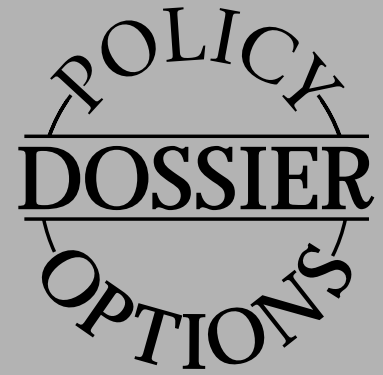


# TRADE POLICY AT THE CROSSROADS

Bill Dymond and Michael Hart



The arrival in office of a new government offers an unusual opportunity to set new directions in trade policy. While Canada played a role of regional and global leadership in negotiations that led to Canada-US free trade, NAFTA and subsequently the creation of the World Trade Organization at the conclusion of the Uruguay Round in the GATT, current opportunities for trade initiatives are severely limited by the stymied Doha Round in the WTO and the stalled hemispheric trade talks for a Free Trade Area of the Americas (FTAA). The values-driven foreign and trade policies of the last decade could well be replaced by interest-driven policy, particularly the challenges of managing Canada's deepening economic integration with the United States. The first and foremost obligation of Canadian diplomacy over the next few years, conclude Bill Dymond and Michael Hart, is to reach a new accommodation with the US.

L'entrée en fonctions d'un nouveau gouvernement nous a offert une rare occasion de réorienter notre politique commerciale. Si le Canada a exercé un leadership régional et mondial dans les négociations qui ont entouré l'Accord de libre échange Canada-États-Unis, l'ALENA et la création de l'Organisation du commerce mondiale consécutivement au cycle de l'Uruguay du GATT, toute initiative commerciale se trouve actuellement compromise par les obstacles soulevés lors du cycle de Doha et l'interruption des discussions sur la ZLEA. Il nous faut donc en prendre acte. Aux valeurs qui ont inspiré nos politiques étrangères et commerciales des dix dernières années devraient maintenant se substituer la promotion d'intérêts liés notamment à la gestion d'une intégration économique plus poussée avec les États-Unis. Dans les prochaines années, concluent Bill Dymond et Michael Hart, nos efforts diplomatiques doivent viser en priorité l'élaboration de nouvelles ententes avec nos voisins du Sud.

**W**hen Paul Martin asked Jim Peterson to be his trade minister and separated the trade portfolio from foreign affairs, Peterson no doubt thought about the offer carefully, not long, but carefully. On more sober reflection, or as Horace Rumpole would say, upon further and better particulars, he might have wondered about the agenda he had been handed.

Since the double-hinged trade and foreign affairs portfolio was created in the 1980s, the principal job of the trade minister has been to lead Canadian trade negotiations. When there are no trade negotiations, the incumbent becomes the minister of trade disputes and trade promotion. The former is usually a lose-lose game in Canadian politics because Canadians are embarrassed about winning and insulted when they lose. The latter role was effectively eclipsed during the Chrétien years, when the trade minister played second fiddle to the prime minister on Team Canada

missions. In any case, neither the management of trade disputes nor the care and feeding of Canadian exporters are very satisfying for any politician of ambition anxious to play a role in the governance of the country.

Not so long ago, the trade negotiation agenda provided a rich and exciting complex of challenges. Canada was an enthusiastic participant in talks among the countries of the Asia-Pacific region (APEC) aiming for a free trade agreement to enter into effect by the end of this decade for the developed country members and by the end of the next for developing countries. In the Americas, Canada made a major commitment to the negotiations for a hemispheric free trade agreement with an agreed implementation date of 2005. Globally, the World Trade Organization (WTO) agreed at its ministerial meeting in Doha, Qatar, in 2001 to launch a new round of comprehensive trade negotiations, also to be concluded in 2005.



AP Photo

Canada's new trade minister, Jim Peterson, shakes hands with US Trade Representative Bob Zoellick at their first meeting in Washington in mid-January. Authors Hart and Dymond suggest Peterson and the Martin government would do well, in the absence of progress in global and hemispheric trade talks, to focus on Canada's all-important trade and economic relationship with the United States.

All of these negotiations have stumbled badly. Within APEC, the Asian financial crisis of the late 1990s effectively terminated the free trade negotiations, proving once again that the ambitions of statesmen cannot overcome hard realities. APEC leaders annually endorse the goal of free trade, but the goal of a regional free trade agreement has been sent into the solitary confinement of solemn declaration.

In the Americas, the ambition of hemispheric free trade has fallen before the obduracy of Brazil and the decision of the United States to seek its goals through bilateral and mini-regional deals rather than expend scarce political capital on a project wholly disproportionate to the potential for economic gain. Taking a leaf

out of the APEC book, the Monterrey summit in January reaffirmed the goal of free trade, but like those in APEC, these negotiations have been reduced to ritual, trotted out for endorsement when leaders meet, but not to be taken seriously.

The multilateral news is scarcely more positive. At the WTO ministerial meeting in Cancún, Mexico, last September, it quickly became apparent that the Doha success had only papered over the severe problems with multilateral trade negotiations that have become increasingly apparent. To be sure, multilateral trade negotiations in the past have recorded their share of failures, and it may be that following the US elections later this year, a basis for progress might be found. However, the goal of concluding the negotiations in 2005 was always

a pipe dream and to successfully re-launch the negotiations we will need to find a formula for resolving deep conflicts over their object and purpose.

In the immediate future, the minister will have a range of bilateral free trade negotiations to manage with four countries of Central America, with Singapore, and with the rump of the European Free Trade Association (Norway, Switzerland, Iceland). There are more in prospect, for example, with the Caribbean countries, the Andean group (Venezuela, Colombia, Peru, and Ecuador), and perhaps even Brazil. However, none of these is of commercial significance to Canada. They may serve broad foreign policy goals and keep negotiators in practice, but they do not respond to any pressing Canadian problems or create exciting new opportunities.

In sum, the Canadian negotiating agenda inherited by Peterson is pretty thin gruel. Of course, Canada, on its own, cannot move regional or multilateral negotiations to places they are not prepared to go. At the same time, the minister can hardly be excited by spending his time in office waiting for the negotiating agenda to become more promising, while busying himself with small trade deals that command the interest of tiny constituencies in Canada.

Help for Peterson is at hand, at least potentially, in the form of a review of foreign policy promised by the prime minister in the series of initiatives that he announced upon taking office. That review is to include foreign trade, defence, and development polices and has been assigned to Foreign Minister Bill Graham, to be completed by the end of this year.

The last comprehensive review of Canadian trade policy occurred more than 20 years ago. Issued by the Trudeau government in its last year in office, *Canadian Trade Policy for the 1980s* constituted a confident look at past glories, arguing that Canadian trade policy pursued over three and one-half decades had served Canada well and concluding that effective alternatives were difficult to envisage. While the review proposed looking at sectoral free trade deals with the United States, it concluded that the option of a comprehensive free trade agreement suffered from insuperable practical and political difficulties. Within two years, as we all know, a new government dispensed with sectoral negotiations and launched the negotiations that produced the Canada-US Free Trade Agreement. The multilateral trade system that had served Canada so well became Canada's trade agreement with the rest of the world, governing at that time about 15 percent, at best, of Canadian trade.

The foreign policy review of the first Chrétien government, *Foreign Policy for Canadians*, was a valiant attempt to come to grips with the end of the Cold War as the organizing principle of foreign and security policy and the emergence of the

global economy. Its conclusions, however, were equally firmly rooted in the past. It foresaw the emergence of new centres of influence in Europe, Asia, and Latin America to replace the bipolar, superpower-centred world and provide the basis for the construction of a new order. On trade policy, it stated that the multilateral trade system and a new round of (multilateral) trade and investment negotiations were critical to Canadian prosperity.

It is perhaps inevitable that a government policy review will find little to fault with previous policies and every-

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thing to recommend their continuation in the future. We know. We were involved in both earlier reviews. Bill Graham will no doubt be sorely tempted, and strongly advised, to cling to the orthodoxies of the past. This would be a serious error. However well or ill the policies of the past have served Canadian interests, it will do the country little good to hark back to a "Golden Age" of trade or foreign policy and hope that either may return and carry us forward. Rather than celebrating past glories, Mr. Graham's review should look hard at the reasons why the current trade policy agenda seems so shopworn.

The first is the continuing allure of multilateralism as the central organizing principle of Canadian trade and foreign policy. As we have argued elsewhere (*Canada and the Global Challenge*, CD Howe, 2003), Canadian foreign policy generally has been driven by strong multilateral impulses as a means of equalizing the power asymmetries between Canada and powerful countries with which we transact most of our international business, notably the United States. For the last 50 plus years, multilateralism has been the watchword of Canadian foreign policy and Canada has been in the forefront of supporting rules and institutions of global governance, whether they serve Canadian interests or

not. Although recent Canadian foreign policy makers have preached multilateralism more frequently than they have practiced it when vital Canadian interests have been stake, it remains a strong force, as the Chrétien government's position on the Iraq war demonstrated.

The multilateral impulse in Canadian trade policy found its expression in Canada's strong commitment to the forerunner of the WTO, the General Agreement on Tariffs and Trade. Even after the FTA and its successor, the NAFTA, together with other free trade

agreements, effectively removed almost 90 percent of Canadian exports from GATT/WTO rules, old instincts linger. While acknowledging the obvious, the importance of trade with the United States, the government continues to insist that the WTO is the cornerstone of Canadian trade policy. Canada's ambassador to the WTO and former trade minister, Sergio Marchi, cites Canada's dependence on trade as the reason why the WTO and the new round of multilateral trade negotiations are so important to Canada. For the Cancún meeting, the Canadian delegation comprised no fewer than three ministers, 74 federal officials, 6 provincial ministers, 10 provincial officials, and 1 municipal representative. In the recent past, the failure of a multilateral trade meeting was a matter of grave concern for Canada. These days, it may be regrettable, but it is hardly critical to the performance of the Canadian economy.

The second impulse is the strongly held view among some Canadian elites, not including the business community, that Canada's economic dependence upon the United States is a serious weakness and that trade diversification should be a high priority of Canadian trade policy. The need for diversified partnerships finds its echoes in Canadian foreign poli-

cy. Successive Canadian governments over the last three decades have sought to build privileged relationships with Europe and Japan and a host of other countries. Where other countries have proved willing, as in the case of the European Union, elaborate structures of summit and ministerial meetings, committees of bureaucrats, chambers of commerce, and institutions for science and technological co-operation have been created to convey the impression of complex relationships. The consequence has been a growing gap between Canadian priorities and interests and Canadian foreign policy. In the 1990s, for example, Canada reduced diplomatic representation in the United States, as relations grew more intense, while steadily increasing it in Europe and other parts of the world.

Bilateral free trade agreements have become the principal policy instrument of trade diversification. Shortly after coming to office in 1993, the Chrétien government promptly embarked upon an ambitious policy of proposing such agreements, and enjoyed success with Chile, Israel, and Costa Rica and disappointment with the EU. As noted, the new minister has a growing list of bilateral negotiations on his plate. The commercial objective, in the words of a House of Commons Committee making the case for a deal with Europe, appears to be to alter the psychology of Canadian

ues” agenda on the practice of trade policy. While Canadians have always expected that the country’s foreign policy would contain healthy doses of humanitarianism and philanthropy, the *Foreign Policy Review* joined Canadian values (and culture) to prosperity and security as the triad of Canadian foreign policy objectives of the Chrétien government. With the notable exception of John Manley, the foreign ministers of the last decade have replaced interest-driven policy with a values-driven policy, relying upon the proposition that Canadian values are or should be universal, as reflected in Bill Graham’s assertion that “a better world might look like a better Canada.”

This “vapid preachiness,” to use historian Jack Granatstein’s colourful phrase, is increasingly also finding a place in Canadian trade policy. The Canadian interest in incorporating labour and environment clauses into trade agreements, stoutly resisted in the NAFTA, is explained as a reflection of Canadian values. Former trade minister Pierre Pettigrew was fond of stating that trade negotiations are a way of promoting “values which we hold dear,” and that Canada should share and export its values. At the Cancún WTO meeting, Pettigrew argued for the elimination of subsidies to cotton producers, although Canada produces no cotton, in

No Canadian is against reducing child labour, improving the environment, or increasing global equity, but heaping all these goals on trade negotiations risks losing sight of their fundamental goal.

A new government, empowered with the expected spring election, creates an opportunity to break out of the dogma of Canadian trade policy. This dogma holds that international trade occurs between autonomous firms engaged in arms-length transactions across national borders. Canada engages in multilateral and bilateral trade agreements to generate trading opportunities for Canadian firms and expand the choices for Canadian consumers. If problems arise in the trading relationship between Canada and other countries, they can be solved through the negotiation of new trade agreements. Canadian dogma further argues that trade agreements can be insulated from other areas of international relations and negotiated and managed according to their own dynamics. The menu of WTO and bilateral negotiations in Trade Minister Peterson’s briefing book corresponds to this traditional dogma, as do the proposals advanced from various quarters for Canada to negotiate a NAFTA-plus deal with the United States or, more ambitiously, a Canada-US customs union.

Canadian skill at such trade-agreement making in the GATT, and subsequently in the FTA and NAFTA, has made a major contribution to Canadian prosperity.

Through the first forty years of the GATT, Canada achieved reductions in US trade barriers and largely embedded GATT disciplines into domestic policy. The result was a better-structured and more prosperous Canadian economy. The FTA and the NAFTA accelerated the transformation of the Canadian economy from an east-west to a north-south axis, created the basis for an increasingly integrated North American economy, and realized the final major benefits to the Canadian economy of classic trade liberalization. In the case of Canada-US trade, it is only in a few

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firms by getting them to look for new business opportunities beyond North America. The reality is that the vast majority of Canadian businesses choose to do business in the United States and have proven impervious to any and all government initiatives to alter their psychology. Hence Minister Peterson may well have affirmed in his first speech (in Frankfurt in January) Canada’s continuing interest in an agreement with the EU, but he has few committed followers.

The third impulse is steady encroachment of the foreign policy “val-

order to benefit poor African cotton farmers, while almost in the same breath condemning the rhetoric and grandstanding that poisoned the atmosphere of that meeting. Not surprisingly, the minister did not extend his new-found fervour for values-based policy to the need to eliminate Canada’s obscene tariffs on dairy products for the benefit of consumers and competitive producers alike. Trade and trade agreements may expand human freedom, but to make such a value the guiding principle for negotiations is to render much of trade policy incoherent.

old-economy sectors, for example, lumber, that cross-border trade barriers susceptible to negotiation remain relevant to influencing the flows of trade and investment. For the flows of trade and investment in the integrated sectors — for example, automobiles, aerospace, information, and telecommunications — the classic trade liberalization agenda is irrelevant. It is finished with the United States and further efforts with other countries will bring at best marginal benefits.

The need to dispense with the old dogma is thrown into sharp relief by the trade agenda pressed upon the government by the business community. In a brief to the government last year, the Canadian Council of Chief Executives proposed a new arrangement with the United States to create a seamless border, effectively proposing the removal of border impediments to the flows of trade and investment. The council argued “the need for a comprehensive North American strategy integrating economic and security issues” and requiring “a strategy with five major elements:

- Reinventing borders
- Maximizing economic efficiencies
- Negotiation of a comprehensive resource security pact
- Reinvigorating the North American defence alliance
- Creating a new institutional framework”

If the government were to embrace this brief, it is immediately apparent that the traditional trade-agreement approach would prove woefully inadequate. A trade agreement, like any other intergovernmental agreement, constitutes a snapshot of the problems at a moment in time and devises solutions to deal with them. If new problems arise, a new round of negotiations is required. The capacity for rapid adjustment and expeditious problem solving does not exist in trade agreements. Moreover, multilateral trade agreements are taking longer and longer to negotiate. The Uruguay Round, for

example, took eight years to complete. The current round, while scheduled to conclude in 2005, is almost certain to continue for many years to come. It is not an exaggeration to suggest that the business environment and business organization that the new round is intended to influence will have changed beyond all recognition by the time these negotiations conclude. While bilateral negotiations can often be completed more quickly, the basic problem is that rule making embedded in trade agreements no longer provides an efficient vehicle for solving today’s most pressing problems.

Against this background, as the government embarks upon a comprehensive foreign policy review,

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here are some factors which ought to bear heavily on the trade dimension.

First, the growth of the Canadian economy depends critically upon further North American economic integration. The US economy surpasses all its rivals to the point that it is approaching the dominance it held 50 years ago as the engine of global growth. Growth in Europe and Japan can no longer compensate for a poor US performance. While developing countries like China, Brazil and India may have immense potential, the prospect of their becoming alternative centres of growth independent from the United States any time in the near or medium terms is remote. Whatever the merits of having our commercial eggs in one basket, there they are and there they will remain for the foreseeable future.

Second, the probable re-election of

the Bush administration may produce one of those rare moments in relations between the two countries when creative policy making becomes possible. The creativity will have to come from the Canadian side. In the history of Canada-US relations, ideas originate north of the border, not because our American cousins have no ideas but because Americans have big ideas and Canadians, or at least their politicians, prefer small ideas. The art of Canadian-American negotiations is to package a proposal in a small enough way to reassure Canadians and at the same time in a big enough way to capture American imagination and attention.

Third, the Canada-US agenda is essentially bilateral rather than trilateral in nature. The successful conclusion of a trilateral North American Free Trade Agreement created expectations about the evolution of a North American community. This has not happened. Trying to address Canada-US issues on a trilateral basis is likely to prove counter productive. The Mexican factor is important but not critical. The challenge for Canada

is to decide upon the architecture of the relationship with the United States that it wishes to have in the 21st century and, on this basis, to seek a new accommodation with the United States, irrespective of Mexican desires and objectives. If Mexico reaches compatible conclusions, a parallel initiative would become possible. If Mexico is not so disposed, Canada needs, nevertheless, to press forward. The relationship with the United States is too important to be made hostage to the policies and preferences of another country.

Fourth, although there is a compelling argument that increasing North American integration already exhibits the principal characteristics of a common market, the negotiation of a customs union on the European model would be an immense task. It would involve noth-

ing less than a constitutional convention for economic integration in North America. Following the European model would require the creation of a supranational institutional infrastructure with authority over national governments. It is hard to envisage either Canadian or American enthusiasm for such a prospect. The European Union grew out of the lessons of history; from its origins through to its current evolution, it has been driven primarily by geopolitical imperatives employing the forces of economic integration to achieve larger goals. Such historical antecedents do not exist in North America.

Fifth, there is a broad measure of comfort among Canadians with arranging for the security and prosperity of the country within the North American framework and with seeking new arrangements with the United States to capture and manage the forces of silent integration. Concurrent with this comfort is a new confidence among Canadians in their identity, evident in the absence of a sense of apology and the need to assert difference or defensive self-assertiveness. Recent polling shows both high levels of support for the current trade agreements and growing differences in values, preferences, and life styles of Canadians vis-à-vis Americans. Apart from the geriatric Left, there is a refreshing absence of pressures emanating from the public for initiatives to re-establish artificial distinctions and differences from the United States or from any other country. The public debate about the relationship with the United States is spreading beyond academic and political circles and beginning to resonate in the broader public. It will be a different debate than the free trade era, calmer, more mature, and better informed. It is, nonetheless, essential that the government lead this debate.

**O**verwhelmingly, Canada's leading trade and foreign policy partner is the United States, surpassing all other partnerships combined in the breadth, depth, and intensity of the

relationship. Cross-border trade and investment drive our economy. US innovation and entrepreneurship provide both opportunities and competition. US popular culture dominates, not because it is forced on Canadians but because Canadians choose it. The US military provides a blanket of security. US warm weather cossets millions of Canadians each winter. The US pres-

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ence pervades every aspect of Canadian life, including, as Foreign Minister Bill Graham recognizes, foreign policy. Virtually every aspect of Canada's political, economic, cultural, and social life is measured by Canadians in terms of the US yardstick. The first and virtually only priority for Canadian diplomacy over the next few years is to reach a new accommodation with the United States. Canada and the United States need to take deliberate steps to bring the architecture of their relationship into line with the challenge and fact of deepening integration as well as with the political and security realities ushered in by the events of September 11.

Jim Peterson has a key role to play in devising a new accommodation with the United States. Both the US preoccupation with homeland security and the dynamics of the integrated economy require the government to devise a comprehensive approach that will necessarily have to be led by the prime minister and engage a wide range of ministers, including the trade and foreign ministers, but also their more domestically oriented colleagues. The days when Canada-US issues could be treated in separate, self-contained compartments are long gone.

Peterson should insist that his officials explore three key aspects of a new accommodation with the United States:

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

the United States can be removed through equivalence and harmonization (e.g., health and safety regulations in sectors such as consumer goods, drugs, transportation and immigration)?

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

The foreign policy review provides a convenient platform to consider how best to reach this new accommodation. And for Trade Minister Jim Peterson, the foreign policy review could prove a critical vehicle for carving out a useful and important role for his new department as one of the principal executors of this new accommodation.

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