

Remarks to
Canadian Centre for Management Development
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Memorandum to the New Prime Minister
re
Canada-United States Trade Relations

Summary

The most important foreign policy issue of your mandate will be the Canada-U.S. relationship, especially the trade and economic relationship. There is an urgent need and an opportunity to restructure the relationship to reflect the realities of the new global geopolitical paradigm and the global economy.

The volume, depth and range of Canada-U.S. trade and economic relationship is an indicator of the inexorable integration of Canada into the North American economy. The policy choices for the government are narrow: whether to help integration and reap the economic benefits or to hinder it at the economic cost of individual Canadians.

Current Canada-U.S. agreements and institutions for the management of the trade and economic relationship are inadequate to the demands being placed upon them, particularly in the light of U.S. security priorities. A new approach reflecting new circumstances is needed.

Canada needs to rethink its aversion to issue linkage and institution building with the U.S. not only because the U.S. will not be responsive to our trade interests in isolation but more importantly because we can make issue linkage and institutions work for us.

Canadians can walk and chew gum at the same time: there are high levels of comfort with deepening integration and equally high levels of comfort with Canadian identity and diverging values and preferences.

A Royal Commission should be mandated to make recommendations on the management of the Canada-U.S. relationship and report no later than the first quarter of 2005.

Global Realities

The United States is a hyperpower. No other state approaches the U.S. in current or potential power and influence. Economically, the U.S. surpasses all its rivals to the point that it is approaching the dominance it held 50 years ago as the engine of global

economic growth. Growth in Europe and Japan can no longer compensate for a poor U.S. performance. Militarily, the U.S. has no rival.

Since September 2001, the U.S. has been pursuing an aggressive, single-minded, America-first foreign policy. While the support of allies for U.S. foreign policy imperatives is welcomed, for example, in the war on terrorism and with Iraq, it is not essential. In particular, it should not be expected that the United States will “pay” Canada or any other country for its contributions, nor be ready to act only with the consent of its allies.

The dilemma for Canada and other U.S. allies is that, while the impact of U.S. actions on their interests is enormous, their influence on U.S. policy, either its strategic direction or implementation, is marginal. The essential policy issue for Canada, the UK, and others on issues such as Iraq is not whether Iraq is compliant with UN resolutions but the impact of their position on their relations with the United States. For Canada, the hard reality is that the United States is only interested in knowing whether Canada supports or opposes U.S. policy. Major consequences flow from either position.

Integration

The volumes of cross-border trade—\$677 billion annually, \$1.85 billion daily, the daily 30 thousand truck and 100 thousand passenger vehicle crossings, the annual 200 million individual crossings—are only part of the process of economic integration.

Integration is changing fundamentally the nature of trade and investment relationships. Arms length transactions between autonomous firms are increasingly yielding to regional or global corporate business strategies. The fastest growing sectors of Canada-U.S. trade are fully integrated in North America: autos, aerospace, information technology, and business and financial services. A high proportion of trade within these sectors is intra-firm trade.

These integrated sectors are virtually free of traditional trade problems and are impervious to the influence of traditional tools of trade policy. They are seriously affected by an increasingly dysfunctional border, regulatory divergence, and the absence of laws and procedures to resolve barriers to integration.

Deepening integration with the United States is a product of millions of daily corporate and individual decisions by Canadians about what to consume, to produce, to export and import, about where to invest and which investment to seek. The government retains the full arsenal of interventionist instruments to hinder integration but these are devoid of democratic legitimacy. The task for the government is to build a new relationship with the U.S., which captures the dynamics of integration.

Trade Agreements

The NAFTA and its predecessor, the FTA, effected a radical transformation of the Canadian economy on North South lines. The challenges of managing the Canadian half of an integrated economy, in which non-trade issues have come to play an essential part, are beyond the scope of the current or future trade agreements.

For the United States, the trade and economic relationship with Canada, like all U.S. relationships, is subservient to the overwhelming priority which the U.S. attaches addressing global threats to its security. Just as the NAFTA and the WTO could not prevent the closure of the border in September 2001, so are they unable to move beyond trade rules and deal with security, immigration and cooperation on geopolitical issues which is becoming increasingly the touchstone of U.S. foreign policy, including trade policy.

The Smart Border Accord is a useful but limited response to this challenge. It is useful because of its pragmatic, problem-by-problem approach. It is limited because it is not embedded in an agreement or in U.S. law and does not commit the Congress nor the agencies that Congress independently funds and controls, such as U.S. Customs. For these reasons, as an instrument to provide a secure framework for trade and investment and reinforce the rules and institutions of NAFTA and the WTO, it is seriously deficient.

The dynamic structure of cross-border business relationships is no longer susceptible to trade agreement rule making, which is too slow, constitutes a snapshot at a moment of time of issues to be addressed, and is unresponsive to daily business needs and longer-term business planning.

New Approach

The orthodox Canadian and U.S. strategy to manage the relationship is to compartmentalize the issues and avoid issue linkage. Problems of defence and security, trade and investment, resources, environment, immigration, police and justice cooperation, indeed all, are handled individually on their own merits by the ministers and departments of government to which they are assigned. Problems are addressed as they arise, independent of any comprehensive strategy.

Issue linkage is virtually prohibited; the relationship is managed within well-protected silos of bureaucratic and constituency interest and steadfastly resistant to coordination. Canada has traditionally rejected issue linkage as the smaller partner; the United States has not practiced issue linkage in large measure because the vastness of its interests and its divided and dispersed system of governance makes linkage extremely difficult except in extraordinary times.

Both countries have been almost as equally wary of creating strong institutions to manage the relationship. While there is a broad network of effective informal coordination and occasionally joint decision-making (food inspection) the formal institutional infrastructure is light and generally ineffective. Canada has been cautious on institution building because it has worried about countering the weight of the U.S. in any formal relationship; the U.S. has been wary because the Congress is suspicious of any international institution that intrudes upon its prerogatives.

These orthodoxies require profound reappraisal in the new political and economic environment. It is clear that the U.S. will be unresponsive to Canadian trade and economic interests unless Canada is prepared to respond to its security and foreign policy priorities. Whether Canada should or should not be responsive needs to be addressed in

the light of Canadian strategy for the relationship as a whole and not as a result of *ad rem* decisions, without regard for the implications for the relationship as a whole. The linkage issue is not whether Canadian interests in lumber should be balanced against Canadian interests in energy but the constituent elements, to use Alan Gotlieb's phrase, of a "grand bargain" (*National Post*, September 11, 2002).

Mexico should be treated as a partner if it is willing to craft a new relationship on a North American basis. Mexican preferences should not be a factor in any decision taken by Canada.

Walking and Chewing Gum

There is a broad measure of comfort among Canadians with arranging for the security and prosperity of the country within the North American framework and with seeking new arrangements with the United States to capture and manage the forces of silent integration.

Concurrent with this comfort is a new confidence among Canadians in their identity, an absence of a sense of apology, a need to assert difference or defensive self-assertiveness. Recent polling shows both high levels of support for the current trade agreements and growing differences in values, preferences, and life styles of Canadians vis-à-vis Americans.

Apart from the geriatric Left, there is a refreshing absence of pressures emanating from the public for initiatives to re-establish artificial distinctions and differences from the United States or from any other country.

The public debate about the relationship with the U.S. is spreading beyond academic and political circles and beginning to resonate in the broader public. It will be a different debate than the free trade era, calmer, more mature and better informed. It is, nonetheless, essential that the government lead this debate.

Royal Commission

The government needs to consider the options and develop a consensus around a new Canada-U.S. relationship. The time to launch an initiative with the U.S. will be the summer of 2005. For planning purposes, it should be assumed that the Bush Administration will win a second term in the 2004 elections and will require about six months to bring a new Administration up to running speed.

The public debate is unfocused. NAFTA-plus, customs unions, an enhanced Smart Border Accord, are among the ideas in play. Unlike the 1980s free trade debate, there is no firm concept around which positions can form or serious analysis within and outside the government can be conducted.

A Royal Commission would enable a dispassionate examination of the options and the implications. It would take political heat out of the issue during a period when the U.S. political calendar forecloses any serious bilateral discussion. To ensure focus and

timeliness, the Commission should have a well-defined mandate and a fixed reporting date.

The Commission should be asked to examine these questions:

How can the Canada-U.S border be removed as a barrier to the movement of goods and people by eliminating some regulations and moving most, if not all of the others, behind the border (e.g., pre-clearance of commercial shipments)?

How much of the regulatory divergence between Canada and the U.S. can be removed through equivalence and harmonization (e.g., health and safety regulations in sectors such as consumer goods, drugs and transportation, immigration)?

What is the best institutional framework for managing the relationship without requiring a trade agreement negotiation to solve every problem? For example, does the model of the International Joint Commission provide a useful point of departure?

The Commission should be mandated to report not later than the first quarter of 2005.