Invited Presentation

Canada-U.S. Trade Relationships: Developments and Implications

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Introduction

Canada and the United States are the world's largest trading partners. The total volume of two-way merchandise trade in 1985 was $165 billion Canadian ($124 billion U.S.). Canadian dependence on U.S. markets has grown to the point that nearly 80% of our exports are destined for our southern neighbor. By the same token, more than 70% of Canada's imports originate in the U.S. That volume represents 20% of total exports from the U.S., the largest proportion going to any individual country. Obviously, trade relations between Canada and the U.S. are very important to both countries. Indeed, given their combined role in total world trade, the importance of trade relations between them goes beyond whatever it might be to those two countries alone.

Trade relationships between Canada and the U.S. have been changing over the past few years and may be on the threshold of even greater changes in the next few months. I am referring to the expected outcome of the current bilateral negotiations which have become a focal point for any discussion of this topic. Given their importance and the dynamic state of these trade relationships, it is'highly appropriate that they should be considered in a forum such as this. This paper will briefly examine some of the features of Canada-U.S. trade, the issues and environment of the current trade talks, and a few of the likely implications of free trade, if that is where we are going. Emphasis will be on agriculture. It is to be hoped that we will be able to identify a few areas where further research is warranted.

Canada-U.S. Trade

As already noted, Canada and the United States have the largest bilateral trading relationship in the world. In fact, according to Fry, the U.S. exports more to the Province of Ontario than to Japan and more to British Columbia than to China. That is why Canadians are often a little chagrined to hear U.S. spokesmen refer to some country other than Canada as their most important trading partner. To Canadians, it is a clear sign of being taken for granted by the U.S. This is one of the intangibles that affects trade relations because it influences how a country acts or reacts.

If we examine a profile of our merchandise trade, we find that by far the most important component in *both* directions of that two-way flow is automotive products under the agreement known as the auto pact negotiated in 1965. These products represent about one-third of the total value of trade in each direction. Resource based industries figure prominently in exports to the U.S. with forestry and petroleum products ranked second and third followed by metal and chemical products which are based, at least in part, on other natural resources. Agriculture and food exports to the U.S. ranked sixth in importance in 1984 with only 4% of total merchandise trade (Table 1).

Among Canadian imports from the U.S., agriculture and food ranks fourth in importance after automotive products, chemicals and computers. The agriculture and food trade of both countries is more geographically dispersed than the average of merchandise trade between them. This, of course, reflects the predominance of grains and oilseeds in the agricultural trade of each and underscores a measure of competition for third markets for these products. Nevertheless, the U.S. still supplies more than half of Canada's total imports of agriculture and food products and absorbs nearly one-third of our agricultural exports. A profile of agricultural trade by major commodities is shown in Table 2.

Although it is generally not the case in agriculture and food products, (see Table 3) and only recently in other products, Canada currently enjoys a surplus in merchandise trade with the U.S. This surplus is usually outweighed by the deficit in ser-

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Table 1. Canada — United States Merchandise Trade, 1984

Product Group	Value of Trade	U.S. As % of Total	Share Bilateral
	(Billion Can.)		
Automotive	28.7	97.8	34.7
Forest Products	11.2	74.2	13.5
Petroleum, and Natural Gas	8.3	99.8	10.0
Fabricated and Metal Products	7.6	80.5	9.2
Chemical and Chemical Products	3.5	65.7	4.2
Agriculture and Food	3.4	31.8	4.1
Telecommunications and Office Eq.	2.7	72.1	3.3
Industrial Mach.	2.1	74.5	2.5
All Other Items	15.2	53.2	18.4
Totals	82.8	75.6	100.0
Imports			
Automotive	22.9	86.7	33.4
Chemicals	4.1	78.1	6.0
Computers	3.8	91.4	5.5
Agriculture and Food	3.2	53.8	4.7
Industrial Machinery	2.9	71.9	4.2
All Other Items	31.6	—	46.1
Totals	68.5	71.5	100.0

Source: External Affairs Canada *Canadian Access to Export Markets.* Canadian Foreign Policy Series**.** November 1985.

vices and capital flows, normally leaving Canada with a current account deficit.

Both countries are known as trading nations. But, in relative terms, Canada is much more exposed to international markets than is the U.S. For example, Canadian merchandise exports are equivalent in value to about 30% of Gross Domestic Product (GDP) while the corresponding figure for the U.S. is closer to 10%. Similar proportions apply to imports. With respect to agriculture, Canadian exports are equivalent in value to about 45% of the total farm cash receipts versus about 20% as a corresponding measure in the United States. Canadian imports of agriculture and food products correspond in value to 30% of the farm cash receipts. Again, that figure is much smaller in the U.S. where imports represent about 14% of the value of farm cash receipts. As a further measure of the international exposure of Canadian agriculture, it is reported by Gifford (p. 13) that "close to 70% of Canadian agricultural production is priced on an international basis."

In general, then, while trade is important to both countries, it may be argued that Canada has considerably more at stake in these negotiations. The relative potential for gain is enhanced by the much larger U.S. market; but the importance of exports to the Canadian economy, combined with the heavy dependence on the U.S., means the potential losses are also great if that market should be lost.

Trade Issues and Environment

For the past 13 months, our trade representatives have been negotiating a comprehensive, bilateral trade agreement. These talks were initiated by a letter from Prime Minister Mulroney to President Reagan in September 1985, following their earlier discussion of the subject at the "Shamrock Summit" in Quebec City in March of that year. Following actions by both governments to permit the talks to proceed on a "fast-track" schedule, negotiations got underway in May of 1986. Under the fast-track arrangement, a proposed agreement must be presented to Congress by October for signing by the President by January 3, 1988, after which Congress may approve or reject the package without change. Approval or rejection in Canada could be merely a Cabinet decision but is likely to be debated in Parliament.

With regard to the scope of these negotiations,

Table 2. Canadian—U.S. Agricultural Trade by Selected, Commodity Groups 1985

Commmodity Group	Exports to U.S.	Imports from U.S.	Balance
		($ Canadian Millions)	
Grain and Grain Products	273	265	8
Oilseeds and products	113	386	(273)
Live Animals	394	71	323
Meats	630	155	475
Other Animal Products	119	236	(117)
Dairy Products	15	16	(1)
poultry and Eggs	31	104	(73)
Vegetables and Potatoes	144	576	(432)
Fruits and Nuts	77	811	(734)
Beverages	523	64	459
Sugar and Related products	125	49	76
Total Agr. Products	2,974	3,515	(541)

Source: Agriculture Canada, *Canada's Trade in Agricultural Products,* Publication No. 86/2, August 1986.

it has been understood from the beginning that they were to include all sectors of the economy. Negotiators on both sides have maintained their determination to keep as much as possible on the negotiating table. The chief negotiators have recently reinforced their aim of achieving a comprehensive agreement when they declared that they want "« *big deal or no deal".* This approach is consistent with article 24 of GATT which requires that a substantial part of all trade be included in order to meet the definition and exemptions for a free trade area.

What, then, are the issues that have brought us to the negotiating table in the first place? As observed by Wonnacott, the reasons are not identical on both sides of the border. But since Canada has been the initiator of the talks, it is appropriate tc look at the issues from that perspective. A suitable starting point is the stated objectives of the negotiations from Canada's point of view, as reported by External Affairs:

1. *Secure access* to U.S. markets through limits or exemption on the applications of trade remedy laws and clearer definition of countervailable subsidies.
2. *Enhanced access* to U.S. markets through elimination of tariffs and quotas and liberalization of government procurement policies and other non-tariff barriers.
3. *Enshrined access* to U.S. markets through improved dispute settlement mechanisms and institutional provisions that recognize mutual obligations and accommodate differences and the independence of the two governmental systems.

The order in which these objectives are stated is significant. Ordinarily one might expect that the primary purpose of trade talks is to reduce existing barriers (enhance access). The fact that this objective takes second place in these talks reflects both the relatively low level of those barriers and the threat of reversal through growing protectionism in the U.S. It reflects a general deterioration in trade relations between our two countries in the recent past, and the concern in Canada about indiscriminate application of trade remedy laws by the U.S.

We'll return to the issue of secure access in a moment. But first it is convenient to consider briefly the existing impediments to trade in the form of

Table 3. Canadian Agricultural Trade Balances With the United States, 1965-1985

Period	Exports to U.S.	Imports from U.S.	Balance
	(Billions of Current $ Canadian)		
1965-69	**0.27**	**0.59**	**(0.32)**
1970-74	**0.42**	**1.00**	**(0.58)**
1976-80	**0.83**	**2.36**	**(1.52)**
1981-85	**1.86**	**3.30**	**(1.44)**
1986	**2.66**	**3.64**	**(0.98)**

Source: Agriculture Canada, *Handbook of Selected Agricultural Statistics,* (Various issues)

Table 4. Canadian and U.S. Tariffs for Selected Industrial Products, 1987

Category	Canada	U.S.
	(%)	
Textiles	16.9	7.2
Clothing	23.7	18.4
Footwear	21.5	9.0
Furniture and Fixtures	14.3	4.6
Paper Products	6.6	0.0
Chemicals	7.9	0.6
Glass Products	6.9	5.7
Iron and Steel	5.1	2.7
Metal Products	8.6	4.0
Rubber Products	7.3	3.2
Electrical Machinery	7.5	4.5
Transportation	0.0	0.0

Source: Adapted from: Wonnacott, Paul. *The United States and Canada: The Quest for Free Trade.* Institute for International Economics. Washington, D.C. March 1987. (Table 1 . 1 , p. 4)

tariffs and non-tariff barriers to gain some appreciation of the potential for enhanced access.

With respect to tariffs, most trade between Canada and the U.S. is already relatively duty-free. In fact, more than two-thirds of that trade bears no tariff and by the end of this year at least 90% of the total trade between the two countries will face tariffs of *5%* or less. While sizable tariffs remain on a few items, they are not generally a major issue. Nevertheless, it is expected that a plan to phase out remaining tariffs will be a component of any trade agreement.

Existing tariffs on a few selected categories of products are shown in Table 4. As indicated in this small sample, Canadian tariffs on a number of manufactured goods are higher than those of the United States and, on average, are generally believed to be about twice as high. In this sense, Canada has more to give and relatively larger adjustments to make in a free trade deal.

The case is much less clear in agriculture where tariffs appear to be more uniform between the two countries and in some instances higher in the U.S. than in Canada. This is illustrated with selected commodities in Table 5. One set of tariffs which remain important to Canadian interests are the seasonal tariffs which apply to a number of horticultural products during the peak marketing season. In general, however, tariffs are not considered to be a major issue for agriculture and their removal, while injurious to some, is not likely to have a large impact on trade flows.

On the other hand, as noted by Menzie and Prentice, non-tariff barriers such as import quotas, permits, health regulations, grade standards, inspection procedures and a host of government programs ha become relatively more important than tariffs restraints to trade in agriculture. Considerable ef fort is being applied by the negotiators to reduc the effect of many of these NTB's. In other cases relatively little change is expected.

One example which appears to be somewhat of a stand-off are import quotas on dairy and poultry products entering Canada and dairy and sugar entering the U.S. While there could be some adjustments in these barriers, substantive changes are not anticipated at this point.

The real issues for Canadian agricultural interests are those which affect other trade as well. First and foremost among these is the application of trade remedy laws such as countervail duties. Since 1980 the application of countervail or other duties on 16 items including live hogs, fish, softwood lumber, cut flowers, and a number of other products, sometimes on questionable grounds, has cost Canadian interests large sums of money and has shaken their confidence in trading with the U.S. Efforts to secure access to the U.S. market through exemption from trade remedy laws, or similar strong assurances, are thus a number one priority for Canada.

This is a complex and difficult problem area which is clearly linked to the impact of non-tariff barriers in the form of government subsidy programs. One of the key steps in removing the uncertainty associated with trade remedy laws is, therefore, an agreement on a clear definition of what constitutes a subsidy and what is countervailable. The scope of this problem is, of course, much broader than that of bilateral trade between the U.S. and Canada. Fortunately, as evidenced by the recent OECD ministerial agreement[1] and other indicators, there is increasing recognition of the international impact of domestic agricultural policies. It is to be hoped that this will be accompanied by an increasing resolve to correct the distortions caused by these programs.

The best opportunity for comprehensive action on this front is through the new round of GATT negotiations just getting underway. In the meantime, however, Canada and the U.S. may, and must, make some progress on defining countervailable subsidies and restricting their applications on bilateral trade and in other markets where we have a common interest.

One area where more work is needed is in the measurement of trade distortion and other impacts of agricultural subsidies. Indeed, it is the seemingly

[1] See "24 Western Nations Call trade-war truce." *Ottawa Citizen,* May 14, 1987, p. F9.

Table 5. Canadian and U.S. Tariffs on Selected Agricultural Commodities

Product	Canadian Duty	U.S. Duty
Milling Wheat	12 cts./bu.	21 cts./bu
V/heat Flour	25 cts./cwt.	52 cts./cwt.
Com	5 cts./bu.	5 cts./bu.
Corn Oil (N.E.S.)	15.0%	4.0%
Soybeans	Free	Free
Soybean Meal	Free	30 cts./cwt.
Sovbean Oil (N.E.S.)	15.0%	22.5%
Canola	Free	40 cts/cwt.
Cattle (live)	1 ct./lb.	I ct./lb.
Beef (fresh, chilled. frozen)	2 cts./lb.	2 cts./lb.
Hogs (live)	Free	Free'
Pork (fresh, chilled. frozen)	Free	Free
Chicken (eviscerated)	12.5% (5-10 cts./lb.)	5 cts/lb.
Eggs (shell)	3.5 cts./doz.	3.5 cts./doz.
Cheese (Cheddar)	3.5 cts./fb.	12-16%
Potatoes (fresh)	35 cts./cwt.	35 cts./cwt.
Potatoes (processed)	Free	10%
Carrots (fresh)	0.5 cts./lb. for up to 40 wks. otherwise free	0.5 cts./lb.
Strawberries (fresh)	3.0 cts./lb., not less than 10% for 8 wks otherwise free	0.2-0.75 cts./lb. depending on date of entry.
Strawberries (frozen)	15%	14%

' Subject to countervail duty of 4.386 cts. Can. per Ib. since 1984.
Source: Agriculture Canda, *Tariffs on Selected Agricultural Products,* Ottawa, June 1980.
and 'Menzie, Elmer L. and Prentice, Barry E. *Barriers to Trade Between Canada and the United States, IED Staff Report, ERS-USDA Washington, 1983.*

arbitrary applications of U.S. countervail duties on the basis of subsidies which has caused concern in Canada. The most recent, and perhaps most celebrated case is that of softwood lumber where the U.S. reversed its earlier decision (1983) and decided that provincial pricing policy (stumpage fees) constituted a countervailable subsidy on Canadian lumber imports in 1986. (Wonnacott, pp. 91-101) But the U.S. imposition of a countervail duty on imports of live hogs from Canada also provides a clear example of the weakness of the system in failing to accommodate accurate economic analysis. Because of the importance of such cases, it is worth taking a closer look at this one on live hogs. Faced with low prices and increasing imports of hogs and pork from Canada, hog producers in the U.S. requested a study of the subsidization of hog production in Canada in 1984. Early in the process, it was estimated by Grimes on the basis of price flexibility analysis using assumed demand elasticities, that the injury to U.S. producers from Canadian hog and pork imports was a price decrease ranging from one to 2.5%, ($1.93 to $4.80 per cwt. in 1984). The U.S. Department of Commerce added up the cost of Canadian stabilization programs, the federal grading service and a few other programs and divided by the number of hogs produced in Canada in 1983-84 in arriving at a recommended countervail duty of 5.52? per Ib. on pork and 4.390 per Ib. on live hogs. The final determination by the International Trade Commission maintained the duty on live hogs only.

While the economic consequences for Canada could have been much more serious, more thorough analysis of impact and injury to U.S. producers have raised questions about the validity of the case in the first place. For example, Martin and Goddard have found that there has been very little supply response of Canadian hog producers to stabilization programs and that any injury to U.S. hog producers as a result of these programs is more likely to be in the order of 150 per cwt. (0.30%) than the $1.93-4.80 per cwt. (1-2.5%) estimated by Grimes. These findings are supported by the work of Rowsel and Kenyon who similarly found little evidence of supply response to stabilization program in Canada, and by that of Gilmour and Cluff who estimated the impact on U.S. hog prices to be in the order of 2 to 120 (U.S.) per cwt. of dressed carcass if Canadian stabilization programs were eliminated. It is the unreliability of the process with regard to economic analysis, and the uncertainty that it creates, that have prompted Canada to seek an improved mechanism for settling disputes as well as relief from the trade remedy laws of the U.S.

While Canadian trade representatives have publicly insisted that relief from trade remedy laws must be part of the deal, and U.S. trade representatives have publicly insisted that would be impossible, there is likely to be some give and take on this issue. One possibility suggested by Wonnacott that would provide a certain latitude for both governments to pursue selective policies (such as industrial grants for regional development in Canada), would be to raise the threshold values *(de minimas)* at which countervail duties may be applied. At the present time, these could be imposed if the amount of subsidy is found to exceed 0.5% of the value of the product. That threshold could be raised to anywhere from 2 to 5% to provide a margin of shelter without appreciably distorting trade.

The economic and political climate surrounding these talks is worthy of comment because of its effects on the motivation and feasibility of reaching a satisfactory outcome. As already noted, the talks were initiated by Canada, but public support for these talks is by no means universal, generally ranging around 45 to 55% of these polled, depending on the timing of the survey. Support also differs by region in Canada with the east generally less in favor than the west. This reflects the feeling that most of the benefits of Canada's current trade laws are concentrated in the manufacturing industries of Ontario and the relatively greater importance of export oriented resource industries in Western Canada.

These features, in addition to the overall importance of trade to the Canadian economy, have given the talks a very high profile in Canada. Media coverage often echoes the deep rooted Canadian concern of American dominance by virtue of sheer size and indifference toward Canadian interest. (That concern was aptly described by former Prime Minister Trudeau when he declared, a few years ago, that living beside the U.S. was a bit like sleeping with an elephant—"no matter how good natured the beast, one is inclined to feel every twitch and grunt." Wonnacott, p. 2)

These conditions are important in that they impose certain constraints on the maneuverability of the Canadian government. That maneuverability ic further impaired by the political influence and jurisdiction of the provincial governments, some of which have expressed reservations and all of which have demanded a consultative role in the talks. In response to provincial and industry concern, the federal government has established a formal advisory committee system for consultative purposes All of this increases the difficulty and complexity of the negotiating process.

Canadian sensitivity on the trade talks has long been present as reflected in the failure of previous efforts. In 1911, after negotiating an agreement and campaigning in favour of reciprocity with the U.S., the Liberal government of Sir Wilfred Laurier was defeated at the polls. The succeeding Conservative government never implemented the agreement. In 1948, again after a comprehensive trade agreement had been negotiated with the U.S. that would have eliminated tariffs and opened up other trade restrictions, Prime Minister Mackenzie King decided the risks were too great to proceed with approval and implementation.

An earlier reciprocity treaty for free trade in natural products, negotiated in 1854 while Canada was still a British colony, was abrogated by the U.S. in 1866 in retaliation for British support for the Confederate states during the Civil War. After Canada became a country in 1867, several other attempts were made to negotiate a reciprocity treaty. Failure of this effort in 1874 was followed by a period of increased protectionism in Canada. So the records of history do not offer much promise of success in Canada-U.S. trade negotiations.

On a more positive note, however, the auto pact negotiated in 1965 is regarded as having been good for both countries and now accounts for a very large part of Canada-U.S. trade. Indeed, trade under the auto-pact alone accounts for some 7 percent of Canadian GNP. This explains why Canada is concerned about possible changes in this agreement.

In terms of current economic environment, it is a difficult time to be negotiating a trade agreement. Economic growth is sluggish, both countries are struggling with large budget deficits and the U.S. faces a record trade deficit. As noted by Reisman, it is traditionally in difficult economic times that Canada seeks improved trade access while the U.S. usually reacts by becoming more protectionistic. (Wonnacott p. 58) This time around, the growing protectionism in the U.S. is accompanied by much more aggressive subsidization of exports, at least for agricultural products.

Despite their importance to both countries, agricultural problems are neither the driving force nor the central issue in the current trade talks. Indeed, many people would not have been surprised if agriculture had been excluded from the bilateral talks.

Because of the complexity of agricultural policies on both sides of the border, this potential outcome was recognized by the Hon. Donald Macdonald, Chairman of the Royal Commission which recommended the trade talks.[2] More recently, recognizing the importance of price support programs, the difficulty of harmonizing domestic agricultural policies, and the overwhelming impact of the Common Agricultural Policy of the European Community on both Canada and the U.S., Wonnacott (p. 29) acknowledges, with respect to the bilateral talks that, "The strongest case for exception can be made in agriculture."

It should be no surprise then that the chief negotiators (Reisman and Murphy) have identified agriculture as one of "the most difficult issues" in the talks.[3] Despite these difficulties and reservations about importance and feasibility of negotiating an agreement in agriculture, it appears that there may be some progress in reducing trade barriers, and perhaps on defining subsidization aspects of domestic agricultural policy.

Impact of Free Trade

What, then, would be the impact of freer trade in the event that such an agreement is reached? A few studies have been conducted which provide some insight in this regard. First of all, it is worth reminding ourselves of the principal sources of gain from further trade liberalization in this case. The first of these, probably the best known and most often cited by proponents of free trade, and the *least* important in this case, are the efficiency gains associated with the specialization of production accortting to the principle of comparative advantage. Potential gains from more efficient allocation of resources may be impressive when comparing free trade with a no-trade situation, when resources are fully employed in two countries with very different resource endowments and when products trade in perfectly competitive markets but when these resources cannot, themselves, be traded. This does *not* describe the context of freer trade between Canada and the U.S. and the potential gains from more efficient resource allocation in this case are not impressive. Indeed, citing two studies which produce conflicting results on which country would gain and which one would lose under these conditions, Wonnacott concludes that, in the absence of economies of scale, the gains from bilateral free trade between Canada and the U.S. would most likely be less than 1% of GNP in either case.

So it is economies of scale, then, that offers the greatest potential for gains from freer bilateral trade between Canada and the U.S. Having the smaller market and the smaller plants, Canada stands to gain the most in cases where economies of scale are important. These gains might be only partially offset by the removal of the higher tariff structure in Canada, and by the conduct and performance of firms in concentrated market structures. Indeed, according to an empirical analysis by Harris and Cox (1984) which allowed for economies of scale, the Canadian gain from freer trade with the U.S. was estimated at up to 9% of GNP. In a later study, Harris (1985) identified the winners and losers by sector: the textiles and clothing sectors would experience the largest increase in production followed by the paper, rubber, knitting, tobacco and transportation equipment sectors; production would probably decrease 10-20% in the furniture, agricultural and non-agricultural equipment sectors and could go either way in chemicals, electrical equipment, food and beverage manufacturing, and several other sectors. Lower employment was predicted for food and beverages and a number of other sectors.

In a study for the Economic Council of Canada, Magum came to a similar conclusion for the food and beverage sector, forecasting no change greater than 2.5% in either direction. Assuming constant returns to scale, Brown and Stern forecast a reduction of at least $15 million in output in the Canadian food and beverage sector as a result of free trade with the United States.

So the results of the general equilibrium analysis appear to be somewhat mixed. While it seems that the Canadian economy in total would gain if economies of scale are important, it also appears that the major gains would be concentrated in relatively few sectors. This raises questions about how those gains from trade will be distributed and whether the losers might expect to be compensated.

For the food and beverage manufacturing sector, it appears that there is just as much, if not more, likelihood of loss as of gain from freer trade. But the change in either direction may not be large. In

[2] Remarks by Hon. Donald Macdonald during luncheon address to the Canadian Institute of International Affairs, Montreal, 1985 (Response to question from author).

[3] "Latest talks on Trade solved little, say official" The *Ottawa Citizen,* April 30/87.

the final analysis, it will be the competitiveness of the sector and its ability to adjust that will determine the direction and amount of change.

There are at least two indicators that may not bode well for the competitiveness of the Canadian food and beverage sector. The first of these is productivity. According to Salem (1987b) multifactor (capital, labour, and energy) productivity in the food and beverage sector has declined at an average rate of .03% in Canada from 1978-82 while that of the U.S. industry *grew* at an average annual rate of 1.34%. Lanoie observed the same phenomenon over the period of 1972-81 with respect to labour productivity in the food and beverage sector. He noted that, after adjusting for exchange rates, the value added per hour in Canada declined from 78% of that in the U.S. in 1972 to 69% of the U.S. level in 1981 with wage rates virtually the same in both countries.

Another indicator of competitiveness in the agrifood sector is plant size. With average plant size across the entire sector in the U.S. more than twice that in Canada, the U.S. industry should currently have an important edge if economies of scale are important. (Table 6). Of course, access to larger markets might permit Canadian plants ot expand and become more efficient.

Ironically, according to Salem (1987b), the industry in *both* countries is demonstrating *decreasing* returns to scale, more so in the U.S. than in Canada. (Perhaps small is beautiful in this case!)

Table 6. *Plant Size*
Average Value of Shipments by Establishment in Selected Food and Beverage Industries in Canada and the U.S. 1982

Industry	Canada (1972 $Can.) Millions	U.S. (1972 $U.S.) Millions	Ratio^ (U.S. /Canada)
Slaughtering and			
Meat Processors	6.97	8.67	1.53
Poultry Processors	5.39	12.68	2.89
Fruit and Vegetable			
Canners	3.0	6.03	2.47
Freezers	5.11	8.70	2.09
Dairy Products	4.56	6.93	1.87
Breweries	12.63	59.23	5.77
Total — Food &			
Beverage	2.79	6.22	2.74

Source: C. Lanoie, "Comparison of the Canadian and United States Food and Beverage Industries, *Market Commentary,* Vol. 7 No. 3 Agriculture Canada, Ottawa, p. 45.
^/ U.S. Shipments are converted to Canadian Dollars by an exchange rate of 1.23 before dividing by Canadian sales.

Table 7. International Orientation of Food and Beverage Industries of Canada and the United States, 1982

	Exports As % of Shipments		Imports As % of Domestic Supply.	
Industry	Canada	U.S.	Canada	U.S.
Red Meats	13.0	3.4	5.2	3.7
Fruits & Vegetables	13.7	3.3	27.2	4.3
Dairy Products	5.0	1.2	1.8	1.6
Flour & Breakfast Cereal Products	25.0	1.0	4.8	0.2
Distilleries	45.3	3.3	27.4	25.3
Breweries	8.3	0.3	0.8	4.2
Total — Food & Beverages	12.6	4.0		
(Excluding Fish)	(9.2)		8.7	3.5

Source: C. Lanoie. "Comparison of the Canadian and United States Food and Beverage Industries" *Market Commentary* Vol. 7 No. 3 Agriculture Canada, Ottawa, p. 50.

This raises doubts about this source of gain from free trade in the food industry.

Competitiveness of the Canadian food and beverage manufacturing sector may also be judged on the basis of its orientation and exposure to international markets. On this basis, it comes off quite well with respect to the U.S. For example, in 1982, 12.6% of the value of shipments from Canadian plants was exported compared to only 4% in the U.S. On the other side of the ledger, imports of processed food and beverages represented 8.7% of the value of consumption in Canada versus 3.5% in the U.S. (Table 7). In both countries, the food and beverage sector as a whole is relatively more isolated from international markets than the average for the total manufacturing sector in terms of the relationship between production and trade volumes.

A few other observations and comparisons on the food and beverage sector in both countries may be of interest in anticipating performance under freer trade. First, the industry is much more concentrated in Canada with a weighted average CR4 of 51.8% in 1978 versus 20-25% in the U.S. (Lanoie). To the extent that freer trade means more competition, performance might be expected to improve in the longer term. Secondly, foreign control of the industry is much higher in Canada (28%) than in the U.S. (5%), and most of that control (76%) is held by U.S. interests. Are we facing the likelihood of branch plant closures in Canada as trade barriers are lowered? This is a question that needs further study.

As a further measure of the role of large, foreign-controlled firms in Canadian trade, it is reported by Harris (1985) that in 1978, 72% of imports were to foreign controlled firms and 50% of all imports were accounted for by 50 firms, 35 of which were foreign controlled. This degree of mtra-corporate trade raises questions about the extent to which market forces will be reflected in the distribution of gains from freer trade in Canada.

Competitiveness at the farm level in Quebec has been examined by Proulx (1986), using the following definition:

> To be competitive, a group of firms in a given sector, must be able to sell their products at a price equal to or less than the competition and, with that price, to remunerate resources not less than the competition, without recourse to government support greater than that of the competition.[4]

Proulx added the further criteria of maintaining or increasing market share, and maintaining or improving the trade balance in that product. He found that, with the exception of poultry and eggs, Quebec agriculture performed very well, both with respect to the rest of Canada as well as the United States. But he also found that a number of the products in which Quebec could be competitive were those which the U.S. tends to overproduce and that there would be little opportunity for expanded markets. At the same time, the increased instability from being more integrated into the U.S. and other international markets, coupled with the growing tendency of the U.S. to subsidize its agriculture, raised serious doubts about the potential of net social gain from freer trade with the U.S.

A study released by the Ontario Ministry of Agriculture and Food also finds little to cheer about in the prospects of free trade in the agri-food sector. While acknowledging some potential opportunities for increased production and the gains to consumers from lower prices, the report observes that the potential gains are limited and that adjustment costs could be significant. The sectors identified as facing the largest adjustments at both the farm and processing level would be dairy, poultry, eggs, fruit and vegetable, wineries and breweries.

Even in Western Canada, where support for the free trade initiative has been strongest, the prospects for gain are apparently modest insofar as agriculture is concerned. It has been estimated that production would increase 1% and farm cash receipts by $60 million by 1995 under free trade with the United States, (Deloite, Haskins and Sells). The gains, concentrated heavily in beef and canola would tend to be offset by losses in poultry and feed grains.

Summary and Conclusions

What can we conclude from this rather sweeping treatment of Canada-U.S. trade relationships? The main points are summarized below.

1. Canadian-U. S. trade relationships have been changing in a variety of ways. The volume of trade has been growing rapidly in both directions and Canadian dependence on U.S. markets has been increasing. But our trade relations have been deteriorating. Growing U.S. protectionism is evidenced by 16 trade actions taken against Canada since 1980, and others still pending.
2. Inspired by the fear of losing part of the U.S. market due to indiscriminate application of contingency protection, Canada initiated the bilateral trade talks with the U.S. in 1985. The Canadian objectives of those talks are *secure access, enhanced access* and *enshrinement of access* to the U.S. market.
3. There may be an opportunity for gain through exploitation of economies of scale under free trade with the U.S. but most of the gain will be concentrated in a few sectors. This raises questions about the distribution of those gains in a highly concentrated and foreign controlled manufacturing sector. Moreover, there is evidence of *decreasing* returns to scale in food manufacturing.
4. The potential gains in the agriculture and food sector appear to be quite modest and may well be non-existent due to reduced production in several industries. The largest adjustment under a complete free trade agreement would be poultry, dairy and some parts of the horticultural industry. Complete free trade is unlikely to happen but removal of tariffs and reductions in non-tariff barriers are expected.
5. Further work is needed in measuring the gains from trade under conditions that reflect *actual* market conditions of excess resources and imperfect markets. Work is also needed on the trade distortion effects of government policies and definition of countervailable subsidies. Both of these will be useful for the GATT negotiations as well as in the bilateral context.
6. Given the current depressed state of agriculture in both countries, freer bilateral trade

[4] Translation from french text by author.

will do little to improve the situation. The best, if not the only, hope for resolving global agricultural trade problems lies in the forthcoming round of GATT negotiations. Any progress that can be made in improving trade relations between Canada and the U.S. will be important to the growth and efficiency of the agri-food sector in both countries. But we should not expect too much.

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