

THE NAFTA, MANIFEST DESTINY AND ALL THAT

**Bruce. W. Wilkinson, Department of Economics,
University of Alberta, ALTA, Canada**

Introduction

Back in 1988 advocates of the Canada-US economic integration agreement, more commonly known by its official euphemistic title, the Canada-US Free Trade Agreement (CUFTA), were arguing that one of its great merits was that Canada was the only nation in the world (other than little Israel) that had privileged access to the great US economy, that substantial economic benefits would accrue to Canada from this deal, and that as the Canadian economy was strengthened so would its political sovereignty be. Like so many of the arguments for CUFTA which its supporters used, these were based on an extremely limited interpretation of the agreement, almost total ignorance of - or at least a complete unwillingness to take into account - over two centuries of American expansionist attitudes towards the Americas, the then-President Reagan's declared desire to see a new close arrangement uniting the economies of North America with the US at the helm, and the expressed statement by Clayton Yeutter, the US Trade Representative, that a deal with Canada was only the first step toward "something like a North American Common Market" (L Martin, 1993, p102). Thus, it came as no surprise to many of us when, on 10 June 1990, President Carlos Salinas de Gortari of Mexico and President George Bush announced that they would pursue a free trade agreement. This was consistent with our expectations and also with Bush's new Enterprise for the American Initiative which envisaged all of the North, South and Central Americas and the Caribbean being one huge area of liberalized trade and investment under US leadership.¹ On 24 September of that year, Brian Mulroney formally told Salinas and Bush that Canada wanted to participate.

The negotiations officially commenced 12 June 1991 and an agreement in principle was reached on the North American Free Trade Agreement (NAFTA) on 12 August 1992. The heads of the three governments signed the detailed agreement on 17 December 1992. It is now scheduled to come into effect 1 January 1994, providing that the US Congress approves the deal before then. There is a real incentive for them to do so because President Salinas' term expires in the summer of 1994, and the Mexican constitution does not permit him to run again. Then, unless someone

as favourable to the deal as Salinas replaces him as President - and one would hope that whoever is elected will come into power without the questionable voting and vote-counting procedures that brought Salinas into office² - the opportunity to fulfil another extension of the great American dream of controlling the Americas could be lost for the time being.

We shall assume, however, that the deal is going ahead. I have been asked to comment on what I see as its implications for Canada. In brief, I consider the NAFTA as just another in a series of many measures taken over the years toward the Americanization of Canada, and the fulfilment of the Manifest Destiny doctrine as expressed by John L Sullivan, editor of the *New York Morning News* on 27 December 1845:

"We have a still better title than any that can ever be constructed out of all these antiquated materials of old black-letter international law. Away, away with all these cobweb tissues of rights of discovery, exploration, settlement, continuity, etc ... And that claim is by the right of our manifest destiny to overspread and to possess the whole of the continent which Providence has given us" (Weinberg, 1935, p145).

In the light of this perspective, many (not all) of the analyses made by economists and others of the various sections of the NAFTA remind me of mice cheerily chomping on the cheese, blissfully unaware that the door has been slid shut behind them and there is very little chance of escape. Lest you think that this is the mere ranting by some xenophobic nationalist, please note the comment Clayton Yeutter made on 3 October 1987, right after signing the less comprehensive, less-detailed CUFTA:

"We've signed a stunning new trade pact with Canada. The Canadians don't understand what they've signed. In twenty years, they will be sucked into the US economy" (*Toronto Star*, 6 October 1987).

With this introduction, and with our conclusion in mind, let us consider in more detail Canada's motives for joining the NAFTA negotiations, what the models tell us (and do not tell us) about results for Canada, some of the key provisions of the NAFTA, and Canada's overall situation, given these provisions and US attitudes and objectives.

Why Did Canada Participate?

After signing the FTA, further trade liberalization with Mexico

beyond what was already provided for in the Generalized System of Preferences, was not at the forefront of anyone's aspirations in Canada. Canadian exports to Mexico in 1992 were only \$0.78 billion or .5 per cent of total shipments abroad, and but .12 per cent of GDP. Canadian imports were larger - about \$2.8 billion, undoubtedly in part because Canadian tariffs on Mexican goods averaged only about 2.4 per cent, with over one-third of the items already entering tariff-free. (About 80 per cent of the total value of imports are duty free) (Canada: 1993, p29). But these amounted to only 1.9 per cent of Canada's total imports.

Nevertheless, with the US taking the initiative for a US-Mexico deal - while all the time trying to make it look as if it were Mexico's idea, the same strategy that was used with Canada in the FTA - Canada asked to be included. It was recognized in Canada that unless the nation also had liberalized access to Mexico, it would be further disadvantaged *vis-à-vis* the US as a site for new investment designed to serve North American markets. In addition, it was felt that with a US-Mexico agreement to which Canada was not a party, Canada would experience greater competition from Mexico in the US market without having at least some partial offset to this via expanded access to the Mexican market as the US would have. (One estimate indicates that in 1989, Canada and Mexico already exported about 2,500 products in common to the US market, but they only traded 366 products between themselves. The 2,500 products comprised about 60 per cent of Canadian exports to the US) (Watson, 1993, p6 and p25, p16). In addition, if Canada did not participate, there would not likely be the same freedom for Canadian firms to invest in Mexico as American firms would enjoy.

While these arguments did suggest that there was reason for Canada to negotiate a liberalized trade and investment agreement with Mexico, they did not necessarily require that Canada become a party to a tripartite deal which, as was predicted by a number of us, would result in the reopening of the CUFTA and enlarging and strengthening it along the lines deemed appropriate by the US. Canada could have entered a separate negotiation with Mexico, and thereby still gained the advantages it sought without facing some of the additional constraints essentially imposed by the US as conditions for Canadian entry into the NAFTA.³

Be that as it may, the deal has now been written in black and white, so rather than consider any further what might have been, let us examine some of its characteristics and possible implications. First, a few words on what the quantitative model suggest as to the probable effects of the NAFTA are appropriate.

Quantitative Results

A number of quantitative studies (Applied or Computable General Equilibrium Models) have been undertaken to estimate the aggregate and sectoral impacts (Harris and Cox, 1992; Brown, 1992; and Roland-Holst, Reinart, and Shiells, 1992). These have been reviewed elsewhere (Watson, 1993; Stanford, 1993; see also Grinspun, 1991) so only limited detail need be given here. In essence, these results suggest that the effects upon Canadian GDP will be negligible. Estimated gains are projected to be in the neighbourhood of about one-tenth of one per cent, possibly more if all NTBs were removed (which they will not be). These gains, as tiny as they are, would come primarily from the improvement in efficiency being generated via increased competition. (Most economies of scale gains would have been achieved from the prior access to the US under the CUFTA.)

The models are designed to allow for several different effects:

- 1 The increased competition for Canadian firms in the US market from Mexican products. The Harris and Cox model predicts that the Canadian share of the US market would diminish somewhat in all sectors except refining, forestry, and mining, with the biggest reductions being in non-alcoholic minerals and machinery and appliances. Other significant reductions are expected in Canada's largest trade surplus generator - wood products and paper - as well as in other resource-based sectors - steel and metal products, agriculture, and food, beverage and tobacco. (We might note in passing that the Mexican shares of the US market would expand more than the Canadian shares would decline, owing to Mexican replacement of products from fourth countries, that is, from trade diversion.)
- 2 Increases in Canadian imports from Mexico, particularly in labour-intensive sectors such as clothing, leather and footwear, as well as in textiles and metal products, non-ferrous metals, and electrical machinery. These are not anticipated to be as large as some might expect because even prior to the NAFTA, Canada included Mexico in its Generalized System of Preferences. Thus, already the average Canadian tariff on Mexican imports is only about 2.4 per cent, and about one-third of items which Canada imports from Mexico already enter tariff-free (Watson, 1991).

- 3 Some expansion (albeit from a very small base) in Canadian exports to Mexico in sectors such as glass products, footwear, high-fashion clothing, non-metallic mineral products, some furniture, as well as wood, textiles and rubber. It is also believed that there will be increased shipments of automobiles and parts over time, once Mexico's high tariffs on parts (13.2 per cent) and cars (20 per cent), and quantitative limitations on imports of parts and cars related to the use of Mexican production, are removed (Watson, 1993).

The models do not allow for all the economic implications involved, a number of which would well be unfavourable to Canada, and a few which could be favourable.

To begin with, the estimates do not take into account that increasingly, with both Mexican- and Canadian-based firms supplying the US market with similar products, the US buyers will be in a strong position to play the one set of suppliers off against the other. Also, to the degree that firms in both the US and Canada are selling similar goods to Mexico, the US firms will have a locational advantage over those in Canada in terms of transport costs, speed of delivery and service. Again, to the extent that production in Canada is by foreign-owned firms (which account for over two-thirds of manufactured goods sales in Canada) and about 70 per cent of which are owned in the US, there is a strong likelihood that for this reason, too, sales to Mexico may well come from American rather than Canadian locations. A few industries such as telecommunications equipment and urban transportation equipment, which, uniquely, involve large Canadian-owned firms, the foreign-ownership issue is not an important one. But for many others, such as the machinery and automotive sectors which are heavily foreign-owned, it may well be.

Again, the models do not really allow for the possible movement of manufacturing plants from Canada to Mexico to serve North American markets, because labour costs are lower and environmental requirements are not as stringent or are not enforced. (The side agreements on labour and the environment will not eliminate this possibility.) Yet, the major Mexican motive for the NAFTA has been to attract much new foreign capital and industry. (Certainly this is what the Maquiladoras have been all about.) Instead, because the assumption inserted into the models was that substantial increases in productivity and profits would occur in Canada, capital inflows for new investment (not just takeovers of existing plants) are projected to increase here.

The possibility of manufacturing activity departing Canada was ignored in the model-building of CUFTA, too, even though it has been well known historically that the main motivation for many plants being located in Canada was the tariffs between the two nations. That this has been an important oversight can be seen by looking at a few statistics. From June 1989 until early 1992 the reduction in manufacturing employment in Canada amounted to 26 per cent of the total work force in manufacturing! It is difficult to believe that this was solely or at least primarily due to the severe recession as FTA supporters argue, because in the US over the same period, the reduction in manufacturing employment was only 5.7 per cent. As well, 65 per cent of the jobs lost from 1989 to 1992 in Canadian manufacturing were a consequence of permanent plant closures. In contrast, during the serious 1981-1982 recession, only 22 per cent of the lost jobs were from this cause (Campbell, 1992, pp99-101).⁴

Again, the models do not attempt to assess the full effects on employment. Wage flexibility is assumed to reallocate labour among sectors as changes in production and trade flows occur. And little consideration is given to the fact that a balanced increase in Canadian trade is not employment-neutral. Rather, it has a negative effect on employment.⁵ This is because Canadian imports are more labour-intensive (not just unskilled labour-intensive, but high-tech labour-intensive, too) than are exports.

It is also worth noting in this context that the employment effects on increases in exports from Canada will not compensate for reductions in government or consumption expenditures either. Recent computations by Morley Martin of External Affairs and International Trade Canada (1993) indicate that although merchandise exports amount to about 23 per cent of Canadian GDP, they account for only 13.4 per cent of all jobs in Canada. This calculation counts total input-output goods requirements and indirect service inputs to Canadian merchandise exports. Moreover, even though Canadians often take pride in the fact that a larger proportion of their exports to the US are manufactured goods than to any other market, the fact is that exports to the US generate substantially fewer jobs per billion dollars of exports than do exports to other nations in the world.⁶ This is because so many of our manufactured exports, especially to the US, have extremely high import content. Therefore, an expanded concentration of Canada's two-way trade with the US - as has occurred in the last five years⁷ - is not really cause for unqualified rejoicing with regard to employment effects.

The models also make the assumption of national product differentiation - the Armington assumption - the idea that products produced

in different countries are imperfect substitutes for one another in consumers' minds. Thus, the changes in international product flows from tariff reduction are assumed to be relatively modest. However, where the production is by transnational corporations, manufacturing virtually the same products regardless of which nations they locate in, it can be quite inappropriate to assume that consumers are going to distinguish among the products from the different nations involved and give preference to home-based production. One study, for example, relaxed the assumption that buyers have strong national preferences and found that automobile production will decline in the US and Canada and increase in Mexico in response to the NAFTA (Hunter *et al.*, 1992).

Some, of course, argue that Mexican wages will rise rather dramatically as productivity improves via new investments in machinery and equipment thus discouraging major shifts of production to Mexico from Canadian locations. I hope they are correct. But this could be more wishful thinking than sound economic analysis. Actual unemployment rates in Mexico are well over 20 per cent (in spite of "official" government figures suggesting that they are less), 80 per cent of the populace is under 30 years of age, about 1,000,000 new potential workers are coming into the labour force each year for years to come, and union activity is still discouraged. (The trilateral side agreement on labour cooperation will not alter this fact.) Wages, therefore, are unlikely to be strongly reflecting rising productivity levels.

In summary, then, there are a variety of reasons for thinking that the tiny estimated economic benefits to Canada from a NAFTA could turn into net losses. Even if such losses turned out to be relatively small, they would nevertheless aggravate the already high Canadian unemployment rate of well over 11 per cent. One can only hope that gains to the strong financial sector and some fairly high-tech service industries, through trade with and investment in Mexico, which were not fully accounted for in the formal models, will, at least in part, compensate for possible losses in the goods-producing sectors.

My concerns about NAFTA, however, go beyond these narrow trade and employment issues. They relate to the present and longer-run implications for Canadian sovereignty. The argument has five steps. The first involves briefly looking at the extensions to CUFTA that have been added to NAFTA and which are very much in US interests. The second step is to note a number of the topics that it would have been in the Canadian interest to see in the new agreement, but which were not included in NAFTA. The third and

fourth steps are to observe how these first two sets of data are consistent with the US behaviour under the CUFTA, and with historical US attitudes and behaviour, respectively. The final step is to consider what this may all mean for Canada in the future, insofar as its sovereignty goes.

*The Nature of the NAFTA*⁸

The NAFTA is a much lengthier and tighter document than the CUFTA. Some sections involve, primarily, an increase in detail and increased clarification on matters covered in the CUFTA, but with no large changes in principle or the broad rules. This is the case for items such as basic tariff elimination; the extension of national treatment to goods from member nations; minimization of the use of technical standards to reduce trade; provision for emergency action in the event of import surges due to liberalization; and a variety of other institutional arrangements.

Of much greater significance is that the US used the occasion of the NAFTA negotiations to further its own agenda in a number of directions through the extension of its influence and control over Canadian policy and the Canadian economy generally. Many of these new provisions are not surprises, at least to some of us. They simply bring to pass items on the shopping list which the US had spelled out for further negotiations with Canada in Section 304 of the legislation it passed to bring the CUFTA into effect. (Some of them were also marked as areas for further negotiation in the CUFTA document itself.) One such item was a set of detailed rules on the protection of intellectual property rights, a subject excluded from the CUFTA because Canada at that time objected to US demands. These provisions strongly favour the corporate originators of new intellectual property and the country in which most of them are situated - that is, the US - at the expense of Canada and Mexico which are the primarily user nations. Also, new rules were developed on government procurement so that governments will not have the freedom to insist that foreign bidders on contracts buy locally a significant proportion of their supplies etc so as to promote domestic economic production and employment, or to reduce balance of payments current account deficits. Again, disputes about the application of existing foreign direct investment limitations are henceforth to be included in the dispute settlement mechanism. This way, if the investing nation is unsatisfied with the administration of restrictions, they can seek recourse through arbitration or the courts, an alternative the US did not have under CUFTA. Also, the definition of foreign investment was substantially expanded to

include such things as minority interests, portfolio investment and real property, as well as investments by companies not owned in partner countries but only incorporated in partner countries, regardless of their original home country. The liberalization of telecommunications services was increased as well, so that nations will not be able to prevent firms from partner countries from having access to the use of their public telecommunications networks. Also, in the NAFTA, new rules have been instituted to increase the liberalization of financial services with regard to "the right of consumers to purchase financial services on a cross-border basis and the right to market access through the establishment of a commercial presence" (*Canada*, 1993, p73). As one Canadian government document says, "The NAFTA establishes a comprehensive principles-based approach to disciplining government measures regulating financial services" (*Canada*, 1992, p14). The liberalization of other services has been expanded to include land transportation, and the provision that nations from one country offering services in another partner country need not even establish a "local presence" in that country. The NAFTA also goes much beyond the CUFTA in specifying provisions for the development of common sanitary and phytosanitary measures relating to agricultural trade. Again, the energy-sharing provisions in CUFTA are extended to cover basic petrochemicals as well - which places additional constraints on independent Canadian action in this sector. And there are clauses authorizing individual states or state agencies, or other end-users, as well as suppliers, to negotiate contracts for energy products without federal governments or agencies being able to be involved in the outcomes. These rules formally condone what the powerful California authorities have already been doing in renegeing on their long-term gas purchase contracts with Alberta sources and working to lower their present, future and past gas costs.

The agreement also establishes new, detailed rules of origin for calculating regional value content. With regard to automotive products the rules may work to the benefit of Canada as well as the US (providing more production is not shifted to Mexico), for they specify that North American content for what are, essentially, direct costs, is to be increased from 50 per cent to either 60 or 62.5 per cent depending upon the nature of the product. This is like raising the North American content for automotive products to about 80 per cent or more of export value.⁹ However, with regard to textiles and apparel the North American content provisions requiring both fibre and yarn to be produced within NAFTA are not in Canada's favour. This is because Canadian producers rely much more heavily than do US or Mexican

producers on fibre and yarn imported from non-NAFTA nations. For the next few years the magnitude of tariff-free fibre and yarn imports allowed Canada are sufficient to prevent a competitive disadvantage for Canadian firms. But over the longer run, these restrictions are certainly not in the Canadian interest.

A final change worth noting is the erosion of the finality and authority of Dispute Settlement Panels or Extraordinary Challenge Committees of the CUFTA. A major new article has been inserted into the NAFTA - Article 1905 - which incongruently is labelled "Safeguarding the Panel Review System." This article actually introduces a third stage of review by a Special Committee (of three judges or retired judges, the same as the Extraordinary Challenge Committees), and also provides for a dispute to be "irrevocably referred to the appropriate domestic court for decision" - the very thing which the dispute panels in the CUFTA were designed to eliminate because of the long, dragged-out, expensive nature of court proceedings! In other words, a vehicle has been introduced to enable US interests to get disputes back onto their own courts completely and out of the hands of dispute panels which they cannot always control to their own benefit. Although some Canadian reviewers of the NAFTA seem to see Article 1905 as fairly innocuous (eg: Winham, 1993), the interpretation here is very much in line with a statement included with the US implementing legislation for the NAFTA.¹⁰

Noteworthy NAFTA Omissions

It is not only what has been included in NAFTA that is of interest. What has been excluded is also noteworthy. The powerful US maritime interests were able to ensure that Great Lakes and Ocean Shipping were excluded from liberalization. This was an area where Canada felt it could compete well. However, the US Jones Act, which requires American trade to be carried in American ships, will continue to apply. (We should recall, too, that the original CUFTA document signed in October 1987 did include the liberalization of shipping, but this section was deleted before the document went to Congress - owing to the immense pressure of the US vested interests.)

As well, government procurement, an area where Canada felt it could make great gains in the US, was not opened up beyond the very limited improvement made under CUFTA. Consequently, 90 per cent of US government purchases are still inaccessible to Canadian firms. (The value of this market is estimated at US \$760 billion) (Christie, 1993, p30).

Again, no progress was made in defining and developing common rules on what are acceptable and unacceptable subsidies, and in limiting repeated US trade harassment actions through the use of countervailing and anti-dumping duties. Given that (1) this was one of the key reasons, if not the key reason, why Canada entered the original CUFTA negotiations, (2) that the matter was not resolved in the CUFTA, and (3) that the CUFTA expressly provided for negotiations to continue on these matters with the objective of reaching a resolution within five years from the beginning of the CUFTA, that is by January 1994,¹¹ the overwhelming dominance of the US in the CUFTA and NAFTA negotiations is strongly evidence. (The NAFTA provides only that consultations on these matters should occur, with nothing more binding than this involved.)

Financial services is another area warranting comment. Under the CUFTA, some Canadians were optimistic about Article 1702 which promised that when the US Glass-Steagall Act was amended (and there were indications that it would be) to allow commercial banks to engage in investment banking, Canadian banks in the US would receive the same rights and privileges. However, the amendments were never forthcoming. No commitments were made in this regard under the NAFTA either. So, liberalization of the US financial markets is not keeping pace with what has been occurring in Canada and in which US institutions are able to participate.

Because of the pace and diversity of technological advance today, it would also have been highly beneficial for Canadian firms if formal rules had been established whereby Canadian firms could regularly participate in US organized consortia involving common research projects and the sharing of the resulting new technology. Canadian involvement in publicly supported US consortia is often prevented by "patent, national competitiveness and national defence legislation, and may face an even greater variety of implicit barriers through government procurement regulations" (Caldwell, 1993, p2). But no breakthrough occurred in NAFTA in this area. Apparently the national treatment of firms is only a suitable principle to follow provided that it is limited to those areas of long-run advantage for the US.

Finally, it is worth noting that the great contrast existing between the nearly eleven pages of provisions for the enforcement of intellectual property rights - which, as we have already noted, are primarily in the interests of the US - and the complete lack of any enforcement or penalty provisions should one country fail to "take into account the export interests of the other Party in the use of any export subsidy on any agricultural good exported to third countries..." (Article 701 of the CUFTA and Annex 702.1 of the NAFTA).

The US has certainly failed to consider Canadian interests in its use of its EEP to subsidize wheat exports to Mexico, a traditional market of Canada. Canada has requested the establishment of a binational dispute-settlement panel to resolve this issue. But without any strong and well-defined penalties as exist in the case of intellectual property, one has to have doubts about whether the compensation to Canada will be adequate, assuming that dispute panel report favours the Canadian position.

* * * * *

These are just a few of the issues involved. Yet, what has been said should be sufficient to indicate that there is more to NAFTA, and before it, the CUFTA, than what some modelling efforts and the tracking of recent trade flows reflect. What is at issue is the fact that many Canadians in government, academic, and business circles see trade and investment liberalization agreements almost as ends in themselves, and that any steps in that direction, however imperfect they may be on occasion, are desirable. There is seemingly child-like trust that the results will automatically be in Canadian interests, and that if trade flows increase between the two nations (as under CUFTA) this is evidence enough that they are. In contrast, we have the US position that trade investment and investment liberalization is desirable, providing US interests are clearly achieved or satisfied. If such liberalization does not do this, then the rules have to be challenged, bent or changed so that these purposes are accomplished. Consider, very briefly, a few situations which are arisen under the CUFTA.

Some CUFTA Disputes

A good example of US attitudes is with regard to the export of Canadian durum wheat to that nation. The US has twice used the CUFTA dispute settlement mechanism to challenge Canadian exports to the US on the grounds that Canadian programs involved subsidies which result in "unfair" prices. Both times (in 1990 and again in February 1993) panels convened in accord with CUFTA rules have ruled that these charges were not supported by the facts. However, US farm interests and their Congressional representatives such as Senator Max Baucus of Montana, have been unwilling to give up. Recently, they have been pressing the Clinton Administration to take action against Canadian durum wheat sales under Section 22 of the US Agricultural Adjustment Act of 1933 which authorizes the use of quotas or tariffs on

imports damaging US farmers or thwarting US farm programs. There are indications that such action may be the price of getting these politicians' support for NAFTA.

The irony of the situation is that the expansion of exports of Canadian durum wheat to the US is a consequence of the US Export Enhancement Program which provides a more favourable price in the international market for US exporters than they could get domestically. (The subsidies are currently averaging US \$1.00 per bushel.) Thus, US millers have found themselves short of durum wheat and have had to seek suppliers from other sources such as Canada (Alberta Pool, 22 October 1993.) (Notice also how US domestic legislation takes precedence over the CUFTA commitments.)

It is also ironic when one recognizes that the increased durum sales to the US are just one side of an expanded flow of grains in both directions since the advent of the CUFTA in 1989. Canadian shipments to the US are up 155 per cent, whereas US sales to Canada are up 146 per cent (Alberta Pool, 24 September 1993). Apparently, if the world does not evolve as US interests think it should, then the outcome is "unfair". (I am reminded of a press release by the US State Department back in 1966 which said that the world distribution of water was also unfair!)

Another example of the US approach is regarding softwood lumber. It is not a new issue, for it has been around since 1983 when the US forest industry lobby charged that Canada was unfairly subsidizing its lumber production by not levying high enough stumpage fees. At that time the US Department of Commerce itself rejected the allegations. The same complaints were raised again in 1986, and this time, because of the precedent-setting carbon-black case (involving Mexico), the US Department of Commerce ruled that indeed Canada was subsidizing lumber exports. Rather than taking the case to GATT, Canada capitulated and levied a 15 per cent export tax, designed to make up for the stumpage charges deemed inadequate from the US perspective. Over the years the Canadian provinces hiked their stumpage charges and/or raised other forest management charges. By October 1991, the Canadian government deemed that stumpage and other fees had been increased sufficiently that the export tax could be removed. Immediately the US lumber interests charged that Canada was again subsidizing exports. In due course the US procedures produced findings by the US Department of Commerce that a 14.48 per cent countervailing duty should be imposed on Canadian lumber exports, because of inadequate stumpage charges (6.25 per cent), and because British Columbia forbade raw log exports (8.23 per cent).

It was deemed irrelevant to the Department of Commerce that US policy also forbids the export of raw logs. The US is able to do such things, but other nations must not. The US International Trade Commission (ITC) also subsequently decreed that the US industry had been injured, even though (1) Canada's share of the US market had been declining, (2) the volume of Canadian exports to the US was also diminishing, (3) the price of lumber in the US had increased, and (4) Canadian lumber was already higher priced than US lumber (*Canada*, 25 June 1992).

Canada therefore used the binational panel procedures established in CUFTA. The panel results strongly supported the Canadian position that (1) subsidies were not involved and (2) that there was no injury to the US industry. The Department of Commerce and International Trade Commission both disregarded the panels' instructions and refused to amend their positions. So once again, the binational panels are having to review the DOC and ITC determinations. Decisions should be forthcoming in December and January.

The same type of story could be given regarding other Canadian exports to the US, too. Live swine exports are currently going through their sixth administrative review by US authorities of alleged subsidization - in spite of the fact that an Extraordinary Challenge Committee ruled in favour of Canada last April when upholding the decision of a binational panel that subsidies were not involved. Charges of dumping of steel products by Canadian producers and determination of large dumping margins by the COC is another case of US protectionism and disregard for the facts if it is in the US interest to do so.

What are the broader, long-term implications of these US attitudes and tactics for Canada which finds its economy now so inextricably linked to the US? To answer this question, let us look briefly at a bit of history.

Manifest Destiny and All That

Most Canadians have some limited knowledge of the War of 1812 with the US, which Canadians won, and the fact that Confederation in 1867 was a Canadian response devised to prevent the northern half of the North American continent from becoming another part of the US. But few have an understanding of the depth and historical consistency of US aspirations for our nation - even though volumes have been written on the subject.¹² Few are aware, for example, that American troops entered Montreal 198 years ago this past week, nine months prior to the American Declaration of Independence, and demanded that it surrender, and that a convention be held to "elect

delegates to the Continental Congress, and declare Canada the fourteenth American colony" (Hatch, 1979, p97). After Montreal's fall, the walled fortress, Quebec City, was the next objective. The American view at the time can be summarized in the words of John Adams, the man who would become the second US president., "The Unanimous Voice of the Continent is Canada must be ours! Quebec must be taken" (Hutchinson, 1955, p147). British ships with additional troops arrived in time, however, and the Americans were routed.

Subsequent to this event and to the American Revolution, the pattern for the next two centuries of American conduct towards Canada, and the British response to American overtures was established. When British and US representatives met in 1783 (The Treaty of Paris) to work out details of US boundaries, Benjamin Franklin suggested that for full reconciliation to be established between the two nations and prevention of future armed conflict, all of the Canada of that day, which included all of what is now Michigan, Wisconsin, Illinois, Ohio, and Indiana, part of New York, Lake Michigan and a share in the remaining Great Lakes, be assigned to the US. Lord Shelburne, the British prime minister, naively "cherished the delusion that it was possible to make the Americans grateful and friendly by generous concessions" (Creighton, 1956, p79). And so all the area south of the Great Lakes was given away to the US.

This of course was not the end, although perhaps, in Churchillian words, it was the beginning of the end, that is, for Canada. The US invaded Canada in 1812, supported by much US rhetoric. Henry Clay, for example, Speaker of the House of Representatives, said

"I am not for stopping at Quebec, or anywhere else; but I would take the whole continent from them, and ask no favors. I wish never to see peace till we do. God has given us the power and the means. We are to blame if we do not use them" (Ryerson, 1963, p294).

The intensity of the Canadian resistance, and the strategic skill of Indian warriors was underestimated by the US. Canadians won the day against tremendous odds. Unfazed by their defeat, the US at the 1814 Treaty of Ghent negotiations to formally conclude the war, acted as though they were victors and demanded all of Canada. British negotiators, who did not allow any native or immigrant Canadians at the bargaining table, allowed the US to retain their pre-war boundaries, and declined to press for the Indian "demand for a neutral Indian territory in the region of the upper Mississippi" (Orchard,

1993, p29).

The story repeats itself. The 1820s saw US desires for New Brunswick timberlands. Thwarted, the US prepared for war, New Brunswick and Nova Scotia stood up to the US and this time it backed off. But in subsequent negotiations with Britain, the US received a huge wedge of timberland between the New Brunswick coast and Quebec which was added to Maine.

During these years and the years thereafter up to 1848 the US also took Florida from Spain, as well as Texas, and much of what is today New Mexico, Arizona, Nevada, Utah, and segments of Colorado and Wyoming from Mexico. Simultaneously, the doctrine of "Manifest Destiny" was developed to justify the 1844 slogan of "fifty-four Forty or fight", whereby the US, against all history and legal principle, laid claim to all of the Pacific North America up to Alaska (Hofstadter, Miller and Aaron, 1957, p279).

One could go on to document the US-inspired annexation movement of 1849 which was offered as a solution to Canada's economic difficulties at the time (that has a familiar ring to it); the US cancellation of the Canada-US Reciprocity agreement in 1866 in the hope of "bringing Canada to its knees"; the unanimous condemnation by the US House of Representatives in 1867 of Canada being established as a separate nation; the US demands for all British provinces in North America to be transferred to the US for payment of the damage done to the US by the British-built Confederate ship, Alabama, during the US Civil War; the US attempts to use the Red River Rebellion as an opportunity to annex all the land from Manitoba to Vancouver; the annexation movement of the 1880s with free trade and a commercial union being the first step; the American shennanigans in 1902, including threats made to Britain of war if the coastal lands of what would have otherwise been part of northern British Columbia (but are now part of Alaska) were not given to the US; the free trade agreement of 1911 which defeated the Laurier government; the US initiative in the 1935 trade agreement with Canada which was seen by the US Ambassador to Canada, Mr Armour, as a means of "bringing Canada not only within our economic but our political orbit", and a way of shifting Canadian production more to crude resource extraction and away from manufacturing and from becoming a growing competitor with the US (Armour, 1935); the 1948 free trade agreement which the US negotiated with Mackenzie King (but which he quietly quelled after remembering the fate of Sir Wilfrid Laurier); the US unwillingness to recognize, officially, Canadian sovereignty over the Arctic; and the present US desire to change the official boundary between Canada and the US by the Queen Charlotte Islands

off the British Columbia coast, because the Canadian area has rich fishing grounds and very favourable oil- and gas-bearing subsurface formations.

This sketch illustrates that the CUFTA and the NAFTA are not really new initiatives by the US, but simply the late twentieth century manifestations of aspirations that have been smouldering in the American Psyche, and repeatedly bursting into flame over the centuries. Now the flame is burning rather briskly and it will not be easily put out. My impression, having examined the CUFTA and NAFTA documents, being cognizant of a wide range of other ways in which US influence in Canada is enormous (eg: US control of the movies shown in Canadian cinemas, and its domination of television, books and magazines circulating in Canada), and being aware of Canadian economic circumstances, is that Canada has relatively little negotiating room left. Consider what this might mean.

A Possible Scenario

Canada is not in very good economic shape. In addition to much unemployment and large government fiscal deficits - circumstances shared by a number of developed nations to varying degrees - Canada, with over \$300 billions worth of net international debt, has the unfortunate distinction of being the world's largest international debtor after the US. But because we are only about one-eleventh the size of the US, the relative magnitude of our net indebtedness is far greater than that of the US. For 1992, conservative estimates suggest that it amounts to about 45 percent of GNP. (US debt is still less than 10 percent). And if one used current dollars rather than historical book values of foreign direct investment, the percentage would approach 55 percent of GNP.¹³ (Wilkinson, 1993). In addition, the total indebtedness is growing more rapidly than is GNP - by about \$28-32 billions annually - depending on whether the statistical discrepancy is counted as part of the current account deficit - which amounts to well over 4 percent of GNP.

In this context, note Article 2104 in the NAFTA. I would call this a sleeper article for it has not been given much, if any, attention as far as I know. It greatly limits a partner nation in its ability to impose restrictions on international transactions in the event of "serious balance of payments difficulties, or the threat thereof". For example, restrictions "may not take the form of tariff surcharges, quotas, licenses or similar measures". (Article 2104.5.d). And any other restrictions that are allowed must be consistent with not only the relevant IMF articles on such matters, but also the rest of the NAFTA in terms of its effect on financial services and investment. Thus, a

range of policies which have been used in the past by nations for balance of payments purposes are removed from Canada's policy bag. The implication is that the major means of correcting severe balance of payments problems will be income-based --with all the hardship that implies for the common person. To violate these strong NAFTA provisions would be difficult to do.

Therefore it would not be inconceivable to me that even before the turn of the century, new pressures will be building for Canada to seek political union with the US and send Representatives and Senators to Washington. Many Canadians would be very strongly against such a move, for they dearly love Canada and have no desire to be a part of the US. But if the alignment of forces and arguments are anything like those employed during the heated CUFTA debate, or even the much less well-developed NAFTA debate (less developed partly because the government made the detailed documents less available and partly because many felt that NAFTA was not nearly as important as CUFTA was), there will be strong voices in favour of such a move. We might caricaturize the situation at that time as follows.

The Business Council on National Issues, consisting of the CEOs of the largest corporations in Canada, will be arguing that it is all very efficient and sensible because most of Canada's trade is with the US, and we need a more effective voice in Washington. Many economists will probably be arguing that Canada itself was all an economic and political mistake, and that Sir John A. Macdonald and his National Policy should be treated as outdated symbols of a less enlightened past. Trade flows, we will be told, should naturally be on a North-South basis, and political union will simply enhance such flows - a natural outgrowth of adherence to "market forces" in a world dominated by the mega-corporations from the mega-nations.

Simultaneously, the Governor of the Bank of Canada will be able to point out proudly that the policies of the Bank have for decades led Canada in this direction. The Bank persisted in keeping interest rates well above those in the US and thereby attracted capital inflows and maintained the Canadian dollar above where it otherwise would have been, and simultaneously reduced the trade surpluses on merchandise account, and increased the deficit on services account, and expanded Canada's net international indebtedness and net interest and dividend outflows. He will also be able to assure Canadians that political union with the US will eliminate at one stroke about 70 percent of Canada's net international indebtedness problem for it is owed to the US.

We may even have by that time another prime minister, his party's coffers bulging with the contributions of the business elite, many of whom are with US-owned corporations, who is himself enamoured with the US and

wants to enjoy the approval of the US President. He may see it as his mission in life to increase greatly the ties of Canada with the US, and therefore be prepared to argue, in phrases not unlike those of another prime minister we once had, that application for membership in the US is a sovereign act of a sovereign state, and that the application itself shows the great confidence he has in Canadians to be able to enter the American union and thereby have more influence in the US. And there could well be Western Canadian premiers suggesting to their voters that joining the US is in their best interests, for it will remove permanently the threat of new resource taxes being imposed by Ottawa and unfair treatment in the distribution of federal funds or contracts. Anyone who cannot see the sense of these arguments will be labelled a wimp.

The government will be able to assure Canadians generally that they need never again fear being referred to as a nation of mere "hewers of wood and drawers of water" because they are going to become part of the great American dream, and this label is not a part of that great dream. And all the while we will have the American Ambassador to Canada and a host of US economists attending conferences in Canada quietly explaining that the initiative for this change must always be seen to be coming from Canadian academics and leaders, for to have it come from Americans could well raise the hackles of the average Canadian and scuttle the deal before the major blocks are in place.

And so with all this rhetoric and ritual, the 20th century which was supposed to belong to Canada will be over, and Canada will come to belong to the US instead.

Many may argue that this could not happen, and that Canadians would not be so naive as to fall for reasoning such as used here. In the late 1970s and very early 1980s I would have agreed with them. But I no longer would today because, as those of you will know who are familiar with the arguments trundled out during the CUFTA debate, and given wide publicity by the media, the ideas presented above are not unlike those used at that time.

Are There Any Options?

So where do we go from here? Do we have much leeway left? I would argue that there is not a great deal, and there is not sufficient time to discuss these issues here. But one or two possibilities can be mentioned in the little time that remains.

First, I would submit that Canada would be better off by not going

along with NAFTA, but instead negotiating a separate agreement with Mexico that avoids some of the new constraints put on us by the NAFTA. Then we should go on and negotiate additional agreements with other nations of Central and South America. Those nations likely would be far less apprehensive of dealing with us who have never had dreams of greater control of the Americas and who are without the economic and military means to bring such dreams about even if we had them, than they are of negotiating with the US. Canada in turn needs to diversify its markets much more and reduce its dependence on the US. There is not much scope for this in Europe. And in Asia it would be extremely difficult to counter the already well-established Japanese linkages and the rapidly expanding influence of nations like Korea and the Tigers. We have a certain geographic kinship with the nations of Latin America and a common interest in not being completely engulfed by the US. We need to cultivate this kinship much more.

No one should minimize the difficulty of Canada doing this, for the tremendously powerful ties that already exist between Canada and the US because of foreign direct investment, merchandise and service trade, as well as language and culture, and the political pressure that the US is able to bring on Canada at any one time, make it very difficult for Canada to do anything that big-brother does not approve of. Yet, I think that we have to try.

In order to compete with Latin America over a wide range of goods, however, and to make Canada a generally desirable place for foreign firms to locate, a further decline in the Canadian dollar will be necessary. I would not be unhappy to see it at seventy cents US or even lower. Given the high unemployment rate in Canada - which would be much higher if there were not so many discouraged workers who are no longer even looking for work and are therefore not counted in the statistics - we need not worry that a further decline in the Canadian dollar would stimulate a new round of spiralling inflation. Without a lower dollar, Canada will have difficulty generating the type of trade surplus necessary to slow down the growth of our foreign indebtedness and actually begin to reduce it.

These measures are no panacea. But I believe that they are worth considering. Otherwise Manifest Destiny may be our lot - as unbelievable as that may sound to many Canadians.

Endnotes

1. This Enterprise for the Americas Initiative set forth what was expected of participants in the way of macroeconomic and structural reforms of their economies, the expectations of

"partnership" in a huge trading bloc (where, obviously, the US would be dominant), and the rewards the other nations might have in the way of greater access to the US market if they brought their economies into conformation with the US view of how they should operate.

2. For a look at these, see Andrew Reding (1988), pp35-37, 44-45.

3. The "hub-and-spoke" argument, so popular among economists in Canada, is that Canada had to be a party to a trilateral agreement because otherwise it would have been, like Mexico, merely a spoke, involved in a single agreement with the US. This view ignores that the spokes could have agreements with one another, and reflects the overly narrow perspective taken by many evaluators of Canadian alternatives.

4. A fairly recent example of this type of behaviour is that of the large Canadian steel-maker, Dofasco, which decided to build a US \$300 million steel mill in Kentucky rather than in Hamilton, Canada. The reasons given by the CEO were that the US location entailed lower labour costs, cheaper power, more access to scrap steel, and avoidance of trade disputes instigated by US interests. Financial Post, May 8, 1993, p5.

5. Schwanen (1993) mentions this possibility in his discussion of FTA effects, but downplays its importance.

6. The jobs per \$billion are as follows:

US	11,039
Mexico	13,222
Japan	15,759
EC	13,699
Total World	12,019

(Morley-Martin, 1993, p18)

7. For the first eight months of 1993 merchandise exports to the US accounted for 80.2 percent of all Canadian exports, compared with 74.5 percent in 1988. Similarly, imports from the US were up to 72.9 percent of total merchandise imports compared with 68.9 percent in 1988.

8. This section draws on my work entitled "The North American Free Trade Agreement" for the UN Economic Commission for Europe (1992).

9. This is because the NAFTA specifically says that the "net-cost" method must be used when calculating regional content. This method does not count such items as royalties, sales promotion, packing and shipping, and limits the counting of interest costs when calculating valued-added.

10. This statement specifically entreats American industries to take advantage of the greater flexibility the NAFTA provides to question binational panels. It said "The Office of the United

States Trade Representative encourages private parties to notify USTR when a binational panel has taken action that the private parties believe may warrant [challenges]...". Quoted in The Financial Post, November 6, 1993, p. 3.

11. Article 1906 provides that if no agreement is reached within 5 years, a further two years could be taken to do so. Then if an agreement is still not arrived at either party could terminate the CUFTA on six months notice. The US enabling legislation provides essentially that the President at that time must report to Congress on why he believes the CUFTA should even be continued - a clause which gives the US considerable bargaining power in any negotiations.

12. This section relies on Daniel Orchard, The Fight for Canada: Four Centuries of Resistance to American Expansionism (1993) and many of the references cited there in Chapters 1-14.

13. This is because much of the foreign direct investment in Canada entered years ago, whereas most Canadian direct investment abroad has transpired in recent years. Thus, when the book values are inflated to account for current values, Canada's net indebtedness increases by nearly 20 percent.

References

Alberta Pool (1993) *Budget*. September 24, October 22.

Brown, D K (1992) "An Overview of a North American Free Trade Agreement", in W G Watson, ed, *A North American Free Trade Area*. Kingston, Ont: John Deutsch Institute for the Study of Economic Policy.

Campbell, B (1993) "Restructuring the Economy: Canada into the Free Trade Area", in R Grinspun and M Cameron eds, *The Political Economy of North American Free Trade*. New York: St Martin's Press, pp89-104.

Christie, K H (1993) *Globalization and Public Policy in Canada: In Search of a Paradigm*. Policy Planning Staff Paper, No. 93/01. Ottawa: External Affairs and International Trade Canada.

Creighton, D (1956) *The Empire of the St Lawrence*. Toronto: Macmillan. Government of Canada. External Affairs and International Trade (1993). *NAFTA; What's It All About*. Ottawa.

Creighton D (1993) *North American Agreement on Labor Cooperation: Final Draft*, September 13.

Creighton D (1993) *North American Agreement on Environmental Cooperation: Final Draft*, September 13.

Creighton D (1992) *North American Free Trade Agreement*. Ottawa: External Affairs and International Trade Canada.

Grinspun, Ricardo (1991) "Are Economic Models Reliable Policy Tools?"

- Forecasting Canadian Gains From Free Trade", (Unpublished Manuscript, Department of Economics, York University, Toronto).
- Harris, R and Cox, D (1992) "North American Free Trade and Its Implications for Canada: Results from a CGE Model of North American Trade", in US International Trade Commission, *Economy-wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico*. USITC Publication 2508. Washington, DC: USITC. May. pp139-165.
- Hatch, R M (1979) *Thrust for Canada: The American Attempt on Quebec in 1775-1776*. Boston: Houghton Mifflin.
- Hofstadter, R , W Miller and D Aaron (1957) *The United States: The History of the Republic*. Englewood Cliffs, New Jersey: Prentice Hall.
- Hunter, L, J R Markusen and T F Rutherford (1992) "US-Mexico Free Trade and the North American Auto Industry: Effects on the Spatial Organization of Production of Finished Autos", *The World Economy*, 15, January, pp65-82.
- Hutchinson, B (1955) *The Struggle for the Border*. Don Mills, Ontario: Longman.
- Martin, L (1993) *Pledge of Allegiance: The Americanization of Canada in the Mulroney Years*. Toronto: McClelland and Stewart.
- Martin, M (1993) *Exports and Job Creation*. Policy Planning Staff Paper No. 93/06. Ottawa: External Affairs and International Trade Canada.
- Orchard, D (1993) *The Fight for Canada: Four Centuries of Resistance to American Expansionism*. Toronto: Stoddart.
- Reding, A (1988) "Favourite Son", *Mother Jones*. November, pp35-45.
- Roland-Holst, D, K A Reinert, and C R Shiells (1992) "North American Trade Liberalization and the Role of Nontariff Barriers", in USITC, *Economy-Wide Modeling of the Economic Implications of an FTA with Mexico and a NAFTA with Canada and Mexico*. USITC Publication 2508. Washington, DC: USITC, May, pp 532-580.
- Ryerson, S B (1963) *The Founding of Canada: Beginnings to 1815*. Toronto: Progress Books.
- Schwanen, D (1993) "A Growing Success: Canada's Performance Under Free Trade", *C D Howe Institute: Commentary*, No. 52, September.
- Stanford, J (1993) "Continental Economic Integration: Modeling the Impact on Labor", *ANNALS.AAPSS* 526, March, pp92-110.
- Toronto Star (1987) October 6.
- Watson, W G (1993) "The Economic Impact of the NAFTA", *C D Howe Institute: Commentary*, No. 52, June.

WILKINSON: MANIFEST DESTINY

- Watson W G (1991) "Canada's Trade With and Against Mexico", (Unpublished Manuscript, Montreal).
- Weinberg, A K (1935) *Manifest Destiny: A Study of Nationalist Expansion in American History*. Baltimore: Johns Hopkins Press, p145.
- Wilkinson, B (1993) "Canada's Balance of Payments and International Indebtedness", in Susan Phillips ed, *How Ottawa Spends: A More Democratic Canada...?: 1993-1994*. Ottawa: Carleton University Press, pp291-332.
- Wilkinson B (1992) "The North American Free Trade Agreement", (Unpublished Manuscript for the UN Economic Commission for Europe, Geneva).
- Wilkinson B (1988) "Canada in the Year 2000", *Financial Post Magazine*.