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A CANADIAN AGRICULTURAL ECONOMIST'S PERSPECTIVE ON THE CANADA-U.S. TRADE LIBERALIZATION TALKS

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The purpose of this discussion paper is threefold. First, I will describe the background to Canada's initiative in opening the trade liberalization talks with the United States. Second, I will present my assessment of the initiative. I argue that the initiative is unlikely to achieve Canada's primary objective (to restrain U.S. protectionism) but may result in other benefits. Third, I will discuss an alternative trade strategy for Canada that I argue will be more successful in achieving the primary objective.

Background

The latest initiative on trade liberalization has come from Canada because of its high vulnerability in the international market. Canada does not have a large domestic market for its production and so must rely heavily on exports. Exports account for nearly 30 percent of Canadian gross national product (GNP), compared with only about 10 percent of U.S. GNP. Canada is particularly concerned with access to the U.S. market because that market accounts for between 20 and 80 percent of the value of Canada's exports. With the heavy trade deficit in the United States and the strong U.S. dollar, there has been a dramatic rise in protectionist sentiment in the United States which has posed a serious threat to Canadian access to this market.

The initiative can be traced back to the early eighties and the previous (Liberal) government in Canada. However, it was not until the present (Progressive Conservative) government that the initiative became a focus of Canadian Government policy. A number of Canadian industries were being threatened by protectionist lobbies in the United States (hogs, softwood lumber, paper, and fish). In addition, the government received a strong nudge toward trade liberalization by a 1985 report of a Royal Commission on the Canadian economy (the MacDonald report). The report urged Canada to take a "leap of faith" and open freer trade negotiations with the United States. The benefits of freer trade were seen as: (a) protecting Canada's access to the huge U.S. market, (b) encouraging Canadian industry to become more efficient, and (c) discouraging Canadian firms from relocating in the United States (to gain access to that market without worrying about trade barriers). The government took the "leap of faith" in early 1985 and made overtures to the United States administration about trade liberalization. At a summit between the leaders of the United States and Canada in March 1985, the President and Prime Minister agreed to examine ways to reduce or eliminate trade barriers between the two countries.

Since then, Canada has invested considerable resources in preparing for the negotiations. In addition, there has been wide and prolonged debate in the Canadian media on the pros and cons of a trade liberalization agreement (TLA). By contrast, on the U.S. side, there has been little interest in the trade liberalization talks. Nonetheless, the talks on a comprehensive TLA are continuing with the following items, the main ones being discussed:

- (1) the elimination of technical barriers to trade (for example, health regulations);
- (2) the elimination of trade-distorting subsidies;

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- (3) elimination of tariffs;
- (4) exemption from or modification to contingency protection laws (countervail and antidump);
- (5) greater access to government procurement contracts;
- (6) freer access to services markets; and
- (7) transitional policies (that is, assistance to industries that are forced to adjust).

Canada is particularly interested in (4) and (7), while the United States is more interested in (5) and (6).

Assessment of the Initiative

Canada's primary objective in pursuing this initiative was to gain relief for Canadian exporters from the increasing protectionist pressure being applied by U.S. special interests under U.S. trade remedy laws (countervail, antidump, and safeguard). The Canadian Government thus went into the negotiations thinking that a TLA would be an effective way to restrain (discipline) U.S. protectionists. However, what the government and the rest of the country are beginning to realize is that the country with the biggest stick carries out most of the discipline. The main reasons why Canada appears to be in a poor bargaining position are as follows.

- (1) Protectionism is very strong in the United States at present. This is reflected in the attribute of Congress which has over the years gained ever-greater power over the determination of trade policy from the Administration. The trend to greater U.S. protectionism is linked to the strong U.S. dollar and burgeoning trade deficit. It may also be linked to the increasing awareness of and skill in using the U.S. trade remedy laws.
- (2) The Canadian Government adopted a high profile in its search for a TLA with the United States. The achievement of a TLA was made a cornerstone of the government's economic platform. This placed considerable added pressure on the Canadian negotiators to reach an agreement, and hence weakened their bargaining position. To his credit, the Prime Minister appears to have been backing away from this position in recent months. Hence, this may be less of a factor now.
- (3) Canada is relatively far more dependent on the United States for trade than the United States is dependent on Canada.

If a comprehensive TLA were negotiated, the outcome would reflect a situation in which the United States disciplines Canada with respect to its subsidies and distortions but there is little scope for Canada disciplining the United States with respect to its subsidies and distortions. Hence, a comprehensive TLA will not be very successful in achieving the primary objective of the Canadian Government.

A possible secondary objective is more likely to be realized by a TLA. This objective is to encourage Canadian business to be more internationally competitive, which would be good for Canadian consumers and taxpayers. Since we have already argued that the main effect of a TLA is that the United States would be better able to discipline Canadian business with respect to subsidies and distortions, it follows that Canadian business would be subjected more directly to the principle of "survival of the fittest." Even without such an agreement, the rising tide of U.S. protectionism and the application of U.S. trade remedy laws are encouraging a rethinking in Canada of the use of subsidies in export-oriented industries. The advantage of a comprehensive TLA is that it will encourage this kind of rethinking in a

broader set of Canadian industries than just the export-oriented ones. For example, some rethinking might be expected in those domestically oriented industries that would face potential competition from the United States under a TLA.

One major spinoff benefit of the TLA negotiation process is that it has been a valuable exercise leading up to Canada's participation in GATT. There has been an unusually wide-ranging debate over trade issues that should prove very useful to developing Canada's position at GATT. This debate has included input from all sectors of Canadian society: from various industry groups, labor groups, and the provinces, as well as many other special interest groups. In addition, many staffers assigned to work on the bilateral trade initiative are also working on the GATT negotiations and they should benefit from the overlap between the two.

Thus, there appear to be some gains from a comprehensive TLA even if they come more from a secondary objective and a spinoff benefit rather than from the primary objective. However, despite these potential gains, the probability of success appears to be low.

Most experts agree that it is very doubtful that a comprehensive TLA will be achieved with the present Republican administration. And if the next administration is led by a Democrat, it has been suggested that the negotiations will be even more difficult for Canada (because Democrats are thought to be more protectionist). The reason for doubt is the inherent complexity of such an agreement as well as the very tight timetable for reaching agreement during the present U.S. administration. The complexity arises in Canada because it would involve tradeoffs in which some industries and regions or provinces would gain, while others would lose. The problem for the Canadian Government is that it not only has to negotiate with the U.S. Government but also with special interest groups and provincial governments within Canada. For example, many agricultural marketing boards and subsidy programs are subject to provincial or joint federal-provincial jurisdiction.

The deadline for achieving an agreement with the present administration is October 1987. This is necessary in order to gain approval from Congress under the "fast track" mechanism which expires January 3, 1988. Failure to achieve this deadline would almost certainly mean failure to achieve acceptance under the current presidency. Added to the time difficulties may be the recent change in structure of the Senate Finance Committee and Congress in general to domination by the Democrats.

While the negotiators in Ottawa are still focusing their attention on the idea of a comprehensive agreement, there is now some talk of a 'fall-back' position if and when the comprehensive agreement fails to materialize. A fall-back position may include an attempt to get some bilateral commission to address trade irritants (for example, technical barriers such as health regulations and customs inspection procedures). A paper by Bruce and Kerr (discussed in the next session) outlines a proposal for such a commission for livestock and livestock products. I suspect that such a commission would not be too difficult to negotiate in the limited time available. However, it seems unlikely that it would be given any real power by either side to settle trade disputes. Its role would likely be limited to providing an extra channel of communication between the two sides. This may be useful as a safety valve and as a way of allowing the two sides to settle disputes and irritants rather than going through the countervail process.

An Alternative Trade Strategy?

I have argued that this initiative is useful in encouraging Canadian business to be more internationally competitive, but it will not be very successful in restraining U.S. protectionism. The question is: is there another strategy that would have a greater chance of success in

achieving this objective? In broad terms, I think Canada's strategy needs to concentrate on building up its bargaining power vis-a-vis the United States. This may be done through:

- (1) building a consensus within Canada (between the federal and provincial governments, labor and industry) so that Canada speaks with a unified voice;
- (2) building coalitions with groups outside Canada (in the United States and elsewhere) who are expected also to be adversely affected by U.S. protectionism; and
- (3) lobbying in the various forums of power to alter the rules of the game so they are less in favor of the U.S. protectionists. The most important forums of power are in the United States (the Congress, the Administration, State legislatures) and the most important groups with which to form coalitions are those inside the United States (processors, marketers, and consumers of the imported products, as well as taxpayers). However, there are forums of power outside the United States (GATT) and here Canada may attempt to impose disciplines on U.S. protectionists by forming coalitions with other adversely affected countries.

The idea that Canada should get involved in lobbying and coalition-building is not a new one. In fact, it was the strategy adopted by Canada in 1983 and which worked so well in the 1983 softwood lumber case. However, it seems to have been pushed aside by the thrust of the bilateral trade negotiations.

With respect to agricultural commodities (especially grains), I think Australia provides perhaps the clearest example of where this strategy is currently being embraced. Here the emphasis has been on reducing protectionism in the European Community (EC) and the United States. Last year, Australia's Bureau of Agricultural Economics (BAE) completed a well-publicized study of the agricultural policies of the EC. One factor that sets this study apart was the emphasis given by the BAE on publicizing the results inside the EC itself. This suggests that the study's main objective was to develop coalitions within the EC (consumers and the labor force) by pointing out the heavy cost to them of the common agricultural policy (CAP). It is interesting to note that the BAE recently embarked on a similar exercise looking at U.S. agricultural policies. And the emphasis is expected to be on the cost of these policies to groups within the United States (taxpayers). In another initiative, the Australian Government recently organized a ministerial meeting of "fair traders in agriculture." The participants were from 14 countries not including the United States, EC, or Japan. The Australians saw the main objective of the meeting to enable "an important group of countries to increase their collective negotiating leverage" at GATT. Australia was, in effect, attempting to build a coalition of agricultural exporting countries at the GATT forum to address the problem of agricultural protectionism in the United States, EC, and Japan.

With respect to the secondary objective the question is: does Canada need a TLA to achieve greater discipline of its domestic industry? Certainly the current U.S. trade remedy laws are having some effect, and pressures from other countries (through GATT) will have some effect. A strong Canadian Government could also play a part in imposing greater discipline on domestic industry. The problem of course is that unilateral actions to reduce protection are very unpopular and can expect strong resistance from the provinces and special interests. I would say that the advantage of a TLA over the current application of U.S. trade remedy laws is that the discipline imposed on Canadian business would be more broadly based and less capricious.