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U.S.-CANADA FREE TRADE: WHAT ARE THE ISSUES?

Mary Ann Normile¹

The current initiative aimed at producing a free-trade agreement between the United States and Canada is the most recent in a series of similar efforts over history. The impetus for the current talks came from the newly elected Progressive Conservative government of Canadian Prime Minister Mulroney, and gained momentum at the March 1985 Montreal "Shamrock Summit" between Mulroney and President Reagan. The negotiations are currently proceeding under "fast track" authority in the United States, which imposes a January 1988 deadline for concluding an agreement, and stipulates that the U.S. Congress must approve or disapprove, but may not amend, the agreement. Teams of negotiators have met several times and have set up working groups on specific areas such as technical barriers (including phytosanitary restrictions) and subsidies.

The expected outcome of these talks is an agreement that results in free trade, or, what politicians now refer to as "freer trade," between the two countries. Such an agreement would reduce or eliminate trade barriers between the two participating countries, while maintaining existing barriers with third countries. An agreement aimed at establishing a customs union, common market, or economic/monetary union, which would imply a greater degree of economic integration, is not being considered.

Canada's principal objective in initiating the process aimed at obtaining a comprehensive free trade agreement is to obtain secure access to the U.S. market, which accounts for between 70 and 80 percent of Canada's exports. Many Canadian officials believe that secure access can best be achieved by obtaining relief for Canadian exporters from the increasing number of protectionist measures being applied by special interests under U.S. trade remedy laws (countervail, antidump, and safeguard). These officials see a bilateral agreement as a potentially effective way of restraining U.S. protectionist interests. A secondary Canadian objective is to use a bilateral trade agreement as a means of imposing better discipline on domestic industries in order to make them more competitive.

The probability of Canada's achieving its objective in the bilateral talks is low because it is negotiating from a weak bargaining position. The probability of success is low because of strong protectionist sentiment in the U.S. Congress, which is directly related to the strength of the U.S. dollar and the burgeoning trade deficit. There are high political stakes to achieving a bilateral trade agreement with the United States, and the importance placed on achieving a bilateral trade agreement by Canadian politicians has put added pressure on Canadian negotiators, weakening their bargaining position. Relative trade dependence is unbalanced; Canada is far more dependent on the United States for trade than the United States is dependent on Canada and, therefore, has more to gain (or lose) in a bilateral agreement. An added 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 at home. Consequently, the United States is more likely to be able to impose discipline on Canada than vice-versa. As a result, the outcome of negotiations will probably be much less ambitious, and less favorable to Canada, than was originally intended.

Canada's strategy was flawed from the outset. The policy of coalition-building and lobbying pursued in the early eighties was more promising of success than the free-trade negotiations are likely to be. The wisdom of the earlier strategy was demonstrated by the Canadian successes in opposing countervailing duties in the Bombardier subway car case and in the original softwood lumber decision. Canada could improve its bargaining position by building

¹The author is an economist, Agriculture and Trade Analysis Division, Economic Research Service, U.S. Department of Agriculture.

consensus at home, by building coalitions with groups outside Canada (such as U.S. consumers likely to benefit from tariff reductions), and by lobbying to alter rules of the game so they are less in favor of U.S. protectionists. Canada could also attempt to impose discipline on U.S. protectionists in the GATT by forming coalitions with other adversely affected countries. For these reasons, a bilateral trade agreement is not likely to be Canada's best strategy for fighting U.S. protectionism.

U.S. objectives in the negotiations are less clear. The United States is responding to the Canadian initiative and, as such, may not have had the advantage of preparatory study and analysis that the Canadians had. However, some general motives of the United States in pursuing a freer trade with Canada can be inferred. First, the U.S. competitive position in agricultural trade with Canada is worsening. The overall U.S. trade deficit with Canada is second only to its trade deficit with Japan; in agricultural trade, the United States became a net importer of agricultural products from Canada in 1985, reversing a long history of agricultural trade surpluses. Second, the United States would like improved market access for its agricultural products in Canada. U.S. producers of wheat and live hogs, for example, see as unfair a trading situation that permits Canadian products to move freely into the United States, while U.S. products are denied similar access to the Canadian market. There are also compelling political reasons for the United States to seek closer economic ties with Canada, who is not only the U.S. largest trading partner, but also an important ally. Lastly, the United States may want to achieve successful negotiation of reductions of protection and assistance to agriculture bilaterally as a demonstration of what can be achieved in trade liberalization talks to serve as "inspiration" for the multilateral trade negotiations (MTN).

In this connection, there are several parallels between the bilateral trade talks and the MTN. Approximately 75 percent of U.S.-Canada trade is duty-free; therefore, substantive work will have to be done in the area of nontariff barriers. There is a widespread perception that the GATT has failed as a means of settling trade disputes, and current settlement procedures for settling bilateral trade disputes are considered inadequate as well. A bilateral agreement will have to include a mechanism for adjudicating trade disputes that could serve as a model for improved dispute settlement procedures in GATT. However, bilateral talks offer an opportunity to go beyond what either country may reasonably expect to achieve in the MTN.