion is necessary. . . .

Simply ensuring that the Autopact is not prejudiced by a bilateral free trade agreement is not enough to ensure that it is viable in future. The automobile industry is undergoing considerable stress. Both foreign and domestic assembly companies are investing heavily in Canada and in the United States. It is estimated that these foreign and domestic assembly companies will have excess North American production of approximately 3.4 million automobiles a year by 1990. Excess production will result in plant closings because, once production in an assembly plant declines below a critical point, a shift or an entire plant will be shut down at once. The continued viability of the Autopact is vital if Canada is to ensure that it maintains a share of North American automobile production.

Foreign automobile assembly companies have been building assembly operations in Canada and the United States for several years. They wish continued access to the most profitable au-

tomobile market, consequently they are building plants here to provide that access should protectionist pressures increase. These operations compete directly with the domestic automobile companies. The Committee is of the opinion that this competition is healthy because the North American companies must, as a result, develop new designs and products, and produce more efficiently. At the same time, there is a negative side to these developments. Foreign assembly companies are setting up plants that incorporate little Canadian value added. They employ relatively few people in their assembly plants. A significant portion of their component parts are imported. As the shakedown in the industry occurs as a result of excess North American production, it is likely that some domestic assembly companies will be forced to close operations. If these closings are replaced by the assembly operations of foreign producers, Canada will be a net loser. The important issue is whether these foreign producers will begin to use more Canadian value added by incorporating Canadian parts. It does not appear that they intend to do so in the near future.

The Committee has another concern as well. Foreign assembly operations in Canada have been set up under special agreements between the companies and the Canadian government. South Korean automobile imports are exempt from tariff because they benefit from the general preferential tariff available to underdeveloped countries under the GATT. Japanese and European producers face higher tariffs. This different treatment is a trade irritant because Japanese producers have voluntarily restrained their exports to Canada in order to allow the North American industry to adjust. In addition, Canada has a duty remission program in place to encourage offshore producers to purchase Canadian automobile components and parts. A feature of this remission program is designed to encourage investment by these companies. But these programs are viewed by the U.S. automobile industry and by U.S. politicians as a special subsidy to the foreign producers. It is a trade irritant which could bring the entire Autopact into jeopardy without providing real benefits to Canada. By giving exemptions to the terms of the Autopact, which are not onerous and which have proven to be successful, Canada is only encouraging the North American assembly companies to seek exemption as well. North American producers now exceed the Canadian value added levels. When they eliminate capacity, it could very well be Canadian capacity that is shut down. A weakened Autopact will make the outcome more serious . . . .

Making the Case in Washington

The Government of Ontario has a continuing role in efforts to resolve trade disputes, just as it has a particular role to play in the negotiation and ratification of any bilateral trade agreement. Dealing with trade disputes as they arise involves the concerted efforts of the Canadian Government, the provinces, industries and labour. In the past, joint efforts were required to inform United States legislators of Canadian concerns. The Committee has been struck by the fact that many of those in the U.S. government who are knowledgeable about Canada are often unaware of the interdependence of our two economies. Canada's representatives in Washington, D.C., have a tremendous ability to present our country's interests in a forceful manner. They are all conscientious and extremely capable people. Rather, the problem stems from the amount of interdependence itself, which makes unexpected demands for awareness of the implications of events, from the scope of our trade, and from the size and structure of the United States Government. No one part of the government there has so much decision-making authority that other parts need not be considered. Numerous people are involved in the policymaking and arbitration process.

It is important for the province's economic well-being for the Ontario Government to promote the province's exports more effectively. It is equally important for the Ontario Government to assist exporters to present their interests more effectively to the United States Government and its legislators. Ontario has trade representatives in six United States cities but not in that nation's capital. Furthermore, Ontario has an officially designated Ontario House in London and in Paris. There has been official Ontario representation in London since before Confederation and an Ontario House was opened there in 1945. This was appropriate given the fact that the United Kingdom was Ontario's principal trading partner; it continues to be appropriate due to the continuing economic, social and cultural ties that exist. Since Ontario's trading patterns have shifted in the twentieth century to a North American focus, the Committee believes that this fact should be recognized by including Washington D.C. in the province's trade representation to the United States. Whether this is best achieved by adding another office to Ontario's current level of representation or by moving an existing office is a matter for the Government to decide.

Communication with U.S. legislators on both a state and a federal level would help to relay the province's concerns about trade more effectively. The Committee believes that regular channels should be established which will permit Ontario legislators to discuss trade issues with the relevant U.S. legislators. If the relationship between our two countries is to become more cordial as it becomes closer, the importance of understanding one another will grow. Frequent contact may help to avoid some of the trade disputes that seem to arise from a misunderstanding of how the other country operates. ■