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Canada

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Member States Developments

Canada

I. Introduction

As the Mexican currency crisis allowed critics of the North American Free Trade Agreement (NAFTA) to put a new spin on Ross Perot's "sucking sound" manifesto, a slide in the value of the Canadian dollar directed somewhat unflattering attention to some of the problems facing the northern member of the trade agreement. In the context of discussing Canada's debt management problems, an editorial in the *Wall Street Journal* labelled the country as "an honorary member of the Third World."[1] While the label was applied based upon Canada's economic woes, it appears that the nation faces several challenges in avoiding a similar perception in the free trade arena. Internally, Canada struggles with interprovincial barriers and may soon face the possibility of Quebec seceding. Externally, Canada consistently faces trade wars with the United States and is itself raising barriers to certain imports from the United States in the name of protecting its cultural identity. Finally, Canada has expressed an eagerness to expand NAFTA beyond its current membership, a step that the United States seems increasingly unwilling to make.

This desire to expand NAFTA represents the most promising option for Canada to diversify its trading markets. In the world trade arena, Canada suffers from characteristics shared with such European counterparts as Italy that inhibit its consideration as a trade partner of choice. Canada is considered neither an economic superpower nor an emerging market. This makes it difficult for the country to set its own destiny in the free trade game. Canada's proximity and ties to the United States makes it even more challenging for it to establish an independent identity. What this update attempts to focus on is the details of the challenges that Canada faces in becoming independently respected as a free trade partner.

The first area of focus will be upon Canada's internal trade struggles and the impact of these struggles upon free trade. If Canada is to stand on its on as an attractive partner in free trade arrangements, some of its internal problems will have to be solved or diminished. Interprovincial trade barriers represent a key hurdle in Canada becoming a more acceptable trading partner. If Canada itself is not a free trade zone, it seems plausible to doubt whether a trade combination involving Canada can truly achieve free trade status.

Related to this is the division of power between the federal and provincial governments. Canada's federal government is facing choices that would seem to require conflicting means to achieve desirable ends. To dishonor its Third World membership, it seems that Canada's federal government has the incentive to shift certain powers to the provinces. On the other hand, the federal government needs to achieve a certain degree of control over actions between the provinces in order to improve its image as free trade haven. It seems that Canada's federal government faces a difficult task in simultaneously achieving both goals.

1. *Bankrupt Canada?*, Wall St. J., Jan. 12, 1995, at A14.

A final issue facing the Canadian federal government is the possibility of the secession of Quebec. Secession would be embarrassing to Canada and could create a number of problems. Canada has incentive to try to prevent the secession of Quebec, but the costs of catering to the province to keep it a part of Canada could prove costly to the nation in terms of achieving some of its other goals.

This update will next focus on Canada's relationships with the United States and Mexico. Two aspects of Canada's relationship with the United States will be detailed. First will be the continuation of trade wars between the United States and Canada where Canada sees the United States as the aggressor. The second area of focus on the relationship between Canada and the United States will explore Canada's recent actions to purportedly protect its cultural identity from being overwhelmed by the United States.

The relationship between Canada and Mexico is not one that has received as much attention as the relationships between these two parties and the United States. Not a lot has happened in relative terms, but this update will give one example each of a positive and negative development between the two nations. The lack of a more developed relationship between Canada and Mexico at this point may indicate that the expansion of NAFTA may not have the type of impact that Canada desires.

This desired expansion of NAFTA will be highlighted in the final section of this update. Canada desires that the NAFTA members allow other nations to accede to NAFTA rather than for each of the NAFTA members to expand their trading horizons by bilateral agreement. This may be because Canada senses that NAFTA is the best and most likely vehicle for diversifying its trading markets. Whether this is necessarily true will be discussed.

II. Canada's Internal Issues

A. Interprovincial Trade Barriers

A recent General Agreement on Tariffs and Trade (GATT) review of Canada's trade policies cited interprovincial trade barriers as an impediment to Canada's economic progress. The review reported that "[i]nter-provincial trade barriers have become a major problem for Canada, hampering economic growth and job creation, as well as reducing competitiveness of Canadian-based firms." Despite a July 1994 internal trade agreement signed between the federal and provincial governments that was designed to open up government procurement contracts to corporations not located in a particular contracting province, the provinces have reserved the right to maintain and even erect new trade barriers for social reasons.

These barriers do not just apply to trade between the provinces. Under GATT, the provincial governments have been allowed to continue their regional development subsidies without fear of retaliation from other countries. The effect is that provincial trade barriers could make Canada unattractive as a trading partner. The ability of the provinces to subsidize without the threat of retaliation could persuade potential traders from getting too heavily involved in Canada. Until Canada can offer assurances that it has its provinces under control regarding the trade barriers they erect, there will be questions about the desirability of doing trade with Canada.

B. Federal/Provincial Balance of Power

One potential problem with the Canadian federal government exerting control over its provinces is that it may be beneficial for the federal government to shift some power to the provinces in battling its debt crisis. A recent survey of 50 officers of Canada's largest pension fund management firms[2] revealed that 96% agreed or strongly agreed that Canada's deficit problem is not sustainable and that 82% agreed that the deficit should be reduced only through spending cuts. Raising revenues is problematic because of the perception that Canadian tax rates are reaching their limits. For example, the top income tax rates in Ontario and British Columbia are 53% and 54% respectively. The importance in these numbers is that they may reveal that the Canadian federal government would be wise in shifting some of the burdens of its budget to the provinces.

As both an article[3] and subsequent editorial[4] in the *Wall Street Journal* have noted, some provinces have been successful at controlling their debt through cost cuts instead of tax increases. If the Canadian federal government is unwilling or unable to follow this strategy on its own, it could be wise to try to shift the responsibility to the provinces. The threatened secession of Quebec makes a cost-cutting strategy very difficult to impose, since many of the benefits of Canadian spending flow to Quebec. However, a shift of the taxing and spending process directly to the provinces could help Canada achieve two goals. First, it would place Canada's debt problem into the hands that have proven to have the ability and political will to solve it. Second, this show of deference to the judgment of the provinces could be marginally decisive in the battle over Quebec's possible secession.

Despite offering the promise of achieving these two goals, the shift of responsibility to the provinces could be counter-productive from an international trade perspective. More power to the provinces means more potential and more temptation for interprovincial trade barriers. As noted above, these barriers have been criticized as hampering Canada's development. The solutions to a number of concerns in the economic and trade arenas seem to best be solved by conflicting paths. The balance of power between the federal and provincial governments seems to be a key. Letting the provincial governments wield an ax at Canada's budgetary problems while preventing them from wielding it against each other and the rest those who would do business in Canada seems to be a difficult challenge that would be in Canada's best interest to take on.

C. Threatened Secession of Quebec

Another challenge which Canada may be forced to take on is the possible secession of Quebec. Quebec Premier Jacques Parizeau desires to turn the province into an independent nation. A referendum on the independence of Quebec is expected this summer. The first task facing Canada is to prevent the secession effort from being successful. While this can be partially achieved by appeasing Quebec through various political means, it is often difficult to do without attracting criticism from the other provinces. Such criticism was heard when Montreal was named to host the Secretariat for the North American Commission on the Environment. Another step that could be taken is to avoid doing anything

2. *Northern Exposures*, Wall. St. J., Feb. 2, 1995, at A14.
3. Walker, *It'll Take More Than Rhetoric To Strengthen Canada's Dollar*, Wall St. J., Jan. 20, 1995, at A13.
4. *Northern Exposures*, Wall St. J., Feb. 2, 1995, at A14.

that would offend Quebec. In the wake of Canada's debt problems and a consensus that spending cuts are needed, it will be difficult for Canada to pursue sound fiscal policy without rousing the ire of those in Quebec who are affected by spending cuts. Until a referendum takes place, the federal government will have to keep Quebec in mind with regards to countless policy decisions.

Should Quebec gain its sovereignty, Canada will be presented with a series of new problems. Paizeau and others pushing for the sovereignty of Quebec have consistently asserted that an independent Quebec would have immediate access to NAFTA and the GATT.[5] The Canadian government claims otherwise. Since Quebec would need Canada to approve its accession to NAFTA in the case that Quebec was determined to not already be a member; the issue is one that will not be easily conceded by either side. Even though it appears at times that Canada is willing to invite just about every sovereign nation on the planet to NAFTA accession, it is doubtful that an independent Quebec would be granted the same courtesy. The Quebec problem has been hampering Canada trade policy and will continue to do so until its resolution.

III. Canada's Dealings With Other NAFTA Parties

A. INTRODUCTION

In negotiating NAFTA, part of the Canadian agenda was to obtain a better dispute resolution process than existed between it and the United States under the 1989 U.S.-Canada Free Trade Agreement (FTA). The importance of a workable dispute resolution process is evidenced by the facts that about 80% of Canada's international trade is with the United States and Canada has been noted as a frequent complainer about the trade actions of other countries.[6] The fact that NAFTA has thus far proved to be unsatisfactory in smoothing trade relations between Canada and the United States is evidenced by the continuing trade wars between the two countries.

Despite this apparent animosity, there have been some positive developments between the two. For example, the countries have attempted to lower barriers to air traffic through an "open skies" accord designed to deregulate routes.[7] Canada has also been considering a bill to provide compensation for expropriation of investments of American and Mexican investors. While this bill has received criticism that it may violate certain provisions of Chapter 11 of NAFTA, it does show that some issues can potentially be solved through peaceful actions between the parties.[8]

The United States portion of this section will first explore the traditional trade disputes between the parties. Then, Canada's recent actions in the name of protecting its culture will be examined. The Mexico portion of this section will briefly touch on events occurring between the two parties.

5. Special Report: Trade Outlook for 1995, *Canada*, INT. TRADE REP., Jan. 18, 1995, at 136.
6. The recent GATT report on Canada notes that Canada is among the top three nations in having strong complaints about the trade actions of other parties.
7. Phillips, *U.S., Canada May Ease Airline Flight Limits: Treaty Negotiations Could Open Border To Increased Competition*, Wash. Post, Dec. 23, 1994, at B1.
8. *Does Canadian bill violate NAFTA?*, NAFTA WATCH, Nov. 30, 1994, at 1.

B. Dealings With the United States

1. Continuing Disputes

One of Canada's current top priorities is to resolve its numerous trade disputes with the United States. While the softwood lumber dispute that occupied most of the attention in 1994 has been apparently resolved, a number of other disputes are in various stages of development. The most notable unresolved dispute involves U.S. restrictions on sugar-containing imports that took effect on January 1, 1995.[9] The restrictions, by redefining and classifying some sugar-containing products, place some Canadian products which were freely exported to the United States on a list subject to a limitation of U.S. global sugar imports.

While it seems that the stream of disputes between the two countries will be endless, Canada desires to negotiate aspects of the dispute-resolution process that will be more equitable. Current differences in the laws of Canada and the United States seem, on balance, to favor the United States and its citizens and corporations when disputes arise. A harmonization of these rules is desirable.

Another condition that is probably desirable is a lesser dependence on Canada's part to rely on being able to export to the United States. While NAFTA appears to have been a step forward in trade relations between Canada and the United States with a seemingly stronger dispute mechanism process that places a greater emphasis on dispute avoidance, there seems to be less emphasis on complete and open access to U.S. markets. Once a highlight of the FTA, the importance of this aspect of trade between the two countries seems to be diminishing. Because of the tremendous importance of the United States as a market for Canadian products, the United States generally has the upper hand in trade negotiations. Until Canada is able to diversify its international trade practices, it will continue to face an uphill trade battle with the United States.

2. Protection of Canadian Culture

Another battle which Canada purports itself to be fighting is the protection of its cultural identity from complete integration with that of the United States. A series of actions by Canada can be cast either as protection and promotion of Canada's cultural identity or as barriers to trade that could violate NAFTA and other international agreements.[10] In defending these actions, Canadian Heritage Minister Michel Dupuy asserted that Canada "[does] not regard trading in cultural products like trading in corn or beans. We are going to develop our culture through Canadian, not American means."

The first action was a ruling by the Canadian Radio-Television and Telecommunication Commission (CRTC) which required Canadian cable-television companies to drop Country Music Television as an eligible service to be carried by the operators. Country Music Television, an American-owned music video channel, was replaced by a similar Canadian Service. The Supreme Court of Canada refused to hear Country Music Television's application to stay the CRTC ruling. Country Music Television had asserted that the CRTC ruling violates market access provisions of NAFTA.

9. *Canada, U.S. prepare for sugar war,* NAFTA WATCH, Dec. 29, 1994, at 4.
10. De Santis, *Canada Acts On Plan to Aid Its Magazines,* Wall St. J., Dec. 23, 1994, at B2.

In another action which is alleged to be in violation of NAFTA, Canada plans to impose an 80% tax on Canadian advertising in some foreign-owned magazines. The target is Sports Illustrated Canada, a weekly sports periodical which currently publishes one edition per month devoted to Canadian stories. The periodical had planned to expand this Canadian-specific coverage to 52 issues per year. The Canadian magazine industry has complained that Sports Illustrated Canada is taking Canadian advertising dollars away from Canadian magazines. Time Canada, Ltd., the unit of Time-Warner Inc. that publishes Sports Illustrated Canada, claims the tax amounts to "confiscation of our business" and plans to challenge its validity.

Canada is also planning to place a levy on blank audio cassettes. The proceeds raised from this levy would be distributed to Canadian composers, artists, and record companies. The theory is that the Canadian recording industry loses a substantial amount of money each year because of the copying of their products onto these blank cassettes. Foreign entertainers, whose works are also subject to being recorded onto these blank cassettes, would not receive any proceeds. The argument by these foreign entertainers would be that the Canadian recording industry is receiving a type of subsidy partially at their expense.

These three cases represent what Canada claims to be a protection and promotion of its cultural identity. Skeptics claim that it is just protection and promotion of certain Canadian concerns that happen to be involved in certain aspects of entertainment. What Canada may have found here is that their country represents a lucrative market for a product (entertainment) that the United States desires to export and that Canada can control in much the same way that the United States attempts to control Canadian products in more bread-and-butter markets. Canada may also be genuinely interested in developing a cultural identity that is more distinguishable from that of the United States that it currently is. By allowing Canadians to control what entertainment is being provided to Canada (the Country Music Television and Sports Illustrated cases) and by providing a form of subsidy to the Canadian recording industry (the blank cassette case), Canada may be attempting to ease the flow of American culture across the border and to foster the development the institutions that could make Canada's culture more distinct.

C. Dealings With Mexico

Canada's involvement with Mexico has probably not developed as readily as some proponents of NAFTA promised. In a way, NAFTA may be more like a consolidation of two bilateral agreements with the United States into one document. This, of course, is an overstatement, but proportionately more attention is devoted to U.S.-Mexican and U.S.-Canadian developments than to Canadian-Mexican developments. This lack of progress in the Canadian-Mexican relationship may serve as caution to Canada that proceeding by NAFTA-accession rather than by bilateral agreement may not diversify its trading markets as much as anticipated.

Some unanticipated benefits will arise and some anticipated opportunities will be taken away. An example of possible benefits involves Canadian fishermen in the Gulf of Mexico.[11] Canada's fishery workers are currently facing the restrictions of a Canadian federal fishing ban. Mexico's Gulf of Mexico fishing zone is in need of crews and exper-

11. *Canadian fishermen asked to assist Mexico*, NAFTA WATCH, Nov. 10, 1994, at 6.

tise. Although nothing concrete has developed yet, the fact that Canada is part of a multilateral trade agreement with Mexico cannot hurt the prospects of Canadian fishermen. Other countries have proposed providing crews and expertise for the Gulf of Mexico, but it would seem that Canada's NAFTA relationship with Mexico would give it the inside tract and possibly make it easier to keep in place its own domestic fishing restrictions.

On a somewhat more negative note, some Canadian Christmas tree growers found it to be next to impossible to obtain access to the Mexican market this past holiday season.[12] Trees grown in certain parts of Southern Canada and the Northern United States are subject to infestation by the gypsy moth. However, treatment and inspection programs have made it possible to certify trees as being free from the gypsy moth. In a reversal of a position taken since 1993, Mexican officials refused to honor the certificates issued by quarantine officials in Canada and the United States. Despite no real domestic supply of Christmas trees within Mexico and efforts made by Canadian and U.S. officials to assure Mexican officials that the trees were free from pests and disease, the Mexican officials would not relent. Other growers from disease-free regions reported bureaucratic difficulty in processing their trees with Mexican border officials. With the passing of NAFTA, it would be thought that such problems as these would be solved before such highly seasonal and perishable products as Christmas trees were literally in shipment. However, free trade treaties do not always create a spirit of cooperation on every anticipated item.

IV. Canada's Desire for Expansion of NAFTA

Despite occasional differences with Mexico and because of consistent differences with the United States, Canada desires to expand it international trading markets. The vehicle of choice seems to be through expansion of NAFTA. Canada has been critical of bilateral treaties and seems to feel that the NAFTA parties should be willing to first consider admitting a country to NAFTA before taking bilateral action. Canada seems willing to go outside of the Americas in seeking countries to add to NAFTA and has mentioned a diverse group of nations as potential NAFTA candidates.

There are probably a number of reasons that Canada wishes to proceed by accession rather than bilateral agreement. Number one is that the United States and Mexico have characteristics which would attract Canadian targets in ways that Canada alone could not. Indeed, if Canada could attract other nations to proceed bilaterally, it would seem to fulfill a number of desires of the Canadian government. The desires to break free from its dependence on the U.S. markets and to establish a cultural identity that is definitely distinct from that of the United States seem to give Canada incentive to move bilaterally. However, within Canada's North American neighborhood, the United States represents the giant market eager to import what a potential partner has to offer while Mexico represents the star emerging market that can offer many advantages that Canada cannot. Thus nations are more likely to want to proceed bilaterally with the United States or Mexico before considering agreeing to a pact with Canada.

12. Trueheart, *The Christmas Tree That Couldn't Go South: Canadian, U.S. Growers Complain That Despite NAFTA, Mexico Is Raising Barriers*, Wash. Post, Dec. 22, 1994, at A34.

Canada's problem with succeeding at its expansion-of-NAFTA agenda is that its partners, particularly the United States, seem reluctant to do so at this time. An independent Quebec might be an attractive partner to the United States, but Quebec may be the last sovereign nation on the planet that Canada would desire acceding to NAFTA.

V. Conclusion

Canada's debt problem may bring chides of it being an honorary member of the third world, but Canada's trade problem may be that it does not easily fit into any label. It is not enough of a superpower to diversify its trading markets much beyond the hold that the United States currently has on them and it does not possess the characteristics to acquire the emerging market label. Thus, it does not easily fit on either side of the current international trading equation.

Canada's internal problems do not help its status as an attractive trading partner. The potential for Quebec's secession from Canada and the trade barrier erected by the provinces create problems for Canada in presenting a desirable package to the rest of the world. Until the Quebec issue is resolved, much of Canada's policy-making could be driven by Montreal's desires rather than Ottawa's.

NAFTA has proven to provide mixed results for Canada. The trade disputes with the United States continue, but the potential to develop a stronger relationship with Mexico represents a step forward. The two NAFTA partners have much in common regarding perceived bullying by the United States and can potentially work together in combatting actions by the United States.

After the Summit of Americas, it appears that Chile is next in line for NAFTA accession. Canada would welcome this, but there are doubts of whether it will occur due to the reluctance of the United States to expand NAFTA. Once again, it seems that a part of Canada's fate in the world trade arena is too much in the hands of its southern neighbor.

—Tim Baker and Tracey Wallace