

# FINANCIAL SERVICES IN THE FTA: ALMOST AN AFTERTHOUGHT

Stanley H. Hartt

On October 3, 1987, an “elements agreement” in principle was achieved on free trade between Canada and the United States, and achieved as the hands of the clock ticked toward midnight and the expiration of President Reagan’s fast-track authority for an “up or down” vote by Congress, but without amendment. One of the elements was financial services and one of the eight Canadians in Treasury Secretary Jim Baker’s Washington boardroom was Stanley Hartt, then Canada’s deputy minister of finance. Here, he recalls that historic day and the making of a momentous deal.

Le 3 octobre 1987 étaient convenus d’extrême justesse les éléments d’une entente de principe sur le libre-échange entre le Canada et les États-Unis, peu avant l’expiration de la procédure accélérée dont disposait le président Ronald Reagan pour les faire adopter tels quels par le Congrès américain, sans possibilité d’amendements. Parmi ces « éléments » figuraient les services financiers, et parmi les huit Canadiens présents dans le bureau de Washington du secrétaire du Trésor Jim Baker se trouvait Stanley Hartt, alors ministre canadien des Finances. Il décrit ici cette journée historique et l’élaboration d’un accord capital.



**T**wenty years on, those who were there remember the high drama of the final moments of the negotiations to achieve a free trade agreement between Canada and the United States. Canada’s need to gain a measure of shelter from the protectionist elements rampant in Congress, as well as from the politically inspired administration of US trade law, was clear to those involved, if not to the Maude Barlows of this world.

The threat to Canada of the US Omnibus Trade Bill and protectionist Congressional sentiment (and the battles waged to combat these and re-create a level playing field) have been admirably documented, among others, in former ambassador Allan Gotlieb’s recently published *Washington Diaries*.

A high degree of ignorance in the executive and legislative branches of the US government of Canada’s original motivation for the negotiations (and therefore of our bottom-line bargaining position — namely a satisfactory dispute resolution mechanism) and the “war-of-attrition” negotiating style of the chief US negotiator, Peter Murphy, had led to an impasse which threatened to produce the total collapse of the process. What was needed was the political will on both sides to snatch victory from the jaws of defeat.

This is what led to the highly publicized walk-out by Simon Reisman, and his carefully calculated press campaign to impress upon our interlocutors that we were serious, and

that, although they (correctly) assumed that Canada needed the agreement more than the US, this did not mean an agreement on any terms and at any price. Rather, we needed to accomplish the original objective of introducing the rule of law into the settlement of disputes involving allegations of subsidy and dumping.

**I**t worked. Direct communication between the Prime Minister’s Office in the Mulroney government and the Reagan White House led to the dispatching of a high-level Canadian team, led by PMO Chief of Staff Derek Burney, to Washington to make one last ditch attempt to carve an acceptable deal before the “fast-track” negotiating authority granted to the President by Congress ran out at midnight on October 3, 1987. The Americans named James Baker III, Secretary of the Treasury and among the most trusted advisers of the President, as Burney’s counterpart.

Michael Hart, in his excellent reconstruction of the negotiating history of the FTA called *Decision at Midnight*, has captured the flavour of what transpired. With no time left for posturing, Burney and Baker took over the Secretary’s boardroom. Each of the Sectoral Negotiating Teams, which had been working diligently since the beginning of the talks, was summoned to an audience with the two lead figures (each assisted by members of their respective Chief Negotiators’ teams). The sectoral team leaders

were asked to give a brief summary of what issues still separated the parties in their area of responsibility. Burney and Baker then suggested ways to resolve the controversy and create a mutually acceptable basis for the relevant chapter of what was to become the elements of the Free Trade Agreement. If the format proposed seemed workable to the sectoral teams, they were sent away to work it out with a view to meeting the deadline.

Nerves were on edge in the corridors as teams waited to be summoned to the inner sanctum, because months of work came down to a very quick judgment call with virtually no time left on the clock.

But overshadowing all of this was the one *sine qua non* element: dispute resolution. As a result, the “go/no go” decision never depended on autos, energy or services, let alone financial services.

The Americans had decided that, as long as they were confident that the elements of an agreement could

be arrived at, they could safely send messages to the chairmen of the House and Senate committees to the effect that “fast-track” authority had successfully been exercised to produce the elements of an agreement. The importance of this was that, under fast-track authority, Congress granted the president the right to enter into an international agreement that they, Congress, agreed to approve or defeat in a yes or no vote (which they liked to call “up or down”) and to waive the right to nickel and dime the deal to death with congressional amendments.

No self-respecting country could agree to make its concessions in direct negotiations with a negotiating team, and then begin all over again to re-negotiate with the denizens of Congress!

This is how it all came down to a final proposal from Jim Baker on judicial review of decisions by dispute resolution panels to break the impasse on the major sticking point. Baker’s initia-

tive preserved the Canadian insistence that these reviews remain true interpretations of law and not become “helpful” attempts to assist a congressman or senator with an industry in his or her district or state with a real or imagined grievance. When Baker proposed his creative compromise to the eight Canadians waiting in his anteroom (Burney, Finance Minister Michael Wilson, Trade Minister Pat Carney, Chief Negotiator Simon Reisman, Deputy Chief Negotiator Gordon Ritchie, Ambassador Allan Gotlieb, Associate Deputy of External Affairs Don Campbell and me), both sides agreed that the messengers should be dispatched with only minutes to spare before the expiration of the President’s fast-track authority, leaving the details of the language of several of the important chapters to be worked out on the next and subsequent days.

The next afternoon (Sunday, October 4, 1987), Michael Wilson and



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\*Source: PricewaterhouseCoopers. R&D Companies: Driving a Better, Stronger Canadian Economy, 2005.

I were chatting with Baker in the sitting area of his office when he abruptly got up to leave. "Where are you going?" Wilson asked. "To the press conference," Baker replied. Wilson asked, "What press conference?" "To announce our deal," Baker said.

Wilson: "You can't do that!"

Baker: "Why not?"

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Wilson: "Because you don't have a deal yet."

Baker: "Why? What remains to be done?"

Wilson: "Well, financial services haven't been fully resolved yet, for one thing."

Baker (to Wilson and me, as he sat back down on one of the couches): "Okay. You guys have 15 minutes."

Unable on no notice to locate Bill Hood, the former Finance deputy who had so ably led the financial services sectoral negotiating team throughout the prolonged gestation of the FTA, we undertook to address the challenge of finalizing the arrangements to be included in the agreement regarding this important industry.

Financial services were an area in which Canada's regulations had been reformed and modernized more than a decade in advance of developments in the United States.

As a result of the liquidity pressures on smaller domestic banks in the fall of 1985 and continuing into 1986, which had resulted in two very high-profile bank failures and consolidation into more stable institutions for seven others, Canada had acted to eliminate the depression-era rules that separated

the financial services industry into the so-called "four pillars" — banks, insurance companies, trust companies and securities dealers — and to permit enterprises in each of these fields to own businesses in each of the others.

This was designed to strengthen the remaining institutions and to respond to the evolution of financial

markets where full-service or universal banks were emerging as the standard.

So, as a result of the government's actions, Canadian banks rapidly bought up the leading securities dealers, and foreign securities dealers were permitted to enter Canada and establish 100-percent-owned affiliates, in much the same way as the Bank Act revision in the early 1980s had made possible the establishment of what were then called Schedule B banks (now Schedule II). This extensive reform of financial services legislation in Canada has come to be referred to as our "little bang," echoing Margaret Thatcher's 1986 "big bang" which changed the shape of the City of London.

The problem was that the United States was lagging in its own financial services reform. Glass-Steagall, the legislation prohibiting commercial banks from being associated with investment banks, was still very much on the books, as was the 1978 enactment limiting interstate branches of US banks. So when we sat down to hammer out Chapter 17 on financial services, we had to work our way around this disproportionate legislative evolution.

The first preoccupation was to negotiate to have Canadian securities dealers authorized to deal in and

underwrite the securities of Canadian governments and their agencies (federal and provincial) which otherwise would have been prohibited to Canadian dealers by the Glass-Steagall provisions because of the ownership of the dealers by Canadian banks. Second, we obtained an indefinite grandfathering of the interstate branching rights of Canadian banks, which otherwise would have been subject to a decennial review. The US promised Canada national treatment (regardless of how other foreign financial institutions were treated) in any legislation to amend or eliminate Glass-Steagall.

Canada, for its part, exempted US firms and institutions from the "10/25" rule prohibiting ownership by a single non-resident of more than 10 percent, and non-residents collectively from owning more than 25 percent, of a Canadian-controlled, federally regulated financial institution. Instead, we established the "national treatment" rule that requires such institutions to be widely held and to have no shareholder of whatever nationality controlling more than a 10 percent interest.

We exempted US banks from the ceiling of 16 percent of aggregate banking assets, which until then had applied collectively to all Schedule II (i.e., foreign-controlled) banks and from the rule limiting the number of branches they could establish to five, as well as the requirement that such banks focus on the so-called middle market in their lending activities.

All in all, a substantial piece of business, which was accompanied by a commitment on both sides to work toward the further liberalization of the rules governing the financial sector.

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