DENIS STAIRS and GILBERT R. WINHAM,
Research Coordinators

Canada and the International Political/Economic Environment

Canada and the International Political/Economic Environment

R.G.

This is Volume 28 in the series of studies commissioned as part of the research program of the Royal Commission on the Economic Union and Development Prospects for Canada.

The studies contained in this volume reflect the views of their authors and do not imply endorsement by the Chairman or Commissioners.

Canada and the International Political/Economic Environment

DENIS STAIRS AND GILBERT R. WINHAM,
Research Coordinators

Published by the University of Toronto Press in cooperation with the Royal Commission on the Economic Union and Development Prospects for Canada and the Canadian Government Publishing Centre, Supply and Services Canada

University of Toronto Press
Toronto Buffalo London

Grateful acknowledgment is made to the following for permission to reprint previously published and unpublished material: Chief Statistician of Canada; Minister of Supply and Services Canada.

Printed in Canada
ISBN 0-8020-7271-2
ISSN 0829-2396
Cat. No. Z1-1983/1-41-28E

CANADIAN CATALOGUING IN PUBLICATION DATA

Main entry under title:
Canada and the international political / economic environment

(*The Collected research studies / Royal Commission on the Economic Union and Development Prospects for Canada.*
ISSN 0829-2396 ; 28)
Includes bibliographical references.
ISBN 0-8020-7271-2

1. Canada — Foreign economic relations — Addresses, essays, lectures. 2. Canada — Economic policy — 1971- — Addresses, essays, lectures. 3. Canada — Foreign relations — Addresses, essays, lectures. I. Stairs, Denis, 1939- II. Winham, Gilbert R. III. Royal Commission on the Economic Union and Development Prospects for Canada. IV. Series: The Collected research studies (Royal Commission on the Economic Union and Development Prospects for Canada); 28.

HF1479. C35 1985 337.71 C85-099113-7

PUBLISHING COORDINATION: Ampersand Communications Services Inc.
COVER DESIGN: Will Rueter
INTERIOR DESIGN: Brant Cowie/Artplus Limited

CONTENTS

FOREWORD

When the members of the Rowell-Sirois Commission began their collective task in 1937, very little was known about the evolution of the Canadian economy. What was known, moreover, had not been extensively analyzed by the slender cadre of social scientists of the day.

When we set out upon our task nearly 50 years later, we enjoyed a substantial advantage over our predecessors; we had a wealth of information. We inherited the work of scholars at universities across Canada and we had the benefit of the work of experts from private research institutes and publicly sponsored organizations such as the Ontario Economic Council and the Economic Council of Canada. Although there were still important gaps, our problem was not a shortage of information; it was to interrelate and integrate — to synthesize — the results of much of the information we already had.

The mandate of this Commission is unusually broad. It encompasses many of the fundamental policy issues expected to confront the people of Canada and their governments for the next several decades. The nature of the mandate also identified, in advance, the subject matter for much of the research and suggested the scope of enquiry and the need for vigorous efforts to interrelate and integrate the research disciplines. The resulting research program, therefore, is particularly noteworthy in three respects: along with original research studies, it includes survey papers which synthesize work already done in specialized fields; it avoids duplication of work which, in the judgment of the Canadian research community, has already been well done; and, considered as a whole, it is the most thorough examination of the Canadian economic, political and legal systems ever undertaken by an independent agency.

The Commission's Research Program was carried out under the joint direction of three prominent and highly respected Canadian scholars:

Dr. Ivan Bernier (*Law and Constitutional Issues*), Dr. Alan Cairns (*Politics and Institutions of Government*) and Dr. David C. Smith (*Economics*).

Dr. Ivan Bernier is Dean of the Faculty of Law at Laval University. Dr. Alan Cairns is former Head of the Department of Political Science at the University of British Columbia and, prior to joining the Commission, was William Lyon Mackenzie King Visiting Professor of Canadian Studies at Harvard University. Dr. David C. Smith, former Head of the Department of Economics at Queen's University in Kingston, is now Principal of that University. When Dr. Smith assumed his new responsibilities at Queen's in September, 1984, he was succeeded by Dr. Kenneth Norrie of the University of Alberta and John Sargent of the federal Department of Finance, who together acted as co-directors of Research for the concluding phase of the Economics research program.

I am confident that the efforts of the Research Directors, research coordinators and authors whose work appears in this and other volumes, have provided the community of Canadian scholars and policy makers with a series of publications that will continue to be of value for many years to come. And I hope that the value of the research program to Canadian scholarship will be enhanced by the fact that Commission research is being made available to interested readers in both English and French.

I extend my personal thanks, and that of my fellow Commissioners, to the Research Directors and those immediately associated with them in the Commission's research program. I also want to thank the members of the many research advisory groups whose counsel contributed so substantially to this undertaking.

DONALD S. MACDONALD

INTRODUCTION

At its most general level, the Royal Commission's research program has examined how the Canadian political economy can better adapt to change. As a basis of enquiry, this question reflects our belief that the future will always take us partly by surprise. Our political, legal and economic institutions should therefore be flexible enough to accommodate surprises and yet solid enough to ensure that they help us meet our future goals. This theme of an adaptive political economy led us to explore the interdependencies between political, legal and economic systems and drew our research efforts in an interdisciplinary direction.

The sheer magnitude of the research output (more than 280 separate studies in 72 volumes) as well as its disciplinary and ideological diversity have, however, made complete integration impossible and, we have concluded, undesirable. The research output as a whole brings varying perspectives and methodologies to the study of common problems and we therefore urge readers to look beyond their particular field of interest and to explore topics across disciplines.

The three research areas, *Law and Constitutional Issues*, under Ivan Bernier, *Politics and Institutions of Government* under Alan Cairns, and *Economics* under David C. Smith (co-directed with Kenneth Norrie and John Sargent for the concluding phase of the research program) — were further divided into 19 sections headed by research coordinators.

The area *Law and Constitutional Issues* has been organized into five major sections headed by the research coordinators identified below.

- Law, Society and the Economy — *Ivan Bernier and Andrée Lajoie*
- The International Legal Environment — *John J. Quinn*
- The Canadian Economic Union — *Mark Krasnick*
- Harmonization of Laws in Canada — *Ronald C.C. Cuming*
- Institutional and Constitutional Arrangements — *Clare F. Beckton and A. Wayne MacKay*

Since law in its numerous manifestations is the most fundamental means of implementing state policy, it was necessary to investigate how and when law could be mobilized most effectively to address the problems raised by the Commission's mandate. Adopting a broad perspective, researchers examined Canada's legal system from the standpoint of how law evolves as a result of social, economic and political changes and how, in turn, law brings about changes in our social, economic and political conduct.

Within *Politics and Institutions of Government*, research has been organized into seven major sections.

- Canada and the International Political Economy — *Denis Stairs and Gilbert Winham*
- State and Society in the Modern Era — *Keith Banting*
- Constitutionalism, Citizenship and Society — *Alan Cairns and Cynthia Williams*
- The Politics of Canadian Federalism — *Richard Simeon*
- Representative Institutions — *Peter Aucoin*
- The Politics of Economic Policy — *G. Bruce Doern*
- Industrial Policy — *André Blais*

This area examines a number of developments which have led Canadians to question their ability to govern themselves wisely and effectively. Many of these developments are not unique to Canada and a number of comparative studies canvass and assess how others have coped with similar problems. Within the context of the Canadian heritage of parliamentary government, federalism, a mixed economy, and a bilingual and multicultural society, the research also explores ways of rearranging the relationships of power and influence among institutions to restore and enhance the fundamental democratic principles of representativeness, responsiveness and accountability.

Economics research was organized into seven major sections.

- Macroeconomics — *John Sargent*
- Federalism and the Economic Union — *Kenneth Norrie*
- Industrial Structure — *Donald G. McFetridge*
- International Trade — *John Whalley*
- Income Distribution and Economic Security — *François Vaillancourt*
- Labour Markets and Labour Relations — *Craig Riddell*
- Economic Ideas and Social Issues — *David Laidler*

Economics research examines the allocation of Canada's human and other resources, how institutions and policies affect this allocation, and the distribution of the gains from their use. It also considers the nature of economic development, the forces that shape our regional and industrial structure, and our economic interdependence with other countries. The thrust of the research in economics is to increase our comprehension of what determines our economic potential and how instruments of economic policy may move us closer to our future goals.

One section from each of the three research areas — The Canadian Economic Union, The Politics of Canadian Federalism, and Federalism and the Economic Union — have been blended into one unified research effort. Consequently, the volumes on Federalism and the Economic Union as well as the volume on The North are the results of an interdisciplinary research effort.

We owe a special debt to the research coordinators. Not only did they organize, assemble and analyze the many research studies and combine their major findings in overviews, but they also made substantial contributions to the Final Report. We wish to thank them for their performance, often under heavy pressure.

Unfortunately, space does not permit us to thank all members of the Commission staff individually. However, we are particularly grateful to the Chairman, The Hon. Donald S. Macdonald, the Commission's Executive Director, Gerald Godsoe, and the Director of Policy, Alan Nymark, all of whom were closely involved with the Research Program and played key roles in the contribution of Research to the Final Report. We wish to express our appreciation to the Commission's Administrative Advisor, Harry Stewart, for his guidance and advice, and to the Director of Publishing, Ed Matheson, who managed the research publication process. A special thanks to Jamie Benidickson, Policy Coordinator and Special Assistant to the Chairman, who played a valuable liaison role between Research and the Chairman and Commissioners. We are also grateful to our office administrator, Donna Stebbing, and to our secretarial staff, Monique Carpentier, Barbara Cowtan, Tina DeLuca, Françoise Guilbault and Marilyn Sheldon.

Finally, a well deserved thank you to our closest assistants, Jacques J.M. Shore, *Law and Constitutional Issues*; Cynthia Williams and her successor Karen Jackson, *Politics and Institutions of Government*; and I. Lilla Connidis, *Economics*. We appreciate not only their individual contribution to each research area, but also their cooperative contribution to the research program and the Commission.

IVAN BERNIER
ALAN CAIRNS
DAVID C. SMITH

PREFACE

The terms of reference of the Royal Commission on the Economic Union and Development Prospects for Canada required it to report on the "long-term economic potential, prospects and challenges facing the Canadian federation and its respective regions, as well as the implications that such prospects and challenges have for Canada's economic and governmental institutions and for the management of Canada's economic affairs." With the world becoming at once more interdependent and more competitive, this was not a task that could be undertaken without reference to Canada's place in the international economy, where "significant changes" were seen to be in progress. It was therefore determined that a portion of the Commission's research program should be devoted to an analysis of Canada's situation and potential future in the world economy. Much of this work was naturally assigned to economists but, since the issues involved raised important political and institutional issues as well as economic ones, a section titled "Canada and the International Political Economy" was established to augment the work of other divisions on issues related to international trade and the legal environment.

The number of studies that could be initiated was limited by the resources available to the section, and ultimately it was decided that the reseach would concentrate, first, on the general environmental conditions within which Canada's external economic policies must be made; second, on the all-important economic relationship with the United States; and third, on various problems of substance and process in the making of Canadian foreign economic policy. With the partial exception of policies hearing on the economic problems of the Third World, which were being considered in some depth elsewhere, Canada's economic relationships with other countries appeared not to raise political and institutional questions as important to Canada as those with the United States. Because of a limited research budget, therefore, they were not made the subject of specific studies. The papers that have resulted from this section of the Commission's research program are being published in three separate volumes, as listed here.

Volume 28: *Canada and the International Political/Economic Environment*

Denis Stairs and Gilbert R. Winham	*Canada and the International Political/Economic Environment: An Introduction*
Jock A. Finlayson	*Canadian International Economic Policy: Context, Issues and a Review of Some Recent Literature*
Michael C. Webb and Mark W. Zacher	*Canadian Export Trade in a Changing International Environment*

Volume 29: *The Politics of Canada's Economic Relationship with the United States*

Denis Stairs and Gilbert R. Winham	*The Politics of Canada's Economic Relationship with the United States: An Introduction*
J.L. Granatstein	*The Issue that Will Not Go Away: Free Trade Between Canada and the United States*
Kim R. Nossal	*Economic Nationalism and Continental Integration: Assumptions, Arguments and Advocacies*
Charles Pentland	*North American Integration and the Canadian Political System*
Jock A. Finlayson	*Canada, Congress and U.S. Foreign Economic Policy*
Gary C. Hufbauer and Andrew J. Samet	*U.S. Response to Canadian Initiatives for Sectoral Trade Liberalization, 1983–84*

Volume 30: *Selected Problems in Formulating Foreign Economic Policy*

Denis Stairs and Gilbert R. Winham	*Selected Problems in Formulating Foreign Economic Policy: An Introduction*
Gerald Wright	*Bureaucratic Politics and Canada's Foreign Economic Policy*
Robert Boardman	*The Foreign Service and the Organization of the Foreign Policy Community: Views from Canada and Abroad*
F.J. Chambers	*The Emerging Cost Structure of Canadian Firms: Some Implications for International Economic Policy*

R.B. Byers *Canadian Defence and Defence Procurement: Implications for Economic Policy*

Denis Stairs and Gilbert R. Winham

ACKNOWLEDGMENTS

The editors acknowledge with gratitude the continuing interest shown by Research Director Alan Cairns in the section "Canada and the International Political Economy." The combination of his demanding standards and supportive leadership helped to raise the quality of the research papers produced in this section. Further thanks are due to the Commission staff who performed an essential role in bringing these papers to fruition, namely Karen Jackson, Research Program Advisor and Assistant to Dr. Cairns, who managed the logistics of the research station, and Françoise Guilbault, who ably discharged the varied secretarial tasks associated with the section.

In designing these studies the editors were assisted by a Research Advisory Group, which individually or collectively commented on many of the manuscripts included in the section. Their varied expertise on matters of international political economy was a valuable asset in providing ideas and criticism to individual authors. Members of the Research Advisory Group were as follows:

Professor Louis Sabourin
- École Nationale Administration
Publique - GERFI

Professor David Leyton-Brown
York University

Professor Eric Kierans
Dalhousie University

Professor Jeanne Laux
University of Ottawa

Mr. Michael Hart
Department of Transport

Professor Gerald K. Helleiner
University of Toronto

Professor Rodrigue Tremblay
Université de Montréal

D.S. AND G.R.W.

Canada and the International Political/Economic Environment: *An Introduction*

DENIS STAIRS AND GILBERT R. WINHAM

The Changing Global Environment

The two papers included in this volume were commissioned to address the nature of the international political economic system and the pressures it placed on Canada. Jock Finlayson's study addresses the constraints and options facing Canada in the context of a review of literature on Canadian economic foreign policy. Such a review is much needed, and will fill a gap in the writings on Canadian external relations. The second paper, by Michael Webb and Mark Zacher, focusses on the international constraints affecting Canada's trading position. The authors conclude that, because of industrial convergence and the tendency of industrial nations to produce similar goods, the prospects for expansion and diversification of Canadian exports is not good. Therefore, they argue, Canada should not attempt to negotiate new measures of trade liberalization, but should use its limited bargaining leverage to gain further access to foreign markets that have already been opened to Canadian exporters. In their view, Canada should press for stricter international guidelines and discipline to control the introduction of new measures of protectionism that threaten continued Canadian access to foreign markets. This is an argument which has particular relevance for our trade with the United States.

As Finlayson's review makes clear, the industrial world enjoyed unprecedentedly buoyant economic conditions in the reconstruction period following World War II. Growth rates in OECD nations averaged around 5 percent per annum, and the volume of international trade grew by an even faster 7 percent per annum. It was a period of stable exchange rates under the multilateral direction of the International Monetary Fund (IMF) system. It was, in addition, a period of increasing trade liberalization. The world economy faltered after the oil shock of 1973 but regained momentum in the second half of the decade, until the second oil shock of 1979 and the severe global recession of 1980–81. For all nations, the question of how to restore the high growth levels that were the norm through most of the postwar period remains a major problem.

The difficulties confronting the world economy go much deeper, however. For one thing, substantial change — especially industrial change — is occurring throughout the international economic system, and for governments and their constituents alike it has the effect of reducing both the stability and the predictability of the economic environment. Secondly, since the post-1971 reform of the IMF system, free market regimes have co-existed in the major systems that make up the international economy: trade, monetary, and foreign investment. This has reduced multilateral management of the international economy, and has intensified the sense of precariousness now shared by all. Finally, there has been a growth of interdependence, a concept that is documented in the essay by Finlayson. It refers to linkages among national economies and to the complex relationships of the forces that buffet the international economic system. High interest rates in one nation may affect interest rates and exchange values in another; high exchange values create pressures on trade balances; and falling trade balances can expand problems of international debt. This interplay of forces makes national governments less secure in their control of their economies than they were in the past. The combined effect of these developments has been to amplify the sense of risk and uncertainty for all nations.

Much of the uncertainty in the world economy stems from the breakdown of the Bretton Woods system by which, during most of the postwar period, the IMF maintained control over fluctuations of national exchange rates. This system broke down in 1971 and, during the ensuing reform of the monetary system, exchange rates were eventually allowed to fluctuate freely. The change has created problems in international trade: for example, a lengthy and arduous trade negotiation might reduce average tariffs from 10 to 5 percent, but fluctuations in exchange rates can generate price changes of up to three times that amount within a few months. The resulting chaos can lead to expensive losses for traders and cause frustration among governments that are seeking to promote a stable international economy.

The general sense of uncertainty and loss of control is a worldwide problem. Canada faces additional pressures that bear directly on the country's future aspirations and opportunities. These pressures include increasing international competitiveness; the changing nature of international investment; and the intensification of regionalism and discriminatory trading arrangements.

International Competition

One of the most important of the pressures analyzed in this volume is the greater competitiveness of the contemporary international economy. As Webb and Zacher point out, the international structure of competitive advantage that characterized earlier decades has changed over the past two decades. Generally, the concept of competitive advantage was seen to depend on differences in the relative abundance of capital, labour, natural resources, and technology. While it was expected that the competitive advantage of individual nations would change as the relative abundance of the factors of production changed, it was assumed that such shifts would be predictable and would allow time for adjustment. It was further assumed that a few industrial countries were the major traders of manufactured goods. The developing countries served as sources of raw materials and only rarely competed with the industrialized countries in exports of manufactured products, while the socialist countries were largely excluded from the trading system through political hostility.

Today's rapid changes in trade have invalidated these assumptions and tend to impose serious adjustment burdens on countries like Canada. Consider for example Japan, which has caught up with or surpassed the industrial leaders in many sectors of industrial technology. Canadian manufacturing industries have faced strong competition from Japan in a variety of advanced and, hence, more important manufacturing sectors such as those producing cars and electronic equipment. Some exporters have lost foreign markets to the Japanese, although their losses have been limited by the fact that Canada has never had a significant export presence in many of the sectors in which the Japanese have been strong. The most severe direct loss of Canadian export markets occurred in the late 1970s, when our auto exports suffered as a result of Japanese auto sales to the United States.

There is a tendency to assume that the imbalance of Canadian-Japanese trade in manufactures originates in Japanese protectionism. Certainly this protectionism did exist in the first two decades after World War II. Today, however, it is not appreciably greater than that of most industrialized countries, at least as assessed under the rules of the General Agreement on Tariffs and Trade (GATT). The challenge posed by Japan is less a matter of its trade policy than of the competitive economic performance of its whole society. Government policy plays a part in promoting this performance, but it is unrealistic for Japan's trading partners to attribute Japanese success wholly to government intervention and protection.

Another change in the international structure of competitive advantage has occurred with the emergence of the newly industrializing countries (NICs). The NICs are highly competitive producers and exporters of certain high-volume, standard-technology, manufactured goods that require relatively large inputs of low-skilled labour relative to those required for capital and natural resource development. They first made inroads in the textile, clothing and footwear sectors, but they have since become competitive as well in steel, ships, automobiles, electronics and a wide range of consumer goods. In addition, the NICs and other developing countries have established themselves as increasingly serious competitors for Canada's exports of resource-based products.

Nevertheless, Canadians should be careful not to exaggerate the impact of competition from the developing countries. In 1977, as Webb and Zacher report, NICs accounted for only about 8 per cent of total imports of manufactured goods by members of the Organization for Economic Cooperation and Development (OECD) and just over 1 percent of total OECD consumption of manufactures. Therefore the impact of the NICs on production and employment in Western industrialized countries is likely to be limited as well. On the other hand, unemployment associated with competition from NIC exports has nevertheless been serious in certain sectors. It has been concentrated in labour-intensive industries where skill levels are low, and consequently displaced workers have found it difficult to find other work. This difficulty applies especially to the textile and apparel industries in Canada, where the concentration of threatened industries in specific regions has heightened the political sensitivity of the issue.

Foreign Investment

A second form of pressure on Canada comes from modern developments in international investment. As noted earlier, it was traditionally assumed that trade occurred in response to competitive advantage, which was assessed mainly in terms of factor costs and market opportunities. Modern foreign investment decisions, however, call this assumption into question. Increasingly, international trade occurs between related parties, especially between international firms and their affiliates — a fact which raises doubts about the arm's-length nature of many international transactions. The location of major foreign capital investments is usually negotiated between governments and international firms, and motivations are generally political. Host governments often impose performance requirements in order to influence the economic behaviour of firms that establish themselves within their jurisdiction. They also, of course, offer incentives to induce firms to establish affiliates in particular regions, and there is considerable competition among governments for foreign investment.

International firms have shown an ability to adapt to host-government requirements when making investment decisions, and they have in consequence varied their investment patterns in ways that could produce trade flows different from those based on factor costs or market opportunities. It is easier than before for countries to acquire a competitive advantage in a particular sector through manipulation, and they thus have a greater opportunity to influence their own trade patterns. As a result, the composition of trade flows worldwide is becoming subject to the actions of governments.

In Canada, the high degree of foreign investment strongly influences export patterns and prospects in both negative and positive ways. Combined with the trend toward the internationalization of business, extensive foreign ownership has resulted in the high proportion of Canadian trade that is accounted for by intra-corporate transfers between branches of a single transnational corporation. Figures cited by Webb and Zacher and published by the U.S. Department of Commerce show that about 56 percent of Canada's exports to the United States has consisted in recent years of intra-corporate transfers. While comparably precise figures for Canada's trade with other regions are not available, indications are that intra-corporate transfers account for a smaller, but still significant, part of Canada's overseas trade. The result is that a large proportion of total Canadian exports derives from decisions made by multinational firms based outside this country, preventing a large proportion of Canadian trade from being easily influenced by Canadian government policy. Moreover, many foreign-owned subsidiaries were originally established behind Canadian tariff barriers solely to supply the domestic Canadian market, and may be restricted in their export policies by the global strategy of their parent firms. Similarly, Canadian producers that are reliant on foreign technology may find their activities restricted to the domestic market as a condition of their licences to use that technology.

However, while the high degree of foreign ownership in Canada may have contributed to the lack of diversification in export trade, it would be a mistake to see foreign ownership only as a negative factor. Canada, as Webb and Zacher observe, seeks like many other countries to develop capacity in "high-tech" industries. But the global nature of technology in these industries often means that if Canada is going to participate, it will have to do so in partnership with foreign firms. Furthermore, if Canada is to attract investment, it will have to compete for that investment with other countries. Such competition can produce diminishing returns, for it enables foreign companies to play one government's offers off against another's. The costs to governments of subsidizing foreign investment can quickly accumulate, yet in fact there is considerable evidence that incentives are not a major economic factor in attracting foreign investments.

Recent surveys of foreign firms have shown that Canada is regarded as a good place to invest, but that the Canadian government's policies have contributed to a deteriorating climate for investment. What foreign investors look for is stability and secure access to a large market. Thus Canada may be at a disadvantage if firms perceive that Canadian access to the U.S. market (or to markets in the European Community or Japan) is not secure. This fact of economic life indicates the importance of the relationships among investment, trade, and trade policy, and suggests also the importance of retaining secure access to the U.S. market for export trade.

Growth of Regionalism

A third form of pressure on Canada comes from international political activity, specifically the formation of trading and other economic blocs in the contemporary international system. Consider, for example, the international trading system. International trade under the GATT is founded on the principle of non-discrimination which, in practice, means that nations treat all other nations equally in applying regulations and restrictions to trade or foreign investment. The principle of non-discrimination was compromised when "codes" of non-tariff barriers (NTBs) were negotiated at the Tokyo Round, because it was assumed that such codes would apply only between nations actually accepting their obligations. This arrangement is very different from the non-discriminatory MFN principle on tariffs by which an importing nation would apply a single duty to an imported product, regardless of the amount of the duty imposed by the nation exporting that product.

The principle of non-discrimination, which is the foundation on which a multilateral trading system is based, has been even more fundamentally threatened by the establishment of preference areas or regional trading blocs. These blocs have become more important since the 1950s, despite the commitment of all GATT members to accord non-discriminatory treatment to their trading partners. The most important of these blocs is that formed by the European Community and its many associates, which now include a number of Mediterranean countries as well as developing countries in Africa, the Caribbean and the Pacific. As Webb and Zacher report, more than 20 percent of world trade now occurs within the preferential trading system of the European Community (EC). Other important preferential trading systems include the Association of South-East Asian Nations (ASEAN), the Caribbean Common Market (CARICOM), and various Generalized System of Preferences (GSP) schemes, which are applied by most Western industrialized countries to developing nations. These systems all share the feature of discrimination, through tariffs and NTBs, in favour of trade among their members and at the expense of non-members. Although such discrimination violates the rules and spirit of the GATT, it has been legitimized in most instances by waivers from GATT obligations.

Webb and Zacher argue in their essay that the trend toward regionalization in the world trading system holds considerable dangers for Canada. First, Canada is not a member of any preferential trading bloc, which makes it the only major industrial country to lack a guaranteed access to a market of over a hundred million individuals. The small size of

Canada's domestic market puts the country at a competitive disadvantage with the EC countries, the United States, and Japan, all of which have sufficiently large domestic markets to stimulate the development of products that are internationally competitive. Canada's exports to Europe, moreover, have been reduced by the discrimination of the European Community against third parties. Resource-based exports have been most affected, since Canada has never developed a strong export trade in manufactured products with Europe. Cereals exports have suffered most, as the Common Agricultural Policy of the EC has cut into former Canadian markets in Britain and some European countries. Exports of Canadian pulp and paper have also been subject to gradual decline, competing with Scandinavian countries that have negotiated preferential agreements with the European Community.

Another problem that emerges from the Webb and Zacher analysis is the trend toward settling issues of world trade policy in trilateral negotiations among the United States, the European Community, and Japan. When they reach a settlement on any given question, Canada may be given no opportunity even to voice its concerns. Furthermore, in such negotiations there is often an operating assumption that Canada is economically part of a large North American identity, so that it is difficult for Canada to establish a distinct voice in international economic relations. This view, together with the continued movement toward regional grouping, underline the urgency for Canada to define its role in the international trading system of the future.

Conclusion

Since Canada's colonial beginnings, its domestic economy has been defined to a large extent by its relationship to the global economic system. Trading and other economic relations with industrial centres in Europe and the United States sustained Canadian economic activity and helped to shape the country's institutions. Canada benefitted enormously from its relationship with the world economy, but there were costs as well for, as Finlayson has noted, Canada has always been vulnerable to the external world. Today that vulnerability appears to be increasing, and it is more worrisome. As measured by rising ratios of trade to GNP, Canada's economy is now more internationalized than ever before, while at the same time the international economy is becoming a more difficult and competitive environment within which to operate. Together, these developments put pressure on the Canadian government to rethink its traditional strategies in foreign economic affairs.

The global environment is a challenge to Canada today, and that challenge will probably intensify in the next two decades. In political terms, it will require the effective management of international interdependence and the construction of new relationships to accommodate the growing importance that national economies have for each other. In economic terms, it will involve mastering new technologies and adjusting to a more competitive world economy than Canadians have previously encountered. The challenge, in short, will be one of change, adaptation, and adjustment, and it will pose some of the most difficult problems to be found on the agenda of modern government.

Canadian International Economic Policy: *Context, Issues and a Review of Some Recent Literature*

JOCK A. FINLAYSON

Introduction

The remaining decade and a half of this century promises to be a period of great challenge for Canadian international economic policy. The problems evident in the world economy, from increasing protectionism to the Third World debt crisis, will continue to form an unstable and even ominous backdrop against which Canada must evolve its policies toward the external world. Increasing competition from developing and industrialized countries alike will threaten the viability of more than a few Canadian industries in both the manufacturing and natural resource sectors. Developments in the United States, always so central to any assessment of Canada's economic prospects, will continue to demand the attention of Canadian policy makers. Moreover, these and other issues will face the Canadian government at a time when its ability to address the country's economic problems effectively is regarded with skepticism by analysts of all political persuasions. Concern about the strength and adaptability of the Canadian economy is thus joined by doubts about the capacity of Canada's political institutions to respond adequately to the challenges confronting the nation.

More than most industrialized nations, Canada has a great stake in the preservation of a stable and orderly external economic world. Canadian policy objectives must be framed in full awareness of the many ways in which the world economy shapes and constrains Canada's options and opportunities. Such domestic policy objectives as reduced regional disparities and more generous social programs will be difficult, if not impossible, to realize if Canada's competitive position in the world economy deteriorates. As a small, open economy heavily dependent on foreign commerce and capital flows, Canada has a strong interest in the existence and promotion of open global markets and effectively functioning international institutions and rules. Thus, in addition to such objectives as a more competitive economy and improved access to foreign markets for Canadian exports, another aim of Canadian international economic policy will be to continue to support and strengthen such multilateral institutions and arrangements as the General Agreement on Tariffs and Trade, the International Monetary Fund and the World Bank.

This study examines several key issues, and a considerable body of literature, that bear on the future of Canada's international economic policies. The discussion is a selective rather than a comprehensive survey of the subject, and consists of three parts. The first part of the paper examines some general trends in the global political economy that will shape and condition Canada's future policy choices. Treated here are such issues as the growth of protectionism, the nature of the increasingly integrated global economy, and the impact of international interdependence on nations large and small. The second part of the paper deals with the domestic context of Canadian international economic policy. The scholarly literature on the domestic dimension of Canadian foreign economic policy is sparse, and several areas where additional research is needed are highlighted. In the third part of the paper, an attempt is made to survey Canadian international economic policy by examining the policy areas that are usually thought to constitute the subject. Canada–U.S. economic relations are given considerable attention in this section of the paper.

At this point, a few comments on sources are in order. This paper is not a comprehensive review of all the literature relevant to Canadian foreign economic policy. It has been written with a view to its primary audience being political scientists and international relations scholars with an interest in international economic affairs generally, and Canadian foreign economic policy in particular. Because the author has been trained in these fields rather than in economics, much of the economics literature concerned with such issues as the Canadian tariff and exchange rate regimes is not considered in any detail.

Moreover, the writings of Marxist scholars are neither surveyed nor relied upon in this paper. Marxist writers have developed an extensive and varied literature on the international economy, and were interested in this subject long before non-Marxist political scientists turned their attention to it. Their intellectual contributions deserve a separate treatment and evaluation in a more comprehensive review of recent literature on the international political economy and Canada's place within it.

Trends in the Global Political Economy

Students of international politics saw their discipline undergo a remarkable change in the decade of the 1970s. Previously preoccupied with the traditional "high politics" questions of war, peace, security and alliances, international politics scholars became interested in the economic aspects of international affairs and began to write articles and monographs on topics that had previously been the preserve of economists: trade protectionism, development lending, commodity cartels, international monetary relations, and global industrialization. That the interests of many political scientists who study world politics changed in the 1970s is not surprising in light of developments in the real world of international affairs during that tumultuous decade, developments that affected Canada as much as any other advanced industrial country. In the area of international trade, which is the most important means by which nominally sovereign nations affect one another, the impressive liberalization evident in the 1960s carried into the following decade, with trade continuing to grow faster than world production during most of the 1970s (Blackhurst, Marian and Tumlir, 1977, p. 9). At the same time, however, there was a noticeable strengthening of protectionist pressures in all the developed capitalist countries, partly because of the extent to which prior liberalization had caused imports to disrupt various domestic industries, but partly too because the generally poor economic performance of the latter half of the decade had rendered more costly the industrial adjustment attendant upon increased trade. With the devastating recession of the early 1980s, the growth of international trade has slowed and protectionist policies are growing more common.

Another key development in the international economy in the 1970s was the sharp increase in the price of petroleum precipitated by the Arab-Israeli war in 1973–74 and the Iranian revolution in 1979. This led to a massive redistribution of global income away from the industrial and non-oil developing countries to the Organization of Petroleum Exporting Countries (OPEC) and other oil-exporting states. Rising oil prices, and the resultant volatility in this important commodity market, contributed to the instability evident in global trade, monetary and financial relations during the decade of the 1970s. The soft oil market and the prospect of falling oil prices appear to be having a similar effect in the present decade.

Turning to international monetary relations, the Bretton Woods fixed exchange rate regime established with the creation of the International Monetary Fund in 1944 collapsed in the early 1970s, and although the floating exchange rates of the early 1980s are believed by many economists and some governments to be an improvement on the original Bretton Woods regime, currency volatility has become a major issue in relations among the developed industrial states. The past few years have also seen the development of a severe international debt crisis as a growing number of Third World countries groan under the weight of a debt load that exceeds US$700 billion for the non-oil developing countries. How this critical debt problem is addressed will obviously be a political as much as an economic question, with governments and a host of private actors keenly interested in the outcome.

Behind these and other economic issues on the contemporary international politics agenda lie two deeper trends: growing international interdependence, and the politicization of international economic relations. The two are, of course, related. As the prosperity and destiny of national economies become more dependent on the external world and thus on the policies pursued by other states, governments lose their ability to shape their economies autonomously through their own policy choices. This fact is difficult to reconcile with the existence of separate national polities in which citizens demand and political parties promise that elected governments will deliver the economic goods. That the external economic world has an enormous impact on national policies and economic development is hardly a new realization for Canadians. Canada has always been what economists term a small, open economy, sensitive to external economic forces over which it exerts little influence. However, the scholarly literatures of international relations have not been produced primarily by Canadians; American social scientists account for the bulk of the writings in this sub-field of political science, just as they do in the discipline as a whole, and much of the concern with economic interdependence and its consequences found in the contemporary literature of international politics is a reflection of the growing awareness of American scholars that their country has now become locked into a global political economy and is increasingly affected by international economic events. The constraints imposed on national policy by economic interdependence may be news to Americans, but Canadians and the citizens of other small and medium powers have long been aware of the critical importance of the international economy to their own welfare.

In the following section, the general theme of economic interdependence is discussed, as well as a number of important international economic issues that have been analyzed by political scientists. An attempt is made to refer to some of the key literatures touching on the subjects under consideration.

Economic Interdependence

A major focus of much recent writing on the global political economy is the growth and consequences of international economic interdependence. Interdependence may be broadly defined as a state of affairs in which what one nation does directly affects other nations. In effect, "the more one nation has to take into account what other states might do in charting its own international and domestic policy, the higher the interdependence" (Rosecrance et al., 1977, p. 426). For economists, economic interdependence means that national economies are more sensitive to one another. "It is measured not merely by the volume of flows across borders but also by the costly effects of changes in transactions on the societies or governments" (Keohane and Nye, 1977, p. 12). For political scientists it is the vulnerability of nations caused by increasing interdependence that has attracted the most interest. Two nations that import all their supplies of a particular commodity may be equally sensitive to an increase in its price or to a curtailment of supply, but if one has recourse to modestly more expensive domestic sources, while the second does not, then the latter may be said to be more vulnerable than the former (p. 13). The lexicon employed by scholars interested in interdependence tends to be quite confusing. When it is asserted that interdependence has increased for the industrial democracies, for example, what is really being said is that these countries have become more dependent on external economic trends and developments. Dependence, however, is clearly a relative notion. Two states may depend on one another, but not to the same degree. The modern lexicon refers to this as "asymmetrical interdependence." The concept has relevance for Canada, which is often said to be in a relationship of asymmetrical interdependence with the United States (pp. 202–203).

Growth of the foreign trade sector is, for most industrial countries, a major manifestation of increased economic interdependence and features prominently in scholarly treatments of the phenomenon (Cooper, 1968; Rosecrance et al., 1977, p. 427; Katzenstein, 1975, pp. 1023–25). Between 1948 and 1973, the volume of world trade increased sixfold and grew at an annual average rate of 7 percent; this growth rate surpassed that of world production, which was also, however, growing very rapidly (Blackhurst, Marian and Tumlir, 1977, p. 9). Over the years 1963–73, world trade in all products increased on average by 6 percent annually and in manufactures by 11 percent, while world production of all products grew by only 3 percent, and of manufactures by only 7 percent, annually. During the less buoyant economic period of 1973–80, both exports and production increased at a slower pace, but except for 1975, and more recently in 1981–82, trade continued to grow faster than production (OECD, January 1982, p. 6; and IMF, August 1982, p. 241). For the industrial countries, the consequence of the growth of international trade has been increasing dependence on international commerce. Table 2-1 summarizes the evolution of the dependence of the industrial democracies on exports relative to gross domestic product. It should be noted that of the seven major industrial countries in the West, Canada was the most dependent on exports in 1980. Table 2-2 reveals that, when the fast-growing services sector is also counted, the industrial countries are seen to be even more dependent on exports; in Canada's case, exports of goods and services accounted for almost 30 percent of domestic product in 1980.

The sharp increases in the absolute volume of world trade, and in the importance of trade to the economies of the Western industrialized countries since the 1940s, are also related to the existence and strengthening of certain international rules and arrangements. These have been designed to promote trade liberalization and to provide a measure of stability, predictability and order in the international trade system. At the global level, the most important institution is the General Agreement on Tariffs

TABLE 2-1 Ratio of Merchandise Exports to Gross Domestic Product

	1965	1970	1973	1974	1975	1979	1980
				(percentage)			
United States	3.9	4.4	5.5	7.0	6.9	7.5	8.4
Japan	9.5	9.8	9.0	12.2	11.2	10.3	12.4
West Germany	15.6	18.4	19.6	23.4	21.4	22.6	23.6
France	10.2	12.5	14.3	17.1	15.4	17.1	17.1
United Kingdom	13.3	15.9	17.3	20.2	19.1	22.4	22.0
Canada	15.6	19.5	20.2	21.6	19.6	24.2	25.6
Italy	12.3	14.3	15.7	19.5	18.1	22.3	19.7
EEC[a] (including intra-Community trade)	15.2	18.1	20.0	23.8	21.3	23.4	23.6
EEC[a] (excluding intra-Community trade)	8.2	9.0	9.5	11.7	10.8	10.9	11.1
OECD	9.0	10.6	12.4	14.9	14.2	15.4	16.5

Sources: United Nations, *Monthly Bulletin of Statistics;*
OECD, *National Accounts of OECD Countries*, Volume 1, 1951–80.

a. Adjusted to include all the present members of the European Community throughout the world.

TABLE 2-2 Production and Trade of Twelve Leading Developed Countries, 1980

	Production[a]	Exports of Goods and Services		Exports of Goods	
	(billions of U.S. dollars)	(billions of U.S. dollars)	(percent of GDP)	(billions of U.S. dollars)	(percent of GDP)
United States	2,587.1	260.8	10.0	216.7	8.4
Japan	1,040.0	145.1	14.0	129.2	12.4
West Germany	819.1	225.1	27.5	192.9	23.6
France	651.9	146.1	22.4	111.3	17.1
United Kingdom	522.9	148.5	28.4	115.1	22.0
Italy	394.0	99.5	25.2	77.7	19.7
Canada	253.3	74.3	29.3	65.0	25.6
Spain	211.1	32.9	15.6	20.7	9.8
Netherlands	167.6	89.0	53.1	74.0	44.1
Australia	140.0	25.4	18.1	22.0	15.7
Belgium/Luxembourg	121.1	77.2	63.8	64.6	53.4

Sources: United Nations, *Monthly Bulletin of Statistics*;
OECD, *National Accounts of OECD Countries*, Volume 1, 1951–80.

a. Gross Domestic Product.

and Trade (GATT) and the various codes and arrangements that have been developed under its auspices. Since its formation in 1947, seven rounds of multilateral trade negotiations have occurred in the GATT, and these have resulted in a dramatic reduction in the tariff levels of most industrialized countries, as well as in agreements to lower and to regulate more closely the use of non-tariff barriers (NTBS) and distortions to trade. The GATT has provided a forum in which countries can work toward trade liberalization and address the many trade and commercial policy disputes that inevitably arise between them. Its rules and procedures have been particularly beneficial to smaller countries, since the GATT gives them at least a modest degree of influence over the trade policies of larger economic powers. Trade liberalization has not been restricted to the GATT, however. Also important are a number of regional trade agreements and accords that provide for free trade among signatories, particularly those that have been negotiated among the West European countries. Although these have posed problems for the GATT system because they represent a departure from the principles of multilateral trade liberalization and most favoured nation treatment that lie at the heart of the GATT, regional free trade schemes have played a significant role in expanding world trade and economic interdependence. (On the GATT generally, see Dam, 1970; Finlayson and Zacher, 1981a; and Stone, 1984; on regional free arrangements and the GATT, see Stone, 1984, Chapter 7; and Curzon and Curzon, 1976).

Most of the growth in trade among countries in the Organization for Economic Cooperation and Development (OECD) since the 1950s has taken the form of simultaneous increases in both exports and imports in the same industrial sectors, what economists term intra-industry trade (Blackhurst, Marian and Tumlir, 1977, p. 11; Caves, 1981; Grubel and Lloyd, 1975). Intra-industry or -sectoral trade has proved easier for governments to accept than more disruptive inter-sectoral trade because it does not typically involve the phasing out of entire industries. It is this type of trade that has expanded most rapidly within the OECD group of countries. Although precise measurement is difficult, studies have suggested that more than half of the trade of the OECD nations now takes the form of intra-industry trade (Lipson, 1982, pp. 444–45). The trend toward growing intra-industry trade has important implications for the global economy and trading system. It "implies a pattern of adjustment quite different from that assumed by economists working with simplified [international trade] models. The traditional models of trade . . . imply the relocation of production in response to differences in relative factor prices. The studies of intra-industry trade, on the other hand, suggest that certain types of import-competing industries are not extinguished . . . . They can adapt, specialize, and export their own goods" (p. 444). The growth of intra-industry trade helps to explain why the major industrial nations, whose factor endowments are quite similar, trade with each other so extensively.

It also helps to account for the fact that trade among the industrial countries has increased greatly in products that are part of the same industry. As a result of this, the liberalization of international trade that has occurred since the 1940s has led, at least in the case of the major industrial economies, to a significant amount of intra-industry rather than inter-industry specialization (Grubel and Lloyd, 1975, Chapter 9; Lipson, 1982, p. 445).

Another manifestation of the increasing importance of foreign trade for national economies is the growth of trade in services. Services now account for the bulk of Gross National Product (GNP) in almost all advanced industrial economies, and they are becoming a more significant component of world trade as well. Tradeable services include such invisibles as banking, insurance, shipping and travel. Clear international rules and arrangements to govern trade in services do not exist, in contrast to the situation prevailing with respect to trade in goods, where the General Agreement on Tariffs and Trade and other agreements provide some measure of order and predictability. The United States, which enjoys a comparative advantage in many types of services, is the strongest proponent of developing new international rules in this area, and has made this a trade policy priority for the remainder of the decade. This alone will force Canada and other industrial countries to examine the relevant issues in a careful way and to make some kind of response to U.S. demands (Government of Canada, October 1982).

The industrial countries have also become more dependent on trade with the Third World and with centrally planned economy countries in recent decades, although this is less true in the case of Canada (Economic Council of Canada, 1978, p. 70). For the United States, dependence on developing countries as a market for exports of manufactured goods rose sharply in the 1970s, while Japan and Western Europe grew modestly more reliant on the Third World as a market for their manufactured products over the same decade. For the OECD nations as a whole, the most striking manifestation of their greater reliance on and sensitivity to the Third World in international trade was of course petroleum, with both Canada and its western allies becoming much more dependent on OPEC suppliers and other Third World petroleum exporters for this critical commodity in the 1970s and 1980s than was the case 20 years ago. However, despite the continuing importance of petroleum imports to the advanced industrial countries, the growth in their dependence on foreign trade has arisen mainly because of their increasing trade with each other, not with the Third World or other groups of countries.

In addition to the expansion of global trade, another sign of greater economic interdependence that has received some attention from political scientists is the growth of capital flows and the increasing volume of international financial transactions. From the late 1950s to the mid-1970s, direct foreign investment grew at an astonishing pace, in part as a result of the rise of multinational corporations (MNCs), which take a global rather than a national approach to their operations. The bulk of MNC investment in foreign countries has gone to other developed industrial countries, with a smaller share being directed toward less developed economies. Since the mid-1970s, the growth of direct foreign investment has slowed somewhat, particularly to the Third World. However, overall it has kept pace with the rise in world trade and has exceeded domestic economic growth and investment growth rates in the OECD countries (OECD, 1981). American-based MNCs continue to be the most important source of foreign direct investment, but Japan, Canada, and other developed countries also boast an increasing number of companies involved in investing abroad as well as at home.

The expansion of international investment and capital flows brought about by the activities of MNCs has played a significant part in the creation of a more integrated non-communist world economy. A related trend, also partly attributable to the rise of the MNCs, is the increasing integration of the international financial system. Computer technology and improved communications systems now permit billions of dollars to be transferred instantaneously by banks, corporations and governments. These massive international financial flows are highly sensitive to even slight interest rate differentials (Eastman, 1984, p. 627). The huge volumes of American dollars held by foreign governments and private economic agents as a result of the dollar's key role in world trade and payments helped to spawn the creation of new financial markets in the late 1960s and 1970s, particularly in Europe. The existence of many billions of petro-dollars that had to be recycled after 1973 provided a major boost to these new international financial markets. Unlike national financial markets, the so-called Euro-markets are not closely regulated by central banks. They have become so enormous that they now constitute "an international private financial system of similar size to the one inside the United States, but outside the control of any governmental authority" (Zysman and Cohen, 1983, p. 1117).

Private international finance has been critical to meeting the balance of payments needs of many countries, especially oil-importing Third World countries. The latter have required financing far in excess of what even the expanded resources of the International Monetary Fund can provide. International banks and financial markets, flush with petro-dollars, have made tens of billions of dollars worth of loans to the developing countries. However, most of these countries appear markedly less creditworthy in the slow-growth environment of the 1980s than they did in the inflationary environment of the 1970s, and many Western financial institutions are today quite unstable because of the prospect of default by their developing country debtors. Of total Third World debt of some US$700 billion, about $400 billion is private bank debt, owed basically to Western banks, who can thus readily attest to the extent and significance of international economic interdependence (Cohen, 1983, pp. 327–29; Weinert, 1984; Mendelsohn, 1979; Meissner, 1984).

In short, the sensitivity of national economies to one another has increased because of the growth and frequency of international financial flows and the development of an integrated global financial system. The emergence of this system has also altered the international balance of payments regime put in place by the architects of Bretton Woods in the 1940s. Private international finance now plays the major role in providing financing for balance of payments deficits. "Much as in the manner of the United States after World War II, the markets took over from the IMF the main burden of providing supplementary financing for payments purposes" (Cohen, 1983, p. 329). This has posed a major challenge to the IMF's role as an arbiter of access to payments financing. The availability of unconditional financing to countries deemed creditworthy by financial markets weakened the international monetary and financial regime centred on the IMF. However, as the debt problem of developing country borrowers worsened in the late 1970s and early 1980s, private financial institutions looked to the IMF to exert pressure on borrowers to alter their policies in order to increase the likelihood that their debts would be repaid. The IMF is better able to perform this role than the financial institutions themselves, and the latter have increasingly insisted that many developing countries wanting to undertake additional international borrowings should first obtain the IMF's approval (pp. 328–33). Thus, despite the ostensible decline in the IMF's role in the international payments regime, its de facto power in large measure has been retained.

Political Consequences of Economic Interdependence

The discipline of international relations has a tendency to stress the impact of the international system on states, and this is evident in the analysis of the political effects of interdependence provided by many political scientists interested in the international economy. As one somewhat skeptical observer has commented, the literature on interdependence claims that

> . . . interdependence is more than a quality or condition that can be measured by looking at transaction flows. Interdependence involves a new type of international politics that cannot be understood or described by using the concepts and categories of traditional international relations analysis.
>
> (Holsti, 1978, p. 520)

Several themes are stressed in the writings of non-Marxist political scientists concerned with the political consequences of greater economic interdependence. First, many argue that the autonomy of the state and the coherence of national policies toward the international economy have been undermined. The most extreme version of this view — one more popular among economists than political scientists — goes further by claiming that "the state is just about through as an economic unit" (Kindleberger, 1969, p. 207). Few political scientists subscribe to this "sovereignty-at-bay" interpretation of the modern international political economy (see Vernon, 1971; and Gilpin, 1975, pp. 220–27). But many do agree that most states, especially the Western democracies and including the United States, have suffered a loss of autonomy because of increased interdependence (Morse, 1976; Keohane and Nye, 1977; Cooper, 1968; Brown, 1974). The growth of trade and capital movements has increased the exposure of states to the international economy, and rendered more difficult the pursuit of independent national policy. The rise of multinational corporations, with their tendency to integrate global production, has also weakened governments, as has the growth of international financial transactions.

Related to the loss of autonomy is the increased difficulty governments are alleged to face in defining their national interests in a world of economic interdependence. According to many international relations scholars, a central feature of an interdependent world is that multiple channels connect societies. The growth of informal ties between government elites and offices of different countries, of transnational actors such as corporations and banks, and of governmental and non-governmental international institutions of every kind has made government policies in many countries more mutually sensitive and has greatly complicated the determination of which foreign economic policies are in the national interest (Keohane and Nye, 1977, pp. 25–26). Bureaucratic and interest group politics on the domestic scene have become interwoven with global economic issues and developments. Often a particular government agency or a domestic interest group may be allied with external government or private actors (e.g., banks, and international financial organizations such as the IMF). These kinds of linkages make the policy process more complex and difficult to control.

The arguments that the autonomy and sovereignty of the state have been reduced, and that defining the national interest has become more problematic, because of greater international interdependence and economic integration during the postwar period, are usually made with reference to the experiences of the developed capitalist countries. It is important to note that small and medium powers rarely have enjoyed the autonomy and degree of sovereignty attributed to large, powerful nations with diversified economies. Albert Hirschman's brilliant study *National Power and the Structure of Foreign Trade*, written in the early 1940s, analyzed how large countries with diversified economies can manipulate trade relations with smaller, weaker nations. This underscores the importance of giving recognition to the relativity of the concept of interdependence as well as of the notion of national autonomy. Many weak Third World countries, formerly colonies and now dependent for survival on the sale of perhaps two or three commodities or on financial subventions from foreign governments or private entities, have never possessed much autonomy to lose.

Nor are they usefully portrayed as interdependent with the external world. Rather, the language of dependence and impotence better characterizes their situation (Holsti, 1980). In the case of communist countries, they have tended to avoid becoming closely intertwined with the capitalist world economy, although several East European countries have recently become much more exposed to external economic forces and trends. The Soviet Union, however, derives only 2 percent of its GNP from trade outside its bloc and has unquestionably maintained its national autonomy despite the growing interdependence and integration evident in the international economy (Finlayson and Marantz, 1982).

A second theme stressed by much of the literature on the modern global political economy relates to the politicization of international economic relations evident in the past two decades. Economic issues have become central both to relations among the Western industrial nations and to relations between the latter and the more than 120 nations of the Third World. They have also tended to become more contentious and controversial, and failure to resolve economic policy questions often generates talk of international crisis. There are at least three senses in which economic issues have become more politicized in international politics. First, economic questions have come to occupy a more prominent position on the international issue agenda, as is reflected by the institution of annual economic summits among the seven leading industrial democracies and by the fact that deliberations in the United Nations and its associated agencies now have an overwhelmingly economic orientation. Second, these same economic issues are increasingly caught up in the domestic politics of the Western countries, especially in the case of questions of international trade policy (discussed below). Finally, international economic policy has also become linked to some extent traditional political and security aspects of relations among the Western democracies and also between East and West (Hirsch and Doyle, 1977, pp. 12–13; see also Keohane and Nye, 1977, pp. 26–27).

It would be wrong, of course, to conclude that international economic relations only became politicized in recent times. Long before the industrial revolution, nations and tribes were engaged in political and military struggles in pursuit of advantages in trade and commerce. But during much of the post-World War II period, the enormous power of the United States in international affairs provided an unusual degree of stability and order in global economic relations. Largely preoccupied with military and broad foreign policy questions, and little exposed to the world economy even though it was dominant within it, the United States demonstrated the willingness and ability to trade off its external economic interests in order to further its major foreign policy objectives, the most important of which was containment of the power of communist regimes. This was evidenced in the late 1950s when the United States promoted European economic cooperation and integration, despite the fact that the formation of the

European Economic Community (EEC) harmed American export prospects in Western Europe. According to writers who subscribe to the "hegemonic stability" thesis, the stability associated with American dominance could not endure once America's relative economic and political power began to decline (Kindleberger, 1973; Krasner, 1976). Since the late 1960s, the United States has been more exposed to the world economy, but less able to dominate it. Stable international economic relations now require effective multilateral management and leadership.

Another important postwar trend that has had a significant impact on the nature of international interdependence has occurred *within* the industrialized countries: domestic economic issues have become more politicized, and the state has assumed greater responsibility for both macroeconomic performance and the welfare of particular groups, industries and sectors. As Ruggie points out (1983a), the rising levels of international interdependence, and the creation of liberal international trade and monetary regimes since the 1940s, have occurred hand-in-hand with this increase in the role and responsibilities of the state in Western societies. Indeed, the pressures and adjustments forced on societies by greater involvement with the world economy often have necessitated an interventionist response from the state, although this is obviously not equally true of all countries.

The dilemma for governments today is that, while a more open economy, exposed to and heavily involved in international transactions, will probably result in a higher national income, greater industrial efficiency, and faster economic growth, the adjustments associated with higher levels of international economic interaction can generate social instability. The need for countries to adjust their industrial structures when they participate in world trade has grown as economic interdependence has increased. This has politicized the issue of trade in particular. Economist Richard Cooper, several times a senior official dealing with international economic policy in the U.S. government, wrote in 1972 of the breakdown of the "two-track" policy process by which military and security problems in the Western nations were the stuff of high politics, while economic issues with an international dimension were dealt with as relatively innocuous matters of low politics (Cooper, 1972–73). Cooper argued that economic interdependence in general and increased trade in particular had moved trade policy to the centre of diplomacy and politics among the OECD countries. This argument is even more persuasive today than it was a decade ago.

Politicization is also evident in the area of international monetary affairs. The major dimensions of an international monetary regime have to do with the rules governing exchange rate changes, the nature of reserve assets, and the extent of governmental control of international capital flows (Cooper, 1975, pp. 66–67; Cooper, 1984; and Cohen, 1977, Chapter 1). Since the 1950s, extensive changes have occurred across all three dimensions. Higher inflation, divergencies in inflation rates in the major economic powers, rapid increases in international capital movements, and the steady growth of foreign holdings of U.S. dollars (as a result of the latter's role as the system's reserve asset and source of payment for world trade) combined to put an end to the Bretton Woods fixed exchange rate regime in the early 1970s. Intense political discussion has continued ever since among the OECD nations concerning the desirability of controlling exchange rate fluctuations. In the meantime, the heavy burdens imposed on the system by the need to recycle hundreds of billions of OPEC petro-dollars since 1973 have made international monetary policy a major issue in North-South relations. Developing countries argue against the conditions imposed on them by the International Monetary Fund when it lends funds to stabilize payments imbalances or encourages private banks to extend credits and restructure loans. This "conditionality" issue has become a serious international dispute, and the developing countries have put forth a number of proposals designed both to weaken the ability of the IMF to impose conditions on them and to reduce the debt burden of the many nations of the South that have borrowed massively from Western banks. (Weinert, 1984, reviews some of these proposals. On developments in international monetary and financial affairs in the 1970s, see Aliber, 1979; Bird, 1978; Cohen, 1977, Chapter 3; and Bolin and Del Canto, 1983.)

A final aspect of international interdependence that has elicited some discussion in the political science literature dealing with the phenomenon concerns bargaining power. Some observers argue that increased interdependence has strengthened the bargaining power of small and medium-sized states. In part this is because of the declining salience of the military, territorial and security issues that traditionally have been at the heart of international politics. Military force no longer plays as significant a role in world politics as it once did (Keohane and Nye, 1977, pp. 27–29). Partly as a result of this, it is becoming difficult in many international issue areas to determine which states possess how much effective power. According to this view, the overall superiority of the United States and the U.S.S.R. in terms of military power has little bearing on the politics of international economic relations. Bargaining outcomes cannot be predicted, argue Keohane and Nye, on the basis of which states enjoy primacy in terms of overall power. Interdependence has led to a diffusion of power and opened opportunities for states weak in some issue areas to exercise great influence in others (pp. 42–57). The more the international political system and the global economy can be characterized as interdependent, "the harder it becomes to maintain qualitatively unequal . . . relations among the units of the system" (Young, 1969, p. 748). Relatively weaker states should benefit, because rising interdependence implies "a tendency toward strengthening weaker actors against strong states as the web of relationships increases perceived sensitivities, vulnerabilities and opportunity costs for the stronger" (Haas, 1975, p. 860). The relevance of this argument for Canada obviously deserves an assessment. Some preliminary thoughts on this question are offered later in this paper.

Disorder in the World Economy

In its 1981 *World Development Report*, the World Bank suggested that the 1970s "may be remembered for giving new shape to the world economy." "What has evolved," the report goes on, "is a different pattern of economic power, with new centers of production, finance and trade, and new forms of interdependence" (p. 7). The many changes in the global political economy in the 1970s together signalled the end of the Bretton Woods international economic order fashioned by the Western nations after World War II. That economic order was characterized by U.S. leadership, a system of increasingly liberal trade and financial flows, and an agreed regime for international payments. It operated with remarkable success through the 1950s and most of the 1960s. Five features of the postwar international system helped to sustain the Bretton Woods international economic order (see Bergsten, 1977, pp. 2–4). First, it existed within a broader international context of bipolarity and the Cold War. The common overriding objective of the Western nations to resist Soviet power served to mute economic conflicts and made international economic issues matters of low politics. Second, policy makers in the Western nations responsible for international economic questions were acutely aware of the economic disasters of the 1930s and were united in their determination to resist any move toward the beggar-thy-neighbour policies of that decade — stiff trade barriers, competitive currency depreciations, and narrow economic nationalism in general. Third, the first two decades after the war saw the United States move into a position of extraordinarily powerful leadership and influence. Washington allowed the dollar to play the role of the world's reserve despite the balance of payment deficits this policy created, and despite the fact that the dollar's role precluded the United States from devaluing its currency to achieve external balance. The United States also made numerous non-reciprocal trade concessions, in the 1950s especially, permitting Japan, Germany and other Western countries to have improved access to the huge U.S. market without demanding equal concessions in return. Indeed, until 1957–58 Washington allowed open discrimination against its goods in Western Europe; it also strongly supported the creation of the European Common Market despite its negative impact on U.S. exports (Bergsten, 1975; Krasner, 1979, pp. 493–98). A major reason why the United States could afford to pursue this course was that it did not have to contend with numerous effective competitors in industrial markets.

A fourth feature of the postwar order which helped to sustain the Bretton Woods economic arrangements was the existence of a consensus among the major nations regarding the goals of international economic policy. The priority was economic growth and full employment. Not until the late 1960s did a large number of countries — members of the Third World — start to press vigorously for a fundamentally different objective: global redistribution. And not until the 1970s did the Western nations begin to quarrel seriously over the priority to be given to growth and full employment on the one hand, and to achieving price stability in an inflationary world on the other. Finally, it must be stressed that throughout most of the 1950s and 1960s there was a tremendous increase in prosperity and economic growth in the Western world. Standards of living improved dramatically; Western Europe and Japan recovered remarkably from the ravages of the war; and all the major nations enjoyed significant economic growth.

Even the most casual observer of the world economy would recognize that the picture portrayed by the previous two paragraphs does not correspond to the world today. None of the five conditions that allowed the Bretton Woods international economic order to exist and to prosper obtains today (see Bergsten, 1977, pp. 4–9 for discussion of the changes). First, the primacy of international security concerns among the Western nations evident in the 1940s and 1950s did not persist as the Cold War gave way to détente in the early 1970s. This in turn led to more attention being paid to questions of economic policy within the Western bloc. Second, the generation of policy makers whose views were a product of the experiences of the 1930s was gradually replaced by other officials whose knowledge of that period came from textbooks. The fears that the events of the 1930s might be repeated on the international economic scene thus faded. Third, the ability and willingness of the United States to provide strong leadership in international economic policy and to underwrite some of the costs associated with the Bretton Woods order declined. Greater exposure to the international economy and increased competition made the United States more vulnerable to external economic forces. The policy constraints that arose because of the need to fix the value of the dollar were deemed unacceptable and were finally thrown off entirely by President Nixon in August 1971. U.S. trade negotiators also began to demand equivalent concessions from their trading partners in the 1970s. The economic clout of the United States naturally declined as other economies recovered from the war and built up their industries. In 1952, the United States possessed 68 percent of the world's international monetary reserves; by 1977 it had less than 6 percent. In 1950, it accounted for more than 30 percent of world exports; today it accounts for less than a third of that figure. In the early 1950s America produced fully 45 percent of the world's steel; now it provides only 10 percent, and some question exists as to whether its non-specialty steel industry will survive into the 1990s (Krasner, 1979, pp. 497–500). At the same time as U.S. economic power was declining in relative terms, other Western countries, especially in Europe, were becoming less willing to accept U.S. leadership on questions of international economic policy.

The consensus on the goals of international economic policy was also undermined in the 1970s. Some Western countries, including Japan and

West Germany, chose to pursue vigorous anti-inflationary policies; others, such as the United States in the 1970s and France in 1981–82, were inclined to place a higher priority on growth and employment. The postwar Keynesian consensus within the economics profession and among policy makers fell victim to the escalating inflation rates of the 1970s. In addition, the rapidly growing bloc of countries in the Third World could be heard throughout the 1970s loudly articulating their own economic objectives — global redistribution and the creation of an international version of the domestic welfare state (Ruggie, 1983b). Finally, the years since the early 1970s have revealed starkly that prosperity is not a linear phenomenon that allows for ever-improving economic welfare. Average annual real economic growth rates for the seven leading industrial countries were more than halved in some cases in the 1970s. During the period 1966–73, for example, annual real growth rates were as follows: Canada, 5.5 percent; the United States, 3.9 percent; the United Kingdom, 2.9 percent; Germany, 4.3 percent; France, 5.4 percent; Italy, 5.4 percent; and Japan, 10.7 percent. Corresponding figures for the years 1973–78 were Canada, 3.2 percent; the United States, 2.8 percent; the United Kingdom, 1.4 percent; Germany, 2.0 percent; France, 3.1 percent; Italy, 2.1 percent; and Japan, 3.7 percent. The early 1980s have seen a further deterioration in these figures. From the point of view of political analysis, reduced economic growth rates are important because they indicate that it has become more difficult to lubricate the process of industrial adjustment that is attendant upon increased global economic interdependence through general improvements in national economic welfare and prosperity.

The disorder in the world economy is evident in any number of international economic policy areas and these cannot be reviewed here. However, an overview of the state of affairs prevailing in the sphere of international trade is provided, since trade is the most important manifestation of economic interdependence.

Most analysts agree that the international trade system has been experiencing considerable strain since at least the mid-1970s. However, the overall picture is complex. Trade liberalization has continued to move forward in some sectors, but strong protectionist pressures in other sectors have led to the erection of higher trade barriers. Moreover, the forms of protectionism have changed. The high tariffs that were once the hallmark of protectionism have been replaced by an array of non-tariff measures. Many developed industrial countries have negotiated so-called voluntary export restraint agreements (VERs) with exporting countries which are designed to reduce and control the flow of imports and thus to protect their domestic import-competing industries. In addition, a large number of orderly marketing agreements (OMAs) have been negotiated between importing and exporting countries in order to achieve the same objective. These kinds of import restraints have become quite common in the past decade or so, and are the most important evidence of what has been termed the "new protectionism" now evident in the industrialized world (Balassa, 1978). Many contemporary protectionist measures are taken largely outside of the GATT context and in fact represent substantial departures from GATT rules and principles. The fact that developed industrial countries have resorted to VERs and similar kinds of illegal safeguard actions in the face of intensifying import competition for their domestic industries reflects a serious weakness in the GATT system (Stone, 1984, Chapter 16; Finlayson and Zacher, 1981a, pp. 571–72; Jackson, 1978). During the Tokyo Round of GATT trade negotiations in the 1970s, an effort was made to bring VERs and other safeguards within the ambit of GATT surveillance, but the developed countries could not reach agreement on how this should be done. They want to be free to take protectionist actions selectively against particular exporters, in violation of GATT principles.

The protectionist pressures being experienced in the industrialized countries are particularly acute in some of the older capital-intensive industries such as steel and shipbuilding, in which significant global surplus capacity has developed. The pressures are also extensive in industries in which the newly industrializing countries (NICs) of the Third World have developed a comparative advantage, such as textiles, clothing, consumer electronics products and toys (Strange, 1979; Tsoukalis and da Siva Ferreria, 1980). The problems caused for Canada, the United States and other industrial countries by the rapid industrialization and increasing export propensity of the NICs raise disturbing questions about the extent to which the Western economies will be able to adjust their industrial structures in the face of global industrial change. From 1963 to 1979, the share of imports of manufactures of the OECD countries accounted for by the NICs grew from 2.6 percent to almost 9 percent (OECD, 1981a, p. 7). A study published in 1979 predicted that a major transformation of the international industrial structure would occur if this trend continued, with the share of global "industrial value-added" held by the OECD countries falling from 68 percent in 1970 to 50 percent by the year 2000, and that of the Third World rising from 11 percent to more than 26 percent over the same period (OECD, 1979, p. 331). However, this projection was premised on the critical assumption that the developed industrial countries would undertake policies consistent with the increasing industrialization of the Third World, especially policies that facilitated adjustment.

What economists refer to as the issue of "structural adjustment" now lies at the heart of the major problems confronting the GATT and the international trade system more generally (Pearson and Salembier, 1983; Proulx, 1984). The expansion of trade and the increased economic integration promoted by the Bretton Woods trade and payments regimes have led to intensified import competition, especially from Japan and the NICs, and this has posed numerous difficulties for industrial countries such as Canada and the United States (Morici, 1984). The adjustment process associated with increased trade and economic interdependence has proved more costly and complex than predicted by the economics textbooks. As two economists recently wrote:

> As a practical matter . . . resource adjustment is not automatic and instantaneous. Workers released from declining industries are not immediately re-employed elsewhere in the economy. Plant, equipment and skills are not easily transferred to other types of production. Thus . . . the process of adjustment itself also involves real costs to workers, owners of capital, and to the economy as a whole. (Pearson and Salembier, 1983, p. 14)

The economic climate of the late 1970s and early 1980s has not made the challenge of adjustment in the industrial countries any easier. As Tsoukalis and da Siva Ferreria comment, "in a period of prolonged recession and high unemployment and in a welfare system where labour mobility is low and the social cost of massive layoffs of workers politically prohibitive . . . adjustment may be very difficult to bring about" (pp. 335–36). Western governments have put in place a host of policies intended to facilitate adjustment and to ease the costs, imposed on workers in particular, by increased imports in declining industries (Pearson and Salembier, 1983, pp. 56–62). The overall record, however, is not impressive. Most Western countries have in fact instituted near-permanent protective trade barriers in such sectors as textiles, clothing and footwear — all industries in which comparative advantage is shifting to the developing world. Many of the industrial policies pursued by the developed market economy countries seem designed more to resist change than to facilitate and adapt to it (Diebold, 1980). Rather than adjust their industrial structures, countries have been tempted to respond sympathetically to the loud demands for trade protection that emanate from various groups and regions.

While protectionism has definitely grown among the developed countries in some industrial sectors, liberalization within the OECD bloc continues in others. The result, as Krasner has noted, is a "differentiated" trade regime. The industrial countries agreed to lower tariffs further on much of their mutual manufactures trade during the GATT Tokyo Round of the 1970s and also agreed to regulate more strictly the use of certain non-tariff barriers. Yet it is obvious that powerful protectionist impulses co-exist with continued liberalization. Protectionism is especially evident in EEC trade policy toward Japan and in the policies all the advanced countries have begun to follow vis-à-vis competition from the NICs. Krasner suggests that four distinct patterns characterize the trade relationships of countries to each other in the modern global political economy (Krasner, 1979, pp. 506–508):

- No protectionist pressures exist because import-competing sectors are absent.
- Cross-cutting pressures mute the inclination to undertake strong protectionist actions; trade in manufactures between the United States and the EEC is a case in point.

- Countervailing pressures exist, in that both partners have export- and import-competing sectors; U.S.–Japan trade is an example.
- Only one partner has an import-competing sector affected by bilateral trade flows, and protectionist actions will be taken by it. EEC-Japan trade corresponds to this pattern.

These patterns suggest that, while protectionist trade policies will be pursued by the industrial countries, this will mainly be targetted at specific groups of exporting countries and sectors. Further liberalization of trade among the major industrialized countries is thus likely to take place.

The Domestic Context of Canadian International Economic Policy

Students of international relations and political economy exhibit a natural tendency to focus on the ways in which various aspects of the international system affect the policies and politics of the states it comprises. Recently, however, it has been recognized that a domestic perspective is also of fundamental importance to an understanding of a state's policies toward the international economy. Although the advanced industrial democracies display many of the broadly similar economic, political and social attributes associated with all modern societies, the fact remains that significant differences exist among them, differences which in turn may shape their economic policies toward international trade, investment, and monetary issues (Katzenstein, 1976). The domestic dimensions along which they differ include type of governmental system (e.g., parliamentary, republican); whether a state is unitary or federal in composition; the historical role of the state in economic policy and development; the character and influence of interest groups; and the traditional goals of leaders and policy makers vis-à-vis the international economy. Recent literature has suggested that a distinction can be drawn between "strong" and "weak" states insofar as foreign economic policy is concerned. In strong states the national government regularly is able to impose its policy preferences on society, even though elements of society may disagree with the policies and objectives being pursued. In weak states, by contrast, the state typically is forced to shape its policies according to the private preferences of societal groups (Katzenstein, 1977a). An examination of Canadian foreign policies may provide a basis for placing Canada along this continuum, although the concept of a state's strength is both nebulous and inherently relative.

The literature on the domestic aspects of Canadian external economic policy is sparse. (Molot, 1976a, is perhaps the best comprehensive overview, though the paper was never published). The growing importance of the international economy, and thus of foreign economic policy, for Canada and other industrial countries suggests that an improved understanding of the domestic factors conditioning policy is essential. This part of the paper briefly discusses several domestic aspects of Canada's international economic policy and raises a number of questions and ideas for research that might usefully be undertaken in the future. The following dimensions of the domestic sources of external economic policy are addressed: the legacy and impact of the National Policy tariff structure; the impact of federalism on national foreign economic policy and policy making; the federal policy process and bureaucratic politics; the role of the state in international economic policy; and the role of interest groups.

The National Policy

The institution of the National Policy tariff structure in 1879 was an enormously significant development in Canada's economic history, one that has been examined endlessly by generations of historians, economists and political scientists. For present purposes, the most important fact about the National Policy is that it represented a coherent and explicit trade policy for the young dominion. The ending of Britain's imperial trade system and its adoption of free trade in the 1840s had shattered the prospect that Canada's commercial policy might be integrated into that of the mother country. At the time there were only two other options: free trade with the United States, or the adoption of an inward-looking policy that later came to be known in the economics literature as "import substitution industrialization," or ISI (Williams, 1983, Chapter 2). High tariffs on industrial goods thus became a central element of the country's first — and some might suggest only — coherent national development strategy.

The system was highly protectionist. Protection of infant industries was to be the device by which the nation would be developed and resist the pull from an expansionist-minded United States to the south (Phillips, 1979, p. 6). The tariffs "were essential to the national policy — essential to the building of the railroad which, in turn, was essential to the creation of a western settlement and investment frontier, a hinterland for the commercial and industrial empires of the St. Lawrence" (p. 6; see also Fowke, 1957). This high tariff policy had several consequences of interest here. First, it promoted the development of industries that were in most cases uncompetitive internationally because they were insulated from external competition and of insufficient scale to achieve economies. One result of this was that Canadians had to pay more for their industrial goods. Economists have long attempted to assess the costs of this policy, and the general view that has emerged is that the tariffs reduced Canada's national income and helped to saddle the country with too many inefficient manufacturing industries (Dales, 1966, especially 122–25; Economic Council of Canada, 1975).

A second consequence of the National Policy in the view of most economists is that it encouraged the penetration of Canadian industry by foreign companies forced to surmount the tariff wall in order to gain access to the Canadian market. "As economists have long recognized and historians long ignored, the roots of the branch-plant economic structure in North America must clearly be traced to the operations of the National Policy of tariff protection" (Bliss, 1970, p. 32; see also Hunter, 1979, p. 112). Another legacy of the National Policy highlighted in Glen Williams' recent appraisal is that it fostered a highly inward-looking group of industries in Canada, industries determined to serve the home market and unconcerned about exporting abroad (Williams, 1983, pp. 16–22). According to Williams and other economic nationalists, this problem was compounded by the rapid growth of largely U.S.-owned branch plants after World War II, many of which were prohibited from assuming the role of exporters to the world market.

The existence of a large number of relatively inefficient branch-plant manufacturing industries helps to explain Canada's poor performance as an exporter of finished goods. In 1980, for example, only 32 percent of Canadian exports consisted of finished manufactures, while for the other six leading industrial nations as well as for Sweden, manufactures accounted for at least half of exports (p. 8). Furthermore, more than one-third of the value of Canada's manufactured exports is accounted for by automobile exports to the United States under the Auto Pact. Some economists have disputed the contention that the presence of foreign-owned firms in Canada has had a major influence in determining the structure of Canadian exports and that Canada's relatively weak manufacturing export performance is significantly attributable to the high degree of foreign ownership in this sector (Safarian, 1969 and 1979; Globerman, 1979; Palda, 1979). Nonetheless, the view that foreign ownership has eroded Canada's prospects as an exporter of manufactured and high value-added goods remains an article of faith among economic nationalists in this country.

The weakness of Canada's export performance in finished goods is related to its persistent current account deficits (Williams, 1983, p. 10; Robinson, 1980; Science Council, 1978, pp. 25–29). The large volume of foreign investment — another legacy, at least in part, of the National Policy tariffs — also puts pressure on the country's balance of payments since significant outflows of dividends, interest and profits regularly occur (Robinson, 1980, Chapter 5). In addition, the approach taken by the Canadian government toward international trade policy has also been affected by the perceived need to continue rendering tariff protection to many Canadian manufacturing industries. However, in the years since World War II, a degree of rationalization has taken place, and some industries once targetted for protection — e.g., steel — have become much more efficient. Others continue to receive protection in the form of tariffs and quotas. The gradual lowering of Canadian industrial tariffs since 1947 through the process of the multilateral GATT negotiations has greatly reduced the role of the tariff in Canadian commercial policy, but some industries are still heavily protected by tariffs and a range of non-tariff devices (Protheroe, 1980).

Federalism

As it seemingly does in so many areas of Canadian life, the issue of federalism insinuates itself into the discussion of Canadian international economic policy and strategy. "In the most general sense, the imperatives of economic nationhood require that one set of governmental authorities have the capacity to speak for and to commit the nation in international affairs" (Smiley, 1980, p. 202). The federal government would appear to enjoy firm constitutional control over international trade and monetary policy, but this has not prevented the provincial governments from increasing their involvement and interest in international economic questions. Provincial governments have moved to deal directly and independently with foreign public agencies, governments and business; most of this activity has been focussed on the United States, and indeed the states contiguous to Canada have received most of the attention. Political scientists refer to the interaction between a sub-national governmental unit in one country and any type of governmental agency in a second country as trans-governmental relations. Several efforts have been made to measure the extent and focus of the provinces' international interactions, particularly vis-à-vis the national and state governments in the United States (Holsti and Levy, 1974; Johannson, 1978; and Molot, 1976b).

An institutional reflection of the provinces' growing interest in international economic affairs has been the establishment of provincial departments of intergovernmental affairs in which some officials are involved in monitoring external developments and others in promoting provincial interests in foreign countries, again mainly in the United States. Quebec, Ontario and Alberta are the provinces which have made the greatest effort to represent directly their economic interests in the United States, despite several attempts by Ottawa to thwart or retard this process (Clarkson, 1982, pp. 302–10 for a recent overview). Some provinces have complained that they do not receive enough high-quality information from Ottawa concerning developments which bear on their commercial interests in the United States. While this complaint is probably quite legitimate, the provinces may also have political and symbolic goals in mind when they move to represent directly their economic interests abroad.

The consequences of the sharp increase in provinces' official involvement in international economic policy have been debated in the literature. Broadly speaking, there are two basic positions on the matter. Some feel that provincial involvement in international economic affairs poses little risk to the integrity or coherence of federal policy. According to this view, the growth of trans-border links between provinces and various U.S. public authorities is a natural outgrowth of the increase in governmental activities generally, and much of the interaction is of a technical and thus politically innocuous character (Johannson, 1978; Molot, 1976b, p. 6; Leach, Walker and Levy, 1973). A less sanguine interpretation sees the growth of provincial involvement in external economic affairs as a part of a larger process whereby certain provinces have become integrated into the U.S. economy and have as a result come to view Ottawa's trade and investment policies as antithetical to their own interests (Stevenson, 1974). An interesting question to pose concerns the potential for province-state or province–U.S. government trans-governmental alliances against Ottawa on certain economic issues. This appears to have occurred with respect to the Foreign Investment Review Agency (FIRA) and the 1980 National Energy Program, both opposed by British Columbia and Alberta (and the latter by Saskatchewan as well). Another type of alliance suggested by some analysts is a province-state trans-governmental alliance arrayed against the two national governments. As the provinces become more active on international economic issues, these kinds of alliances may be formed more frequently.

Students of Canadian federalism have long stressed that Canada is an imperfect economic union. There are innumerable barriers to the free flow of goods, services, capital and labour within Canada; for the most part these direct and indirect barriers result from the policies of provincial governments. According to Flatters and Lipsey, Canada has fewer and weaker safeguards against the splintering of the nation's common market than any other democratic federation. Indeed, the Canadian common market is weaker than even such supranational arrangements as the European Economic Community (Flatters and Lipsey, 1983). Many economists worry that Canada's economic prospects in a more competitive world economy are harmed by the growth of regionally discriminatory policies and interprovincial barriers to trade and commerce (ibid., and Safarian, 1974). Although the provinces are constitutionally prohibited by section 121 of the Constitution Act of 1867 from levying tariffs on interprovincial trade in goods, they are free to impose non-tariff type barriers of various sorts and to restrict the movement of capital, labour and services through such policies as residence requirements, provincial certification of trades and professions, and many others. As noted below, provincial economic development policies, coupled with the provinces' use of policy instruments that affect Canada's trade with other countries, have complicated the development of a coherent national approach to international trade negotiations.

One international issue area in which provincial activity has clearly increased in recent years is trade. The GATT Tokyo Round of trade negotiations, which concluded in the spring of 1979, witnessed an unprecedented degree of provincial involvement in the preparation and monitoring of Canada's positions. Ottawa created a special committee of senior officials to work with domestic industry and provincial governments concerning the Tokyo Round, and it recognized "that the provincial governments were playing a larger role in Canadian public policy making and [that] it was reasonable to assume they would demand greater participation" in decision making during the Tokyo Round than had been the case in previous trade negotiations (Winham, 1978–79, p. 73). In addition, the fact that the Tokyo Round focussed largely on non-tariff measures rather than tariffs meant that the subjects which Canada's negotiators would be discussing were often within provincial jurisdictions. These included such items as government procurement policy, health subsidies and technical standards that can serve as trade barriers. All the provincial governments submitted briefs detailing what they wanted Ottawa to obtain from the trade negotiations, and "extensive and in-depth consultations took place between federal and provincial senior officials and ministers" (Protheroe, 1980, p. 46). Provinces also played an important role as conduits for the views of interest groups. The establishment of a special coordinating committee by the federal government to deal with interventions from provinces and industry during the Tokyo Round is reported to have increased provincial influence because it provided "a focal point for provincial bureaucrats to penetrate an otherwise decentralized federal bureaucratic structure" (Winham, 1978–79, p. 81). The provinces submitted exceptions lists to the committee of items they wanted excluded from Tokyo Round tariff reductions; these were considered seriously by federal officials charged with formulating Canada's position.

In short, recent experience indicates that the provinces have greatly expanded their involvement in Canadian trade policy making. To some extent, this increased involvement is a strictly bureaucratic phenomenon, as officials interested in trade issues at both levels of government communicate their concerns and priorities. Intergovernmental deliberations on trade have not been either high profile or particularly politicized. Improved federal responsiveness to provincial concerns in the 1970s "was more a matter of bureaucracy than a matter of politics" (p. 87). The positive views of both levels of government regarding this recent consultative process produced an agreement in 1980 that it would be regularized (Clarkson, 1982, pp. 301–302). Thus, despite the fact that provinces tend to differ quite strongly with one another and with Ottawa on several major trade issues, with some regions — e.g., the West — generally more supportive of freer trade than others, the intergovernmental discussions of trade questions that have occurred over the past several years appear to have been quite successful and free of the acrimony that prevails in other issue areas. (Protheroe, 1980, pp. 46–47, and Winham, 1978–79 are the only two published studies that comment on recent intergovernmental deliberations regarding trade policy questions.)

A final aspect of federalism and Canadian international economic policy that deserves mention is the impact of federalism on Canada's negotiating position within the General Agreement on Tariffs and Trade. Because many of the issues subject to regulation and negotiation within the GATT context fall partly or perhaps even largely within the jurisdictions of provinces or other sub-national units of government, national governments may face problems when they wish to make trade concessions. These typically involve a commitment to offer improved access to one's own market in exchange for improved access to that of one's trading partner. Article XXIV of the GATT requires that "each Contracting Party shall take such reasonable measures as may be available to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory." But in many cases, this "reasonable measures" test may be insufficient in the eyes of a trading partner concerned that a concession agreed to by Canadian negotiators will be undermined by provincial policies or actions (see Dam, 1970, pp. 128–29 on this general problem). The problem for federal states may become more acute as non-tariff measures become the major focus of discussions within the GATT. While Ottawa has unfettered jurisdiction over tariffs, the latter are no longer the most important barriers to trade. For example, three issues discussed during the Tokyo Round that affect provincial governments were government procurement, the use of subsidies by government, and the pricing policies of provincial liquor boards. Provinces are clearly involved in a wide range of behaviour that influences trade flows and may pursue policies inconsistent with obligations made by Ottawa either in the GATT or in other negotiating contexts. Given the growing salience of non-tariff barriers in trade policy, the role and impact of the provinces in respect of these barriers may pose serious difficulties.

Policy Making and Bureaucratic Politics

Since the early 1970s, students of international relations and foreign policy have been paying considerable attention to the "bureaucratic politics" sources of foreign policy (Allison, 1971, and Halperin, 1974, are two key studies in this vein). The traditional "rationalist" model of foreign policy analysis, which assumes that the state is a unitary actor that formulates policy objectives and then selects the most effective means to achieve them, has been popular with scholars because of its simplicity, parsimony and elegance. But it obviously fails to capture the internal dynamics and tensions of national policy making. Governments are not of course unitary actors, and the many officials and bureaus charged with fashioning policy may have diverse goals and perspectives. Recognition of this is an important element in any understanding of how the industrial democracies formulate their external economic policies (Katzenstein, 1977a, pp. 598–99).

Several excellent studies of executive branch foreign economic policy making in the United States have been published (e.g., Cohen, 1977, and

Destler, 1980). Comparable studies do not exist for the Canadian case. The best overview of the bureaucratic politics literature on Canadian foreign — not foreign economic — policy is probably Nossal (1979). As a generalization, it can be said that analysts of Canadian external policy tend to believe that the foreign policy-making process in this country is more coordinated, centralized and thus resistant to bureaucratic politics than it is in the United States. As Nossal comments, "there appears to be a consensus that the structure of the policy-making system of a parliamentary government such as Canada's vitiates the effects of bureaucratic politics on policy outcomes" (p. 613, and the sources cited therein). Denis Stairs, for example, suggests that the impact of bureaucratic politics is limited by the powerful role of cabinet in policy determination and as an arbiter; the small number of high officials charged with making Canadian foreign policy; and the frequency of casual intrabureaucratic consultation among officials with similar views and backgrounds (Stairs, 1976, pp. 185–86).

The lack of attention given to the nature and consequences of bureaucratic politics in the Canadian foreign policy literature contrasts with the considerable attention devoted to this subject in the Canadian public administration and policy literature (Nossal, 1979, pp. 616–67; Phidd and Doern, 1978 and 1983; and Campbell and Szablowski, 1979). As Phidd and Doern write, "Economic policy is developed in an executive-bureaucratic arena whose processes bear witness to the importance of legal mandates, organizational roles and obligations, the rationalities and pathologies of bureaucratic behavior, and the values, goals, and influence of individual personalities" (1978, p. 107). The impact of bureaucratic conflict and bargaining figures prominently in Phidd and Doern's analyses of various policy areas. Yet, like most analysts primarily interested in domestic issues, they pay virtually no attention to Canadian international economic policy. There is no reason to believe that bureaucratic conflict is either absent or unimportant to the outcomes of the Canadian foreign economic policy process. Indeed, as Nossal argues, several recent developments suggest that bureaucratic politics are probably more important to outcomes now than in previous periods: the growing importance of economic issues in foreign affairs, which means that decisions will tend to have more of a domestic impact (e.g., trade policy decisions versus those in the military area); the strengthening of the central agencies in the policy process, which has increased the chances of conflict with line departments; the use of the cabinet committee system, which involves more ministers in international economic policy decisions; and the internationalization of many domestic government departments resulting from the heightened salience of foreign economic policy, which has increased the number of departments with an interest in trade, monetary, investment and other international economic issues (Nossal, 1979, pp. 617–18). All this suggests that looking inside the "black box" of foreign economic policy making should yield a better understanding of the outcomes of that process.

Unfortunately, few attempts have been made to address Canadian foreign economic policy through the analytical lens of the bureaucratic politics model, and most of the efforts to employ this approach have not focussed on the major issues of trade, money and international financial policy (see p. 614 for citations). Two recent studies of trade policy making have helped to fill in some of the gaps: Protheroe (1980) and Winham (1978–79), both of which deal with the bureaucratic politics of Canadian trade decision making during the Tokyo Round in the late 1970s. As Protheroe observes, the fact that several government departments, as well as much of industry in the country, are interested in trade issues has meant that decision making is fragmented among several ministries. This in turn, he suggests, is a product of the "differential impact of trade decisions on socio-economic groups, regions of the country, macroeconomic conditions, and relations with other countries" (Protheroe, 1980, p. 67). Among the departments discussed by Protheroe in connection with trade policy making are Finance, Industry, Trade and Commerce (as it then was), External Affairs, Agriculture, and National Revenue. There are also a number of advisory boards and agencies involved in certain trade issues, such as the Anti-Dumping Tribunal, the Tariff Board, and the Textile & Clothing Board.

On the basis of his empirical findings, Protheroe argues that the Department of Finance is the most important single department in the trade policy-making process, not only in connection with those specific instruments for which it is responsible (e.g., tariff setting), but in an overall sense as well. He attributes this to the high quality of its personnel, the cohesiveness of the department, and the fact it is not encumbered by close ties to industry constituencies (pp. 73–78, 168–69). Industry, Trade and Commerce (ITC) — now broken up, with the trade division shifted to External Affairs and the industry division merged with the Department of Regional Economic Expansion — has also been a prominent player in the trade policy process, but suffered because of the "fairly clear clash of priorities" between the international trade relations branch and the industry development branch (p. 70). The latter has been much more concerned withprotecting its industrial constituents from the perceived adverse effects of reduced trade barriers. Nonetheless, ITC has played a key role in Canadian trade policy making. External Affairs traditionally has lacked the economic expertise and the control over policy instruments enjoyed by Finance and ITC, and this has weakened its influence over trade policy. As in other countries, Canada's foreign affairs department has been largely occupied with the task of smoothing relations with foreign countries and providing political and legal expertise relevant to external policy. However, the recent addition of much of ITC's trade policy machinery is certain to elevate External Affairs' role in trade policy, although it will also introduce new internal tensions to the department itself (pp. 78–81).

These three departments have exerted a dominant influence over Canadian trade policy. Protheroe argues that many of the difficult decisions that had to be taken by the government during the Tokyo Round were made through a process of "elite accommodation" and cooperative problem solving among officials from these and lesser departments. However, he also believes that on issues of unusual political and economic controversy, serious divisions among the departments (and in some cases within them) came to the fore, and Cabinet was forced to arbitrate by making rational-political decisions on these matters (p. 166). The decision to impose quantitative restrictions on low-cost textile imports in 1976 is a striking example of bureaucratic politics and conflict at work (Chapter 6).

Winham's treatment of bureaucratic decision making during the Tokyo Round emphasizes the importance of interdepartmental coordination and the management of vast amounts of information. The government was forced to move in 1977 to appoint a Canadian Coordinator for Trade Negotiations in order to introduce more order and control into the process. The office of the coordinator was charged with liaising with federal departments, the provinces and industry, and became heavily involved with the interdepartmental committee established earlier. The enormous complexity of the trade issue area and its importance both for external and for domestic economic management led to the adoption of a variety of ad hoc bureaucratic devices during the Tokyo Round. These devices were designed to manage change, digest and coordinate the flow of information, and coordinate the consultation process both within the government and between the latter and other actors. Winham suggests that the trade policy process will become more complicated and will require "bureaucratic entrepreneurship" to assure acceptable outcomes (Winham, 1978–79).

These two studies have improved our understanding of how Canadian international economic policy is made, but knowledge in this area is still very incomplete. There is virtually no literature on the bureaucratic politics associated with Canadian policy making concerning international monetary and financial issues, although there are strong reasons to believe that the Department of Finance and the Bank of Canada are pre-eminent in these areas, which lack the kind of domestic salience characteristic of trade issues. On foreign investment, the establishment of FIRA under the auspices of the Department of Industry, Trade & Commerce gave that department and minister the lead role in formulating Canadian policy. However, the highly political and controversial nature of FIRA since its inception meant that Cabinet as a whole paid particular attention to the agency and to foreign investment policy for more than a decade. Ostensibly a regulatory body, in practice FIRA has functioned more as a negotiating body determined to extract benefits for Canada from potential foreign investors (Phidd and Doern, 1978, pp. 303–304).

A key problem for those anxious to develop a better understanding of Canadian foreign economic policy making stems from the difficulties inherent in trying to identify explicitly distinct issue areas for examination. This is especially true in the cases of trade and foreign investment which directly impinge on the much broader field of industrial policy in Canada. It is obvious that the role of foreign investment, the structure of Canadian import protection, and the access Canada enjoys to external markets are key industrial policy questions. Indeed, for those determined to provide Canada with a comprehensive industrial strategy in the 1970s, trade and foreign investment were not distinct policy areas at all, but instead were part of a broader package of concerns (French, 1980; Phidd and Doern, 1983, Chapter 15). The analyst of Canada's international economic policy cannot neatly carve out an area of interest and ignore developments and trends in domestic areas. This complicates further the effort to understand how foreign economic policy is made.

The Canadian State and International Economic Policy

The Canadian state has been involved heavily in the country's economic development since its inception, and its activities have increased greatly in number and significance since the 1930s. In addition to regulating the economy and providing for income redistribution between individuals and regions, the Canadian state has become more active in the commercial sphere as a producer and marketer of goods and services (Gordon, 1981; Laux, 1978; Doern and Tupper, 1981). Governments in Canada are also major purchasers of goods and services, and their procurement policies are becoming an important international trade issue. Much of the impetus for the expansion of the role of the Canadian state in the economy has come from indigenous economic and political traditions. However, according to some scholars, the growth of state interventionism in recent decades is also a result of the tensions generated for Canada by increasing global economic interdependence, which has weakened the country's autonomy.

There is little doubt that a good number of the more than 400 federal Crown corporations are producing and selling goods and services to international as well as domestic markets. This practice is also becoming more common for provincial public corporations. Some public corporations, such as Petro-Canada, have actually invested in foreign countries. Laux (1978) describes how the Canadian state has become more active as an entrepreneur, merchant banker and trader in the global economy, for both defensive and offensive reasons. This increased involvement has been implemented through public corporations, including Telesat, the Canada Development Corporation (EDC), Ottawa's two aircraft companies now grouped under the Canada Development Investment Corporation (CDIC), and Eldorado Nuclear. It has also been carried out through such bodies as the Export Development Corporation (EDC) and the Canadian International Development Agency (CIDA), which promote the exports of private Canadian companies. The EDC has expanded the scope of its operations and the resources devoted to subsidize and encourage exports over the past decade. Growing competition in markets for capital goods, high-technology products and other manufactures has led all the developed capitalist nations to use subsidized financing as a tool to win foreign contracts. Canada cannot compete with the export financing offered by larger powers determined to win new markets, but the state has endeavoured to assist domestic capital goods industries in particular. There is every reason to believe that Western governments will continue to increase their involvement in export financing and subsidization, despite recent attempts to regulate this activity more closely in the OECD and the GATT (Paterson and Hicks, 1983).

The phenomenon of state trading has begun to receive considerable attention from scholars concerned about its impact on the international trade regime. Kostecki has suggested that the increasing importance of state trading will make future trade negotiations more complicated because many state entities do not operate according to the same imperatives as private profit-making firms. The employment of various kinds of subsidies by state corporations engaged in foreign commerce also raises issues for the GATT's subsidies rules. He also fears that state trading will further politicize international trade relations (Kostecki, 1979). The GATT's rules in the whole area of state trading are not well developed (Bernier, 1979). Most East European governments and some in the Third World prefer to deal directly with foreign governments' state enterprises rather than private firms, and this may lead Western governments to expand their role in foreign trade through public corporations (Laux, 1978, pp. 127–29). It is worth noting in this connection that both Mexico and Venezuela have expressed a preference to deal on a state-to-state basis in their sales of petroleum to Canada. The simple and undeniable fact that state trading is growing in most countries suggests that the Canadian state may also become more directly involved in producing and marketing goods and services. The Canadian Wheat Board has long been responsible for selling the country's wheat, barley and oats abroad, and in the future, the state may assume this function for other products as well.

Interest Groups and Foreign Economic Policy

Interest groups are fundamental to the policy process in pluralist democracies, but the literature dealing with their role in Canada is not extensive (Phidd and Doern, 1983, p. 78). This is particularly true in the case of Canadian foreign policy. In one widely used text, for example, a chapter on the domestic sources of Canada's foreign policy contains virtually no mention of interest groups, although it does discuss the significance of public opinion (Tucker, 1980, Chapter 1). Interest groups generally may be said to influence policy development by mobilizing political action to support or oppose particular proposals, by offering government useful information, and by seeking to affect the broad climate of public opinion on various issues. They can be divided into two major categories: "producer interest groups," and "broader collective rights associations" (Phidd and Doern, 1983, p. 77). Both are actively involved in trying to shape Canada's foreign policies. For example, church, human rights and academic organizations have made many public and private representations on a wide variety of foreign policy matters, including those involving Canada's international economic policies. However, these groups are less important to foreign economic policy than the various business associations interested in trade, investment and other major economic issues.

In a recent article, Coleman and Jacek estimate that there are no less than 482 "business interest associations" in existence in Canada (1983, p. 257). (This total excludes those in the agricultural sector.) There is ample evidence that such groups have increased in number and become more active in the past two decades as government's roles and responsibilities in relation to the economy have expanded (Thompson and Stanbury, 1979, pp. 226–28). However, some Canadian political scientists have questioned just how effective and influential these and other interest groups really are in our political system given the highly centralized character of decision making in Ottawa (pp. 230–32 and sources cited therein). A problem that arises for the researcher is that this centralized system, in which power is concentrated and the lobbying process typically occurs in private, makes it difficult to determine which groups exercised how much influence over particular outcomes. This is no less true of foreign economic policy than of other areas.

On certain key foreign economic issues, such as those dealing with international monetary and financial policy, there is little evidence to suggest that interest groups are very active. Canada's policy toward the International Monetary Fund and the various complex monetary and financial issues addressed by the Fund appears to be made within the federal bureaucracy by a small handful of officials quite insulated from interest group pressure or representations. With respect to foreign investment, key business associations have long argued against the way in which the Foreign Investment Review Agency has functioned, although few have actually questioned the principle of reviewing foreign investment proposals. Canada's foreign aid and other economic policies toward the Third World have been subject to vigorous interventions by groups anxious to assist Third World development, but the major business associations have not been very active on this subject. However, the government's recent decision to establish a new Aid-Trade Fund stemmed at least in part from lobbying by the Canadian export community, and the existence of this scheme is likely to increase the attention paid by the business community to foreign aid issues.

Of the main international economic issue areas, international trade policy has witnessed the most activity and interventions from Canadian interest groups. More than 40 years ago, in his masterful study of the Canadian Manufacturers' Association (CMA), Professor S.D. Clark argued that the government's decision to proceed with the National Policy tariffs was largely a product of the lobbying of the CMA (Clark, 1939). If so, then this was certainly illustrative of the importance of interest groups to the foreign economic policy process. Today, a large number of business and industry groups are vitally concerned with Canada's trade policy; organized labour and consumer groups have also taken an active interest in this area. Again it is necessary to emphasize the paucity of literature which describes and analyzes interest groups and Canada's trade policy. The only contemporary study is Protheroe's 1980 monograph, in which he discusses the general trade policy orientations of agriculture, the primary resource industries, and manufacturing, as well as the attitudes of organized labour and consumer groups.

Manufacturers have traditionally been wary of freer trade, and the CMA has often cautioned the government against further moves toward liberalization in the manufacturing sector. More recently the views of many Canadian manufacturing industries have been changing in the direction of support for freer trade between Canada and the United States. The Canadian Manufacturers' Association surveyed its members in the late 1970s and discovered that approximately one-third of the respondents believed they would expand under bilateral free trade, another third said there would be no net change in their position, and the final third feared they would be harmed by tariff removal. Larger manufacturers tended to be more favourable toward bilateral free trade than smaller firms, and firms that already exported part of their production liked the idea better than those that served the Canadian market alone. Since the late 1970s, Canadian manufacturers have become more supportive of free (or at least freer) trade between Canada and the United States. In 1984 the CMA formally declared that Canada should consider entering into a free trade agreement with the United States. Thus the manufacturing sector no longer constitutes a bulwark against trade liberalization with the United States, even though important industries within the sector remain very protectionist with respect to competition from outside North America (Senate of Canada, 1982, pp. 52–53; CMA, 1984).

Primary resource industries in Canada do not have a national umbrella association like the CMA, but instead are grouped into specific industry associations, including the Council of Forest Industries of British Columbia, the Canadian Pulp and Paper Association, and the Mining Association of Canada. These industries are heavily export-oriented and have long been proponents of freer trade. Their priority has been to obtain better access to foreign markets for their own products by having Canada offer other countries improved access for manufactures and other traded goods. Some sectors of agriculture, including the feed grains industry, also support freer trade; others such as the dairy, fruit and vegetable industries, have sought, and usually received, protection from foreign competition. Many firms involved in exporting are members of the Canadian Export Association, and retailers who sell imported goods may join the Canadian Importers Association; both are strong exponents of freer trade and the reduction of Canada's trade barriers, as is the Retail Council of Canada. The Consumers' Association of Canada has also made representations in favour of more liberal trade, but has not been very active or effective in respect of trade policy. Finally, the Canadian Labour Congress, while at times rhetorically supportive of freer trade, has kept a low profile in this issue area because of vocal protectionist sentiments among many of its affiliated unions in the manufacturing sector (Protheroe, 1980, pp. 34–42).

Protheroe's analysis led him to conclude that those industries or sectors seeking protection from imports have an advantage in the decision- making process (p. 45). Economists interested in international trade have analyzed why specific protectionist demands are so often acceded to in democratic countries. The argument is made that the political decision makers who respond to demands for protection from industry and labour typically have a very short-run political horizon. Although society as a whole will usually gain from lowering national trade barriers, specific groups may stand to lose a great deal if protection is withdrawn, and gain a great deal if it is instituted. Those who stand to benefit or suffer significantly are more apt to lobby vigorously to protect their interests than the much larger number of citizens and interest groups who stand to be affected only marginally by any single trade policy decision (see Corden, 1971; and, for a Canadian application, Caves, 1977). As one analyst recently put the matter:

> . . . The incentives for labour and capital in declining, import-competing industries to press for protection would be very large since the costs of import displacement would be direct, severe, and acutely felt by all concerned. However the incentives for other groups, such as consumers and exporters, to lobby against protection are likely to be much smaller. Their interests are unlikely to be as directly, immediately, or intensely affected and they therefore have less incentive either to join together on the basis of their common economic interests or to organize as forceful and influential a lobby.
>
> (Biggs, 1980, p. 118)

Protheroe argues that the most effective trade lobbying in Ottawa has been undertaken by industry associations in such specific areas as textiles or footwear, often assisted by unions also anxious to see higher trade barriers (Protheroe, 1980, pp. 42–43). Industry-specific groups are far less likely to suffer from the internal divisions characteristic of broader associations such as the CMA, the Canadian Chamber of Commerce, or the Business Council on National Issues (see Phidd and Doern, 1983, pp. 83–85 on these macrobusiness groups). They are also able to concentrate on specific policy decisions in a way that more amorphous groups rarely do. This helps to explain why the government, despite frequent protestations of fidelity to the goal of freer trade, has instituted highly protectionist policies in several manufacturing sectors that employ significant numbers of workers, including clothing, textiles, footwear, and automobiles. Much of this protection is now described as near-permanent by many analysts (Biggs, 1980, p. 78).

As the agenda of international economic policy expands because of economic interdependence and the internationalization of what traditionally have been domestic issues, it is probable that the activities of interest groups will likewise increase and become more important to the foreign economic policy process. More research is needed on the many interest groups in Canada active on trade issues.

Canada's International Economic Policies: Evolution, Constraints, Options

Canada has always been vulnerable to the external world. In recent decades the growth of international economic interdependence and of Canada's own involvement with the international economy have created a situation where national autonomy in economic policy making has declined (Laux, 1978, pp. 114–15). This is true for all the advanced industrial countries but, for Canada, external economic developments and trends are more critical than for other advanced countries. Canada is more export-dependent than most other major capitalist states, and also has been more reliant on foreign investment than any other major developed nation. In addition, because of the intimate economic linkages between this country and the United States, Canada's trade and monetary performance are very sensitive to U.S. policies, and this has often created dilemmas for the Canadian government. This marked dependence on, and involvement with, the external economic world means that national autonomy, especially in economic policy, is weakened. Laux suggests that recognition of this lies behind the attempts of Canadian policy makers in recent years to recapture a measure of autonomy through state intervention. Rosecrance also argues that at some point the consequences of interdependence in terms of lessened autonomy become too great, and states consciously attempt to reduce interdependence (Rosecrance, 1977). However, it is important to underline the costs that may be incurred by deliberate attempts to scale back a nation's involvement with the external economic world, including lower aggregate national income, a less efficient economy, and the rigidities known to be associated with greater state control (Cooper, 1968). These costs generally have been uppermost in the minds of Canadian economists interested in the country's approach to the global economy.

Canada's foreign economic policies have been shaped by several broad background conditions. First, Canada has been and remains primarily a *market economy*. Despite the undeniable growth of state involvement in economic affairs, the bulk of Canada's external transactions are undertaken by private sector actors interested in their own welfare, most of the country's industrial, finance and retail sectors are privately owned, and government restrictions in respect of currency movements, capital flows and other financial transactions have not been extensive. Second, Canada has been and remains a comparatively *small and open economy*, highly interdependent with the international economy. This simple fact imposes fundamental constraints on Canadian external relations, and also increasingly bears on what were once purely domestic issues. Third, since the end of World War II, Canada has developed *extensive economic relations with the world's greatest economic power*, the United States, and this too has exerted much influence on Canadian international economic policy. Canada's relationship with the United States has also provided the focus for many of the major domestic debates over economic questions that have occurred in Canada during the past quarter-century.

Prior to discussing Canada's international economic policies, a few comments on the country's foreign policy in general are required. Students of Canadian foreign policy have paid relatively little attention to its economic aspects, preferring to concentrate on diplomatic and security issues (see, for example, Tucker, 1980, Chapter 1, which surveys postwar Canadian foreign policy without so much as mentioning international economic issues). This gap is both curious and unfortunate, since the international economy is more critical to Canada's national welfare than it is to most other Western countries. Nonetheless, at least two themes that have received extensive treatment from students of Canadian foreign policy are helpful in understanding postwar policy toward the international economy.

The first theme is *multilateralism*, which relates to the fact that Canada has been a strong supporter of multilateral institutions and negotiations and generally has resisted the temptation to make bilateral deals or take bilateral initiatives. Fear of being dominated by larger powers, especially the United States but also Britain in the past, is usually said to lie behind Canada's adherence to the multilateralism principle.

A second and closely related theme is *internationalism*, which refers to Canada's abiding belief in the need for strong international rules, regulations and institutions in order to foster cooperation and to impose constraints on the actions of the major powers. Canada has been a strong supporter of international order across a wide spectrum of global issue areas, including those of an economic nature, and this helps to explain the strong backing given to the United Nations in the 1950s and 1960s by Canadian foreign policy makers (Lyon and Tomlin, 1979, Chapter 9; Stevenson, 1977). Both these broader themes bear on many specific international economic issues faced by Canada and go a long way toward accounting for Canada's general stance in external policy.

In what follows, the evolution of Canadian foreign economic policy is discussed with respect to four separate issue areas — trade, international monetary questions, foreign investment, and the recent North-South debate concerning reform of the global economy. Only the first two of these four issue areas are treated here at length. The discussion of foreign investment and Canada's role in North-South negotiations has been kept brief, since these subjects are better known among Canadian political scientists and students of international relations. The problems posed for Canada by the country's reliance on the United States are given considerable attention in the treatment of the first three of these four policy areas. A final section briefly assesses the constraints on Canada's international economic policy.

Trade Policy

A full treatment of the history of Canadian trade policy cannot be undertaken here. Instead, a selective recounting of key developments and trends, essentially since the 1940s, is provided, and a number of major contemporary issues are canvassed. (Fuller discussions of Canadian commercial policy are Young, 1957; Dales, 1966; Economic Council of Canada, 1975, especially Chapters 1 and 2; Wilgress, 1963; Stone, 1984; and Government of Canada, 1983. The following is based in large part on these sources.)

Before proceeding, the meaning of several terms used below should be clarified. Broadly speaking, a country's *trade policy* can be said to consist of all laws, regulations and other policy directives that directly or indirectly influence the flow and composition of imports and exports. This includes such obvious trade policy instruments as tariffs, quotas, anti-dumping and countervailing duty rules, and measures to promote or restrict exports. Other laws and policies that affect trade flows less directly are health and safety standards, environmental regulations, and policies undertaken in pursuit of domestic industrial and regional development objectives. The latter are assuming more importance in international trade negotiations, and are particularly important for Canada. In addition to these elements, a country's trade policy also relates to the nature of its participation in international institutions and agreements concerned with trade (Pastor, 1980, pp. 71–72).

A country's *trade relations policy* has to do with the way it manages relations with trading partners. In Canada's case, relations with the United States are the most critical issue in the country's trade relations policy.

It has been argued that "for a small country surrounded by larger countries and heavily dependent on trade with one of them, foreign policy should, in major part, be trade relations policy" (Grey, 1981, p. 3). That this has not been the case in Canada is somewhat curious. It is difficult to think of an industrial country more reliant on trade generally, and trade with a single partner specifically, than Canada; yet trade and trade relations policy appear until recently not to have been major preoccupations of the Canadian government.

The National Policy of 1878–79 saw the institution of high tariffs on industrial goods in order to spur indigenous manufacturing and industrial development. Preferential rates in favour of the United Kingdom were introduced shortly after the turn of the century, and imperial preferences reached a peak after the Ottawa Economic Conference in 1932. Overall, tariff protection remained extensive throughout the first half of the century. Support existed within Canada, especially in the West, for the notion of free trade with the United States, which was the central issue in the 1911 election. But the basic focus of Canadian commercial policy continued to be the stimulation of east-west trade within Canada and the improvement of trade prospects with Europe. The manufacturing sector remained resolutely opposed to free trade with the United States; tariffs on manufactures were increased with the Depression of the 1930s; and capital was drawn into Canada in the 1920s in particular because of the tariff wall (Stone, 1984, pp. 9–15).

In 1934, the United States passed the Reciprocal Trade Agreements Act in order to turn back the tide of protectionism visible everywhere in the early years of the Depression. Canada negotiated reduced tariffs on its mutual trade with the United States in 1935 and 1938, as did the United Kingdom in the latter year. These negotiations, coupled with the wartime economic experience, indicated that a shift in Canada's trade orientation toward the United States and away from Britain was occurring. The first few years following World War II saw the establishment of the General Agreement on Tariffs and Trade in 1947. The GATT was a major step forward for multilateral trade liberalization; it established both a set of rules designed to govern state behaviour in respect of trade barriers and a framework for frequent multilateral negotiations to further lower and control tariffs and other trade barriers. The multilateralism principle enshrined in the GATT was viewed favourably by Canada, anxious to avoid a bilateral commercial policy focus in the postwar period (Stone, 1984, pp. 22–23).

Three factors influenced the direction of Canada's trade policy in the early postwar years. First, the United States had become the world's dominant commercial power, and Canadian policy makers accepted the fact that economic and trade linkages with the United States would grow. Second, the terrible economic performance in the 1930s, with escalating tariffs, competitive currency devaluations, and other beggar-thy-neighbour policies, led to a shift in prevailing economic thinking in the direction of strong support for freer trade and an open, liberal world economy. Canadian policy makers were now more disposed to favour reduced trade barriers at home as well as abroad. However, this did not mean that domestic opposition to liberalization had disappeared or that Canada would unilaterally dismantle its tariffs. Rather, Canada was now prepared to negotiate reduced tariffs with major trading partners in the multilateral GATT context. A third conditioning factor was the belief of Canadian policy makers that strengthening the body of international commercial law as well as international institutions concerned with trade (especially the GATT) was in the interests of a medium-sized economic and political power such as Canada, since strong rules and institutions tend to impose constraints on larger powers that would otherwise be able to get their way because of superior leverage and resources. Canadian policy makers hoped that the GATT's rules would provide a measure of predictability, transparency and stability in world trade relations in addition to reducing trade barriers and discriminatory trade practices.

During World War II, Canada came to rely more heavily on the U.S. economy as a market for exports, a source of imports, and as a source of capital. This "wartime transformation" (Cuff and Granatstein, 1978, Chapter 1) carried over into the postwar period. Canada benefitted enormously from the U.S. Marshall Plan, launched in June 1947 to support the economic recovery of Western Europe, because the Plan was structured to allow the beneficiaries to purchase offshore — i.e., from countries other than the United States, the provider of the largesse (Plumptre, 1977, pp. 113–15). U.S. willingness to allow Canada to benefit from the infusion of Marshall Plan aid into Europe augured well for the bilateral trade relationship. In the 1950s, there were few serious disputes or problems in Canada–U.S. trade relations. Buoyant economic growth in the United States sucked in increasing volumes of Canadian goods and provided Canada with badly needed U.S. dollars. Because of the economic weakness of the war-ravaged nations of Western Europe and the closing of markets in Eastern Europe, Canadian trade with other industrial countries did not grow as quickly as with the United States. Equally important was the fact that most of Europe lacked the ability to pay for imports with hard currencies until the late 1950s.

Canada participated in the initial negotiations when the GATT was established in 1947 as well as in additional negotiating sessions in 1949, 1951 and 1956. These resulted in a significant lowering of Canada's tariffs: average tariffs on dutiable imports declined from some 22 percent over the 1936–41 period to approximately 16 percent for the years 1952–60, (Economic Council, 1975, p. 4). The United States and the Western European countries generally lowered their tariffs more than Canada, and this improved Canada's access to the markets of these countries for a wide range of goods. A major development in the late 1950s was the formation of the European Common Market, which was designed to stimulate trade among its members and to discriminate against exports from outside the Community. Shortly thereafter, those Western European states not part of the Community negotiated, in the form of the European Free Trade Association, free trade in industrial goods among themselves. However, unlike the EEC, the EFTA was not a common market; each member remained free to set its own tariffs vis-à-vis non-EFTA countries. Nonetheless, both the Community and the EFTA moved Western Europe in the direction of a huge regional free trade bloc. Britain's accession to the Community in 1973 foreshadowed the end of the looser EFTA and brought a traditionally important Canadian trading partner into the discriminatory EEC trade scheme; it also raised Britain's external tariffs against third countries, since Britain was compelled to adopt the Community's common external tariff and to abandon its historic preferential tariffs vis-à-vis former colonies, including Canada. (See Wonnacott, 1975, pp. 4–8 on EEC discrimination against external trade and the consequences for Canada; see also Stone, 1984, pp. 72–76).

Significant global trade liberalization occurred in the 1960s through the GATT Kennedy Round of negotiations, which lasted from 1963 to 1967. However, Canada did not join in the linear across-the-board tariff reductions negotiated by the United States, Western Europe and Japan, claiming, along with Australia and South Africa, that its special trade circumstances, resulting from a heavy concentration on raw material exports and a relatively weak manufacturing sector, precluded acceptance of large linear tariff reductions. As a result, Canadian tariff levels on dutiable imports declined only modestly between 1962 and 1973, whereas tariffs were reduced considerably by the United States, Western Europe and also Japan (see Preeg, 1970).

During the Kennedy Round, Canada put forward the idea of negotiating freer trade by sector; tariffs and non-tariff barriers would be negotiated downward by all the industrial countries in such sectors as pulp and paper, aluminum, iron and steel, and chemicals, all industries in which Canada was competitive because of its resource base, and in which Canadian policy makers hoped that better access to foreign markets might be obtained. Canada also hoped that negotiating by sector would provide a better means of dealing with the problem of foreign tariff escalation. A longstanding Canadian trade policy objective has been to secure the reduction of foreign tariffs on processed materials and finished goods, which typically are protected by higher tariffs than the raw materials that Canada exports in abundance. Reduced foreign tariffs in these sectors would increase opportunities for investment and production in Canada of higher value-added goods and the export of these abroad. The major trading powers, however, were not especially interested in negotiating by sector, preferring to work out a basic tariff reduction formula to be applied to all industrial trade. Because Canada did not join the linear tariff negotiations, substantial reductions in Canadian duties did not result from the Kennedy Round in the 1960s (Preeg, 1970; Finlayson and Zacher, 1981a, pp. 571–72).

In addition to liberalization of global trade through the GATT, the 1960s also witnessed important developments in Canada–U.S. trade relations. Canada's dependence on the United States as an export market and source of imports increased during the decade. The share of trade transacted with the United States rose from about 60 percent in 1961 to 70 percent in 1969. This was occurring at a time when Canada was becoming more exposed generally to the international economy. As Table 2-1 (above) makes clear, Canada grew more export-dependent in the 1960s. Exports of goods comprised 15.6 percent of domestic product in 1965, and almost 20 percent five years later. By 1980, the figure was 25.6 percent. The United States accounted for an increasing proportion of this growing trade. A major reason for this was the Auto Pact, negotiated with the United States in 1965. This agreement provided for something approximating free bilateral trade in automobiles and auto parts, and "Canada gained one-sided guarantees from both Washington and the companies; its share of the North American automobile market subsequently rose from 6.7 percent in 1964 to 13.2 percent in 1972" (Lyon and Tomlin, 1979, pp. 102, 127). As Table 2-3 indicates, the Auto Pact had a dramatic effect on Canada's exports, since it was a major factor in the increase of manufactured goods as a proportion of total exports from about 15 percent in 1965 to well over 30 percent by 1970. In addition, the Pact was the major reason why Canada's overall trade dependence on the United States rose in the 1960s. Canada unquestionably gained more from the agreement than did the United States during the first few years of its operation. In 1971, for example, Canada had a positive balance on trade in motor vehicles and parts of some C$219 million. However, this favourable performance was decisively reversed after 1972, and the Canadian automobile and parts industries were often portrayed as being in a state of irreversible decline by the end of the 1970s (Clarkson, 1982, pp. 127–30; Perry, 1982, pp. 15–16 and passim; and Keely, 1983).

Beginning in the mid-1960s, Canadian policy makers began to grow more concerned about both the country's trade dependence on the U.S. market and the fact that, despite the Auto Pact, Canada was still predominantly an exporter of raw and semi-processed rather than finished goods. This was in contrast to its developed-country allies, which rely on finished goods for at least 50 percent of exports. These problems were the focus of criticism from economic nationalists who complained about Canada's relationship with the United States at a time when the latter was becoming more involved in the unpleasant imbroglio in Southeast Asia. As if to justify these concerns, an extremely rude shock was delivered to Canada in 1971 when President Nixon imposed a series of punitive measures to correct the worsening U.S. balance of payments situation

TABLE 2-3 **Canadian Domestic Merchandise Exports: Percentage Distribution by Major Commodity Group, 1960–81**

	Food, Beverages & Tobacco[a]	Inedible Crude Materials	Inedible Fabricated Materials	Finished Manufactured Goods (Inedible End Products)	
				Total	Automotive
1960	18.8	21.2	51.9	7.8	1.3
1961	22.0	20.8	48.3	8.8	0.8
1962	20.1	22.0	47.1	10.6	0.9
1963	21.5	21.0	45.7	11.5	1.3
1964	22.7	20.0	43.3	13.7	2.2
1965	20.0	20.7	43.7	15.3	4.2
1966	19.5	19.3	39.8	21.0	9.9
1967	14.8	19.0	38.0	28.0	15.6
1968	12.1	18.5	36.4	32.7	20.6
1969	10.1	17.1	35.7	36.8	24.3
1970	11.4	18.8	35.8	33.8	21.3
1971	12.1	18.8	33.3	35.6	24.0
1972	12.0	18.1	33.4	36.3	24.0
1973	12.7	20.2	33.1	33.8	21.8
1974	12.2	24.6	33.8	29.2	18.0
1975	12.7	24.5	30.4	32.2	19.8
1976	11.4	22.0	32.5	33.8	21.8
1977	10.5	20.3	34.2	34.9	23.9
1978	10.1	16.9	36.7	36.1	24.0
1979	9.8	19.5	37.9	32.5	18.5
1980	11.1	19.8	39.4	29.4	14.7
1981	11.6	18.7	37.6	31.2	16.1

Source: Government of Canada, *A Review of Canadian Trade Policy*, (Ottawa: Minister of Supply and Services, 1983), p. 26.
Note: Shares will not sum to 100 percent because of the omission of special transactions which accounted for 0.2 to 0.4 percent of the total during the whole period.
a. Including live animals.

(discussed more fully below). Among the measures instituted was a 10 percent tariff surcharge on all dutiable imports. During the 1960s, Canada had been able to obtain exemptions from similar U.S. policies designed to deal with its balance of payments problems. This had led analysts and pundits to speak of the special relationship which Canada enjoyed in respect of U.S. international economic policy. Now, however, there was to be no exemption from the U.S. surcharge, for Canada was identified as one of the targets of U.S. actions, even though the country had long run an overall current account deficit with the United States (von Riekhoff, Sigler and Tomlin, 1979, p. 20; and Tucker, 1980, p. 81).

The Nixon surcharge of 1971, coupled with a number of other measures to restrict imports and to curtail the flow of U.S. dollars abroad, signalled the arrival of a more nationalist and protectionist style of U.S. foreign economic policy. As the competitive position of the American economy deteriorated and the United States became a more trade-dependent and open economy, American policy makers became less willing to trade off U.S. economic interests for the sake of broader foreign policy objectives. Trade and trade policy concerns would henceforth carry greater weight in the thinking of both the executive branch and, even more so, of Congress (Cooper, 1972–73).

These developments helped to create the environment in which the celebrated third option policy was enunciated by the Liberal government in 1972. The third option touched on matters other than international trade, but it is fair to say that Canada's trade dependence on the United States was its major concern. In a paper published by then secretary of state for external affairs Mitchell Sharp, the government explicitly rejected both a continuation of the status quo (option one) and further deliberate integration with the U.S. economy (option two). Instead, it favoured a policy designed to lessen Canada's vulnerability to and dependence on the U.S. economy, the "third option." Domestic policies in the areas of energy, industrial development and foreign investment were to be undertaken with a view to maximizing the economic benefits accruing to Canada and to reducing reliance on the United States. Most important, the government announced its intention to diversify markets for Canada's burgeoning exports (Sharp, 1972).

In pursuit of the goal of trade diversification, platoons of ministers and officials travelled around the globe selling Canada's wares, and diplomatic relations with a number of countries, including the Soviet Union, China, and various developing countries, were upgraded in importance within the Canadian external relations bureaucracy. However, the third option as publicly articulated by the government was rather short on specific policy suggestions to reduce Canada's dependence on the U.S. market. At best it was merely a framework to guide policy decisions (Sharp, 1972; Tucker, 1980, pp. 85–86). The absence of concrete policy initiatives was a harbinger of the ultimate fate of the third option, which completely failed to diversify Canada's economic ties away from the United States (von Riekhoff, 1978). Today, Canada still sends well over two-thirds of its exports to the United States and obtains about 70 percent of its imports from the same country.

Since the early 1970s, Canadian trade policy has been preoccupied with one major negotiating challenge and two underlying problems. The negotiating challenge was the GATT's seventh round of multilateral trade negotiations, the so-called Tokyo Round, which stretched from 1973 to the spring of 1979. The two underlying problems are heavy dependence on a single large market which has been moving in a protectionist direction, and the perceived need to alter the composition of Canadian exports by selling more finished and high value-added products abroad.

The GATT Tokyo Round marked the first time since the creation of the institution that negotiations were focussed largely on non-tariff barriers to trade (NTBs) rather than tariffs. Canada was an active participant in the protracted negotiations, and once again sought to introduce the sector idea. However, the major trading powers — the United States, Japan, and the European Community, which negotiates on behalf of its members — preferred to proceed with linear across-the-board tariff cuts, as they had done during the Kennedy Round. This time around Canada also took part in the linear negotiations. As a result, Canada agreed to substantial reductions in its tariffs: the average cut in Canada's tariffs on dutiable industrial products will be approximately 40 percent by 1987, when the tariff concessions made by Canada are fully phased in. The weighted average tariff rate, including both dutiable and non-dutiable industrial products, will fall from about 15 percent in 1979 to 9 percent by 1987. These tariff cuts will pose adjustment problems for many Canadian industries (Proulx, 1984). Canada's major trading partners made comparable tariff concessions, although most of their tariffs were lower than Canada's prior to the negotiations.

Perhaps more important was the progress made on the non-tariff barrier front. Canada became a party to six NTB codes which impose more stringent rules on signatories in respect of the use of such measures as subsidies and countervailing duties, technical barriers to trade, and licensing requirements. Canada also signed a new GATT agreement concerning customs valuation that, when implemented in 1985, will change the traditional way in which Canada has determined the value of imports for purposes of levying customs duties (Grey, 1981, pp. 38–48). In addition, the advanced industrial nations signed a Code on Government Procurement which goes a modest way toward opening up government procurement to greater foreign competition. The NTB codes were seen as the most significant achievement of the Tokyo Round (pp. 134–43; Finlayson and Zacher, 1981a, pp. 573–74; Krasner, 1979). Especially beneficial to Canada are a number of changes in U.S. NTBs made as a consequence of the Tokyo Round accords. The Code on Customs Valuation required the United States to eliminate a number of its valuation procedures which tended to have a protectionist impact, including the "American selling price" system adopted to protect the chemical and other industries in the 1960s. The Code on Government Procurement will improve Canada's access to the huge U.S. market for government procurement, although both the U.S. federal and state governments continue to give major preferences to domestic suppliers. Finally, as part of the Tokyo Round Code on Subsidies and Countervailing Duties, the United States agreed to accept an injury test, and this led to the removal of countervailing duties which U.S. authorities had imposed against a number of imports from Canada (Government of Canada, 1983, p. 205; Grey, 1981, Chapters 3, 5 and 7).

The Tokyo Round was an important exercise in multilateral trade liberalization. That a number of complex non-tariff issues were tackled seriously is particularly impressive, since NTBs are far more difficult to negotiate away than tariffs. However, despite the apparent commitment of the industrial countries to continued liberalization, strong undercurrents of protectionism were in evidence in Canada and in other developed countries during the period of the Tokyo Round, especially vis-à-vis manufactured products emanating from the newly industrializing countries of the Third World and from Japan (Stone, 1984, Chapter 16). Like its Western allies, Canada imposed a wide array of trade barriers on imports of such goods as textiles, footwear, all manner of clothing, leather goods, and automobiles originating outside North America; in practice almost all of these were targetted at a small number of East Asian developing countries and, in the case of automobiles, at Japan (Biggs, 1980). In this respect Canadian protectionism is aimed, like that of the United States and the EEC, at countries which have developed an international comparative advantage in traditional consumer product sectors, especially those that are relatively labour-intensive. Looking to the future, there is every reason to believe that Canada and other developed countries will continue to experience acute competitive pressures in these sectors and continue to target them for special import protection.

Canadian trade policy has also had to grapple with two underlying problems for the past fifteen years or so: the perceived need to diversify markets for Canada's growing exports, thus lessening reliance on the United States; and the widespread belief that the country should upgrade its exports to include more finished and more high-technology products. The impetus to diversify has come from unease, among policy makers and some intellectuals, about Canada's growing reliance on the U.S. economy. More trade crosses the 49th parallel than any other border in the world, yet there is a striking asymmetry in the relative importance of this trade for the two countries: in 1981, for example, the United States took 66 percent of Canada's exports and supplied 69 percent of our imports, while we purchased 17 percent of U.S. exports and supplied 18 percent of its imports. The fact that the United States dominates Canada's trade picture is even more significant because Canada is such a trade-dependent country in comparison with the United States. About 20 percent of everything produced in Canada is sold to the United States, while for the United States the comparable figure is perhaps 2 percent or slightly less. The United States accounts for an even larger share of Canada's exports of finished products, more than 80 percent in recent years, largely because of the Auto Pact (see Lyon and Tomlin, 1979, p. 100). The major initiative undertaken by Canada to lessen this marked dependence on a single trading partner was the third option, discussed above. However, the struggle to diversify markets has had little success. The government has recently admitted that Canada must continue to look to the United States as by far our most important trading partner for the foreseeable future, and has concluded that major bilateral initiatives are required to improve

Canada's trade prospects in the huge U.S. market (Government of Canada, 1983, pp. 203–13). Given that the United States will continue to loom so large in Canadian trade policy, the major issues in bilateral trade relations will demand considerable attention from both the government and the wider policy community. Several key issues are surveyed later in this section.

The second underlying problem that has shaped the debate over trade policy concerns the composition of the country's exports. Compared to other developed economies, Canada's merchandise exports contain such a small proportion of finished goods that some critics have begun to talk of the country's arrested industrialization (Williams, 1983). Moreover, a large share of Canada's exports of finished products is accounted for by a single sector, the automotive sector. This unimpressive manufactured-export performance has elicited much scholarly criticism and comment. Several arguments have been advanced to explain Canada's relatively weak record as an exporter of finished goods and high-technology products (Science Council, 1978, and Hay, 1982, p. 18). Some have suggested that Canadian managers and entrepreneurs have been ineffective in finding export markets and that excessive risk aversion and parochialism characterize Canadian business behaviour. Economic nationalists have long pointed to the restrictions imposed by some foreign-based multinational firms on the export activity of their subsidiaries in Canada; this is the major theme of Williams' recent study of Canada's manufactured export performance (1983). It has been argued that foreign-owned subsidiaries have a high propensity to import components from their affiliates, and some writers believe that this has contributed greatly to Canada's large deficit in manufactured goods. Another factor may be high entry costs in many manufacturing industries, including those of a high-technology character (McMillan, 1978, p. 46). More recently, it has been noted that many corporations involved in producing finished goods are shifting their operations directly to foreign markets rather than exporting from home markets, and that there is also a tendency for multinational firms to locate in developing countries with lower production costs. Neither trend is helpful to Canada's manufacturing prospects (ibid.; Hay, 1982, p. 18). A problem resulting from Canada's heavy concentration on exports of raw and semi-processed materials is that world trade in manufactured products has grown much faster than has trade in raw and semi-processed materials. This suggests that Canada is dependent on classes of exports for which growth prospects are poor in comparison with manufactures (Daly, 1982, pp. 11–12).

Concern over the future that awaits Canada's manufacturing industries has grown appreciably in the past several years, and some groups, such as the Science Council of Canada, the Canadian Labour Congress and the Canadian Institute for Economic Policy, have called for an inward-looking industrial strategy that focusses on the search for and development of indigenous technologies, the curtailment of foreign ownership of industry, and the use of stiff protective trade barriers to assist developing manufacturing industries, particularly in the high-technology sector. This strategy would involve at least a partial rejection of the generally liberal approach which Canada has taken with respect to trade policy within the GATT; it would also require an increase in state intervention into various industries as Ottawa endeavoured to pick winners and losers in a kind of industrial lottery. A further requirement would be a greater degree of cooperation between business and government, and between Ottawa and the provinces, in economic planning and development than has been the case to date (Wilkinson, 1982, pp. 437–38). Given Canada's record as an exporter of manufactures, and the fact that import penetration in manufacturing industries has increased in the past 20 years (see Table 2-4), it is clear that the country's manufacturing trade performance will continue to be a subject of intense debate in the years ahead.

The search for new markets, particularly for finished products, raises the broader strategic question of how to pursue Canada's trade interests in a world characterized by increasing if more subtle forms of protectionism and heightened competition across a wide range of product sectors. Two basic options are worth canvassing; in both cases, the essential underlying question concerns the future evolution of trade relations vis-à-vis the United States.

First, Canada could decide to stick to the policies of the past. Although the world has changed in many important respects, Canada has on the whole done very well through the multilateral GATT trade regime established in the late 1940s. Continued adherence to this framework would require that Canadian trade policy seek new and expanded markets outside North America, particularly in the newly industrializing nations of the Third World, and also that it remain anchored firmly in the multilateral GATT system. Canada has traditionally been strongly committed to a multilateral approach to trade policy:

> Canada has been a great believer in multilateralism, on the premise that greater gains can be made for a relatively small economic power in a multilateral forum, where the Canadian interest is likely to be consonant with one of the other major players on each issue, rather than on a bilateral basis where bargaining strengths are inherently unequal. (Hay, 1982, p. 18)

The multilateral approach has offered Canada many opportunities for commercial policy gains, but it has worked against the formulation of bilateral deals with the United States (the Auto Pact being a notable exception). Multilateralism suggests that, despite Canada's limited ability to obtain significant trade concessions from Japan and Western Europe in recent years, these markets must remain critical to Canadian policy. Although the record since the unveiling of the third option indicates that market diversification away from the United States is an extremely dif-

TABLE 2-4 **Import Penetration of Major Manufacturing Sectors in Canada, 1966–81**

Manufacturing Sector	**Percentage of Canadian Market Supplied by Imports**			
	1966–73	**1973–80**	**1980**	**1981**
Food and beverages	7.3	9.6	9.4	9.0
Tobacco products	1.1	1.5	1.7	1.7
Rubber and plastics	17.8	22.9	21.9	22.2
Leather industries	21.3	32.6	31.3	33.0
Textile industries	23.9	27.0	26.2	26.8
Knitting mills	21.8	30.5	28.0	30.1
Clothing industries	6.9	11.3	11.6	13.7
Wood industries	9.2	11.7	10.8	11.2
Furniture and fixtures	6.4	11.9	11.4	12.6
Paper and allied industries	6.2	9.6	9.7	11.4
Printing and publishing	13.5	14.3	14.7	14.4
Primary metal industries	23.9	30.0	42.2	40.0
Metal fabricating industries	13.2	15.1	14.5	15.1
Machinery industries	66.3	87.0	75.0	76.2
Transportation equipment industries	61.6	72.3	71.4	71.9
Electrical products industries	26.7	36.6	40.3	41.9
Non-metallic minerals	15.0	17.2	19.2	18.6
Petroleum and coal products	9.5	4.0	4.9	3.9
Chemical and chemical products	25.6	31.3	31.8	31.4
Miscellaneous manufacturing industries	50.1	54.4	55.4	57.5
Total manufacturing	25.5	30.6	31.5	31.6

Source: Government of Canada, *A Review of Canadian Trade Policy* (Ottawa: Minister of Supply and Services, 1983), p. 31.

Notes: All values are in current dollars. Trade data are on a customs value basis, Trade of Canada. The trade have been allocated to industrial sectors according to the 1970 Standard Industrial Classification. Shipment data for 1966–79 are Census of Manufacturers. In 1980 and 1981 shipments data are derived from Inventories, Shipments and Orders in Manufacturing, Statistics Canada. (Shipments are synonymous with "production.").

ficult task, it is one that cannot be forsaken. According to this view, Canadian policy should aim at all costs to prevent the country from becoming even more dependent on the U.S. market, both because it is relatively slow growing, and also because excessive reliance on the United States limits domestic economic policy autonomy (see Clarkson, 1982, and Lazar, 1981, for statements of this perspective).

Perhaps the chief problem with continued adherence to a purely multilateral trade strategy is that it simply may be outmoded in a world of escalating protectionism and strengthening regional trade blocs. Canadian policy makers appear to recognize this, at least implicitly, and nodded in the direction of bilateral trade initiatives in the 1983 trade policy review paper. Canada is one of very few countries in the developed world that lacks assured access to a market of at least 100 million people. U.S. industries can tap a huge domestic market of 230 million, while those in Western Europe have access to what amounts to a free trade bloc of 300 million people (at least for most manufactured goods). Canada lacks assured access to either of these large markets. The trend toward the establishment of regional free trade areas also threatens Canada and eventually may undermine the multilateral GATT regime, which has been based on the most favoured nation or non-discrimination principle (Finlayson and Zacher, 1981a, pp. 566–70). As one economist observes, "As other countries form free trade areas, Canada finds itself unable to compete across tariff barriers with the members of a free trade area who have duty-free access to the same market" (Hunter, 1979, p. 49).

Nonetheless, most economists believe that a world of freer multilateral trade would serve Canada's economic interests, and no Canadian government is likely to eschew this as an ideal. The Economic Council of Canada estimated in 1975 that the achievement of multilateral free trade would add 5 to 10 percent to Canada's GNP (Economic Council, 1975, p. 82). More recently, the Council has reiterated its belief in the benefits available to Canada through multilateral trade barrier reduction (Economic Council, 1983, pp. 131–33). A central theme of the Economic Council's analyses is that the Canadian economy would be more efficient, productive and competitive if Canada were to lower its own trade barriers more rapidly through multilateral negotiations (p. 133). Neoclassical international trade theory suggests that a country will benefit from unilateral barrier reductions even if its trading partners refuse to reciprocate, since consumers will be able to purchase imported goods more cheaply and the whole economy will gain as resources are re-allocated to sectors in which the country has a comparative advantage. However, in practice both Canada and most other industrial countries have approached multilateral trade negotiations with a view to trading better access to their own markets for improved access to the markets of their major trading partners. There is no reason to believe that this commitment to reciprocity will disappear in the future (Finlayson and Zacher, 1981a, pp. 574–78).

The second major trade option for Canada would be some kind of bilateral arrangement, or set of arrangements, with the United States to improve and secure Canada's access to this critical foreign market. The forces propelling Canada's commerce in a north-south direction are powerful, as recognized by the government in its 1983 trade policy review, and include the following:

- geographic proximity, which makes the United States an attractive market from the point of view of familiarity and transport costs;
- common language, culture, and consumer tastes and lifestyles; and

- the extensive linkages between the respective private sectors of the two countries.

How Canada might choose to pursue a bilateral trade relations policy in respect of the United States is an interesting question. Some observers and groups, including the Standing Senate Committee on Foreign Affairs, argue that Canada should immediately negotiate a comprehensive, bilateral free trade accord with the United States (Senate, 1982; P. and R.J. Wonnacott, 1982). Others, including the Economic Council, believe that bilateral free trade should be pursued only if the prospects for liberalized multilateral trade appear dim (Economic Council of Canada, 1975, pp. 82–84). Still another approach is advanced by the government in its 1983 trade policy review paper, where it is suggested that free trade deals be negotiated with the United States in certain sectors — including petrochemicals, textiles and clothing, and specialty steels — but that the notion of a comprehensive free trade area be rejected for the present (Government of Canada, 1983, pp. 212–13 especially).

Ironically, one of the strongest arguments in support of a bilateral initiative is U.S. protectionism. Protectionist forces have been steadily gaining influence in U.S. politics as increasing numbers of domestic industries suffer because of more competitive industrial imports (Ahearn, 1982). Organized labour, in the form of the AFL-CIO, has taken an explicitly protectionist stance since the early 1970s, and this has greatly weakened the commitment of the Democratic Party, the traditional party of freer trade, to further trade liberalization. The fact that the Democratic Party is strong in many states with declining industrial bases is not unrelated to this shift in its attitude toward trade policy issues. However, support for a more protectionist U.S. trade policy is by no means restricted to organized labour and the Democratic Party. Increasing foreign competition, coupled with the sharp rise in the value of the U.S. dollar, has unleashed a flood of protectionist pressures, which are particularly evident in the U.S. Congress. It is widely believed today in the United States that many other industrial countries are not fair traders. This concern over reciprocity is reflected in a spate of bills introduced into Congress since 1981 that aim to improve the access given by other countries to American exports by threatening to make it more difficult for these countries to export to the United States (Cline, 1982; Wonnacott, 1984). Although Canada is not a principal target in the eyes of U.S. legislators anxious to impose tougher restrictions on foreign countries, Canada would still be harmed by new laws designed to deal with what many in the United States perceive to be the unfair and non-reciprocal trade practices of U.S. trading partners.

Because of Canada's heavy reliance on the United States as an export market, the greatest international economic threat facing Canada is undoubtedly U.S. protectionism. A number of Canadian scholars have pointed to the growth of protectionist policies in the United States and the harm they could do to Canada (Clarkson, 1982, Chapter 5; Lazar, 1981, especially Chapter 3). Although the United States has reduced most of its tariffs substantially, there has been a tendency to use and to strengthen various contingency measures that also restrict imports, such as countervailing and anti-dumping duties, "trigger price" mechanisms, and escape clauses invoked when imports threaten to or actually do harm domestic import-competing industries. These now constitute the major threats to Canadian exports to the United States (Grey, 1981 and 1982). As more U.S. industries have been forced to do battle with increasingly competitive foreign suppliers in the domestic market, the political pressures to take protectionist actions have grown enormously. This trend is both reflected in and magnified by the growing role of Congress in U.S. trade policy making. Congress is granted control over commercial policy by the U.S. Constitution and, while much of this has been delegated to the Executive branch, Congress retains the power to make and change trade policy. It is the place where protectionist pressures are felt most acutely and acted upon most readily. In addition, the entire U.S. legislative and regulatory system for trade provides aggrieved domestic parties with many legal opportunities and a variety of means by which to seek protection against imports. This system is open and public, which only heightens the anxiety of foreign governments and exporters about the whole drift of U.S. trade policy.

The various U.S. non-tariff measures and their impact on Canada are well analyzed by Grey (1981 and 1982) and Lazar (1981). It may be useful here to indicate how protectionist pressures are gaining strength in the United States by summarizing some of the major trade legislation discussed in the 98th U.S. Congress:

- Several bills were introduced in the 98th Congress to ensure U.S. exporters of improved access to foreign markets by enforcing reciprocity on trading partners that deny the U.S. access to their markets substantially equivalent to that which the United States itself offers them. According to two trade experts, "the new reciprocity would be aggressive rather than passive as in the past; it would impose new trade barriers as a threat, rather than merely refraining from extending new liberalization to non-reciprocating countries. In past negotiations, the United States and other countries have sought a broadly reciprocal balance of concessions, but the new approach would make judgements of reciprocity not on the basis of changes in protection but on the current level of protection" (Bergsten and Cline, 1982, p. 22).
- Local-content legislation was introduced into both houses of Congress which would require that particular percentages of the total value of automobiles sold in the United States consist of domestically sourced labour and components. Although Japan is the target that U.S. legislators have in mind, local-content legislation could spell serious trouble

for the Auto Pact and thus for Canada's automobile exports to the United States. Fortunately, this legislation did not pass during the 98th Congress.

- Bills to strengthen the position of U.S. high-technology industries vis-à-vis foreign competition were considered in the Senate. One, S. 428, would have encouraged public/private sector research on products for export; another, S. 568, would have altered antitrust laws in respect of major ventures in high-technology industries.
- Bills specifically intended to reduce steel imports into the United States were introduced in the House. Steel exports from Canada to the United States are extensive, and Canadian firms could suffer if the industry — which already receives considerable protection but has nonetheless suffered greatly in recent years — is granted further import relief (pp. 42–43).
- A bill introduced in the Senate (S. 849), the Industrial Revitalization Act, would have lowered the injury threshhold in escape clause cases from "serious" to "material," thus increasing the possibility of using escape clauses to obtain relief from a wide range of imports. Fortunately, in the past few imports from Canada have been caught up in escape clause cases, but this may not hold in the future (Grey, 1982, p. 30 and Chapter 3 generally, on U.S. escape clause actions to restrict imports).
- Two bills were introduced in the Senate that would have toughened U.S. anti-dumping laws.
- Bills to strengthen the ability of the United States to offer subsidized export financing through its export credit body, Eximbank, were considered by both houses of Congress.

(This list is based on the sources cited; Ahearn and Reifman, 1983; and the *Wall Street Journal*.)

It is important not to exaggerate U.S. protectionism, because in many respects America remains an open market. Few of the protectionist bills introduced during the 98th Congress were actually passed. Congress is always the focal point of protectionist pressures in U.S. politics, but most of the initiative in trade policy has rested with the Executive branch since World War II. The introduction of a plethora of trade-restricting bills serves to remind the administration that important constituent groups have grievances about U.S. trade policy and performance, and allows U.S. legislators to claim that they are acting to address these problems. Often the administration responds to protectionist bills by devising alternative strategies to reduce or better manage the flow of imports into the United States, for example by negotiating voluntary export restraint agreements with other countries. In this case, the existence of potentially more restrictive legislation in Congress can assist the U.S. government to convince other countries to agree to such export restraint or managed trade arrangements (Pastor, 1983).

All the industrial countries have moved to strengthen the contingency protection afforded beleaguered domestic industries since the early 1970s (Bergsten and Cline, 1982, pp. 15–28). There is no reason to single out the United States, except that what counts most for Canada *is* U.S. trade policy. It is not possible to predict with assurance that protectionism will continue to strengthen in the United States, but it may well be prudent for Canadian policy makers to operate and plan on the basis of the assumption that the United States will continue to adopt a variety of new measures to protect ailing industries and make use of existing devices with increasing frequency (Ahearn, 1982).

Whether it will prove possible for the Canadian government to negotiate some kind of bilateral trade accord with the United States is unclear. Major obstacles would have to be overcome, both in Canada and in the United States. Although the Canadian business community is growing more sympathetic to the idea of bilateral free trade, significant business opposition to such a course continues to exist, especially in Ontario. Then too, there are many Canadians who fear that Canada–U.S. free trade would threaten Canada's political sovereignty and undermine further the ability of the Canadian government to pursue independent economic, industrial and cultural policies. Economic nationalists and democratic socialists argue that what the Canadian economy needs is not freer trade with the United States, but rather an inward-looking industrial policy that relies heavily on state intervention and economic planning (Rotstein, 1984). On the other hand, it is essential to recognize that the changing views of Canadian business, particularly in the manufacturing sector, have weakened greatly what historically has been the most potent source of opposition to freer Canada–U.S. trade.

Even if a consensus on the desirability of a trade agreement could be developed in Canada, it is far from certain that the United States would be interested enough to allow the idea to come to fruition. Canada has much more to gain, and potentially more to lose, from bilateral free trade than does the United States. Unless strong and committed executive branch support for Canada–U.S. free trade were forthcoming, it is probable that those particular groups and industries in the United States who fear that they might lose from bilateral free trade would succeed in mobilizing enough opposition in Congress to thwart the passage of a free trade pact, especially if this took the form of a treaty requiring the approval of two-thirds of the Senate.

Two specific issues in Canada–U.S. trade relations that deserve brief mention here are automobile trade and the effect of domestic industrial policy on trade relations. Following the negotiation of the Auto Pact in 1965, Canada for several years enjoyed a favourable balance of trade in motor vehicles and parts with the United States, but this began to change in the early 1970s. From 1971 to 1980, Canada registered a total accumulated deficit of some C$10 billion in bilateral trade in motor vehicles and parts (Clarkson, 1982, p. 129). Combined with evidence that the Big Three automobile producers in the United States were disinvesting from Canada and the pressure felt by domestic producers because of increased car imports from Japan, this performance convinced a number of influential groups (including the Ontario government) that the industry had entered a stage of decline and that drastic action was needed to support the domestic vehicle and parts industries (Perry, 1982, Chapters 2–4). In addition to calls for strengthened protection from Japanese imports and the imposition of domestic content requirements on Japanese car companies who wished to sell in the Canadian market, many critics have demanded that the Auto Pact be renegotiated so that Canada can obtain a greater share of the benefits flowing from the manufacture and assembly of motor vehicles and associated parts (Clarkson, 1982, p. 133). During the 1980 federal election, both the Liberals and the New Democrats promised that, if elected, they would obtain a better deal for Canada in the automobile sector.

The government has made no moves, however, to initiate serious talks with the Americans on this issue, perhaps because it realizes only too well that Congress would flatly refuse to accept a revised Auto Pact more favourable to Canadian interests (Keely, 1983). In the event, since 1982 the situation of the Canadian automobile industry has improved greatly; record profits have been made, and substantial investments in new plants and technologies have been undertaken or planned. The share of the Canadian market accounted for by offshore imports has fallen from its 1982 recession peak, and the demand that Japan be forced to adhere to the kind of domestic content rules enshrined in the Auto Pact is no longer being put forth with the intensity evident in 1981–82. Overall, it seems that those prognosticators who predicted the early demise of the Canadian auto industry may be required to reconsider their assessment.

A second trade issue worth noting is the impact of Canadian industrial policy initiatives on trade relations with the United States. Subsidization of industrial development in furtherance of various economic, regional development and social objectives has been on the rise in Canada since the 1960s. Governments at both the federal and provincial levels have become more involved in this type of activity. It is widely recognized that "Canadian industrial policy has been willing to intervene to alter market forces, and the Canadian public generally has supported these initiatives" (Beckman, 1983, p. 15). Many specific industrial policy measures, including subsidized research and development, regional development subsidies, and domestic procurement preferences, can run counter to Canada's GATT obligations. However, as Lazar notes (1981, p. 76 and 1982), the GATT's enforcement mechanisms are weak, and many GATT members have undertaken interventionist industrial policies with minimal international consequences.

The basic problem for Canada in the area of industrial policy is not so much its GATT obligations as it is the probable reaction of the United States to Canadian industrial policy initiatives. The United States does not look kindly on most types of government subsidization of commercial activity, and the Trade Act of 1974 allows U.S. companies and unions to lodge formal complaints that imported goods have received a regional development or other type of subsidy (p. 77). In addition, section 303 of the Tariff Act allows the president to levy countervailing duties on any imported product that has received any type of foreign government subsidy. This section was used to impose countervailing duties on imports of tires produced by a Michelin plant located in Nova Scotia in the early 1970s, since Michelin had received a Department of Regional and Economic Expansion grant package to entice it to establish its factory in the province. This set a precedent for later cases of foreign regional development subsidies in U.S. trade law (p. 28; and Clarkson, 1982, pp. 119–20). R&D and advanced technology subsidies granted by governments in Canada can also run afoul of U.S. trade law (Lazar, 1981, p. 28). Finally, if Canada were to implement an industrial strategy that resulted in the supplanting of imports from U.S. companies with domestic industrial production, the measures incorporated in the strategy could precipitate complaints by U.S. companies under section 301 of the 1974 Trade Act, and this in turn could result in the imposition of tariffs, quotas or bilaterally negotiated orderly marketing agreements in respect of U.S. imports from Canada (p. 77).

International Monetary and Financial Policy

As an open economy highly reliant on trade with the external world, Canada must pay close attention to its balance of payments situation and to the value of its currency relative to those of its trading partners. A country's international transactions can be analyzed by grouping them into two broad categories, the current account and the capital account. The former measures the flow of payments and receipts for goods and services that are exported and imported; the capital account measures short- and long-term flows of capital. Traditionally, Canada has run a current account deficit which has been offset by a surplus on capital account, thanks mainly to substantial inflows of foreign investment. Like other countries, Canada also possesses official international reserves, maintained by the central bank, which may be used to balance our overall payments in the event that there is a deficit on the current and capital accounts combined. Conversely, a surplus on the current and capital accounts combined will lead to an increase in official reserves (which consist of foreign currencies, mostly the U.S. dollar, plus gold and International Monetary Fund Special Drawing Rights). (See Robinson, 1980, Chapter 2.)

The current account generally receives the most attention when the balance of payments is under discussion. It is divided into two broad categories: merchandise trade, which refers to the export and import of goods; and services, which refers to services rendered to or by foreigners, such as travel, insurance and freight, as well as interest and dividends, which are received on Canadian investment abroad and paid out on foreign investment in Canada. In the case of merchandise trade, Canada traditionally has run a surplus because massive exports of raw and semi-processed raw materials have more than offset the deficit in finished goods or manufactures. The surplus on trade in goods has usually been overshadowed by large deficits on services, such as travel, interest, and dividends; this was especially true in the mid-1970s. Growing deficits in services have boosted Canada's total current account deficit in the late 1970s and early 1980s (see Table 2-5). However, 1982 was an exception to this pattern. Because imports dropped drastically during the severe recession in that year, Canada actually recorded a current account surplus of $2.67 billion, versus a deficit in excess of $5 billion in 1981. This marked the first year since 1973 that a current account surplus had been recorded. Surpluses were recorded in 1983 and 1984.

Canada's basic balance of payments problem was well summarized by former senior Department of Finance official A.W.F. Plumptre when he observed that the country's persistent deficit on current account "has to be covered by capital imports which are at any time subject to interruption and which involve increasing impairment of Canadian control over the economy" (Plumptre, 1977, p. 213). Since the late 1940s, the vast majority of the capital imported by Canada has originated in the United States. This is true for direct and indirect (or portfolio) foreign investment, as well as for both short- and long-term capital inflows. Foreign investment issues are considered later, but for now it suffices to note that the volume of capital imported from the United States grew remarkably in the 1950s and 1960s. From 1950 to 1963, more than half the capital inflow took the form of long-term direct foreign investment which boosted foreign control of Canadian industry sharply. By the late 1950s, Americans had invested more capital in Canada than in any other country (Wright and Molot, 1974, p. 672). From the perspective of Canada's international financial policy, this growing dependence on largely American foreign capital has made Canada vulnerable to U.S. policies that have the effect of reducing capital exports. The perceived need to ensure capital inflows to balance Canada's current account deficits has required Canadian policy makers to maintain a climate propitious for foreign investment and to keep domestic interest rates higher than those in the United States in order to entice shorter-term capital inflows.

TABLE 2-5 **Canada's Current Account Trade, 1960-81 (Balance of payments basis)**

	Goods			Goods and Services[a]		
Year	Exports	Imports	Trade Balance	Exports	Imports	Total Current Account Balance
			(millions of dollars)			
1960	5,392	5,540	-148	7,215	8,448	-1,233
1961	5,889	5,716	173	7,904	8,832	-928
1962	6,387	6,203	184	8,548	9,378	-830
1963	7,082	6,579	503	9,416	9,937	-521
1964	8,238	7,537	701	10,887	11,311	-424
1965	8,745	8,627	118	11,648	12,778	-1,130
1966	10,745	10,102	224	13,600	14,762	-1,162
1967	11,338	10,772	566	15,303	15,802	-499
1968	13,720	12,249	1,471	17,464	17,561	-97
1969	15,035	14,071	964	19,425	20,342	-917
1970	16,921	13,869	3,052	21,932	20,826	1,106
1971	17,877	15,314	2,562	23,051	22,620	431
1972	20,129	18,272	1,857	25,483	25,869	-386
1973	25,461	22,726	2,735	31,776	31,668	108
1974	32,591	30,902	1,689	40,352	41,812	-1,460
1975	33,511	33,962	-451	41,840	46,597	-4,757
1976	37,995	36,607	1,388	47,110	50,952	-3,842
1977	44,253	41,523	2,730	54,103	58,404	-4,301
1978	53,054	49,047	4,007	64,577	69,512	-4,935
1979	65,275	61,157	4,118	79,182	84,144	-4,962
1980	76,772	68,284	8,488	93,615	94,711	-1,096
1981	84,221	76,870	7,351	102,543	107,889	-5,346

Source: Government of Canada, *A Review of Canadian Trade Policy* (Ottawa: Minister of Supply and Services, 1983), p. 18.
a. Including transfers.

A major goal of U.S. economic policy in the 1960s was to improve its balance of payments, which was being forced into a deficit position in large part because of massive outflows of capital occasioned by the foreign investments of U.S.-based multinational firms and by extensive borrowing by foreign entities in U.S. capital markets. A number of initiatives were taken to restrict capital outflows during the decade, and these caused great concern in Canada, which depended on American capital inflows to offset persistent current account deficits. In the case of U.S.-Canada transactions, Canada was constantly in a current account deficit position with the United States, but equally regularly recorded a surplus in bilateral capital transactions, particularly in long-term capital movements. Nonetheless, when U.S. authorities took action to strengthen the value of their dollar by impeding capital outflows in the 1960s, Canada was not their principal target.

> In adopting measures to strengthen the position of the dollar, the U.S. authorities were primarily concerned with the new balance between the United States and Europe and the measures they took were for the most part directed toward the reduction of capital exports from the United States.
>
> (Plumptre, 1977, p. 200)

Beginning with the Interest Equalization Tax in 1963, U.S. authorities took a series of actions to stem the outflow of capital, actions which threatened to have a drastic impact on Canada. On three key occasions, in 1963, 1965 and 1968, Canada obtained exemptions from U.S. rules and guidelines designed to restrict capital exports, arguing that the country was heavily dependent on such capital, that the North American capital market was so highly integrated that it approximated a single market, and that Canada would be forced to institute trade controls if U.S. capital flows were sharply reduced, thereby hurting the U.S. balance of payments by reducing the U.S. surplus on current account (Plumptre, 1977, Chapter 9; Wright and Molot, 1974, pp. 675–86). In exchange for such "special treatment," Canadian policy makers were forced to accept limits on the accumulation of U.S. dollars in Canada's international reserves, which elicited strong criticism from some observers. At the time, however, the obligations that Ottawa was required to accept seemed an acceptable price to pay for the privilege of enjoying continuing and largely unfettered access to badly needed U.S. capital.

The international monetary regime established in the 1940s was based on the belief that exchange rates — i.e., the relationship between national currency values — should be fixed rather than determined by market forces. The rules of the International Monetary Fund, of which Canada was a founding member and strong supporter, basically required signatories to maintain their currencies at set "par" values; this precluded the use of competitive currency devaluations, so common in the 1930s, to boost exports and reduce imports. Beginning in 1950, Canada played what has been characterized as a unique role in the monetary regime (English, 1977, pp. 172–73). Because the Korean War increased foreign demand for Canadian raw materials, and a related large inflow of mainly U.S. capital occurred at the same time, there was enormous upward speculative pressure on the Canadian dollar. The IMF allowed the Canadian government to float the dollar, i.e., to permit its relative value vis-à-vis other currencies to be determined by supply and demand. The government discovered that a flexible exchange rate was not inconsistent with stability, "largely because of the huge and economically sound Canada–U.S. trade- and investment-related transactions" (p. 173). Freeing the Canadian dollar also allowed for greater autonomy in the exercise of domestic fiscal and monetary policy. This was welcomed by Canadian authorities, and indeed was the reason why they sought to secure international approval for a floating Canadian dollar. However, the utility of this policy autonomy rested in part on the continued adherence of Canada's trading partners to the fixed-exchange rate regime, and this was largely lost after the regime collapsed in the early 1970s.

The IMF grudgingly accepted Canada's request to continue to float the dollar once the speculative pressures associated with the early stages of the Korean War had diminished, even though other industrial countries had to maintain the par values of their currencies (p. 172; Wonnacott, 1972). In 1962 the government decided to drive down the dollar's foreign exchange value to improve export prospects, and it thus moved to "peg" the dollar at a level of 92.5¢ U.S., where it remained until floating was resumed in 1970. Meanwhile, the international monetary regime was coming under increasing pressure as a result of growing U.S. payments deficits; the refusal of Japan and the West European countries, now recovered from World War II, to revalue their currencies; and divergencies in inflation rates among the major industrial economies. These forces eventually undermined the IMF fixed exchange rate monetary regime in the early 1970s. In May 1970, Canada once again elected to return to a floating exchange rate, and the dollar quickly appreciated relative to the U.S. dollar. Other countries' currencies gradually were permitted to float freely after 1973. By mid-1976, the Canadian dollar was worth US$1.04. Thereafter, however, there began a steady depreciation of the Canadian dollar relative to the U.S. currency as Canada's current account and general economic performance deteriorated. By the end of 1978, the Canadian dollar stood at 84.3¢ U.S.; in June 1982, it fell through the psychologically important level of 80¢ U.S.; and it has hovered in the range of 73¢–81¢ since then.

In theory, a country such as Canada that usually runs current account deficits can pursue several strategies to address the problem. It can use up its international reserves, although this will provide only a temporary breathing spell; it can borrow abroad, registering a surplus on capital account; it can devalue its currency relative to those of its trading partners, which will boost exports and reduce imports; it can depress domestic economic activity, which will slow imports; or it can try to deal with the underlying causes of its current account deficit. Canada has pursued most of these strategies, although for varying periods and with varying frequency. Canada has regularly borrowed abroad to offset its current account deficits (Robinson, 1980, pp. 25–26). It has also devalued the dollar on certain occasions, although in recent years the value of the dollar has been partly determined by market forces rather than government policies. In general, however, Canada has not tackled what economic nationalists regard as the chief causes of persistent current account deficits, namely large outflows of interest, dividends and other services on the one hand, and the massive deficits recorded in finished goods trade on the other (Hudson, 1978). Nor has Canada solved what many economists consider to be the key structural problems afflicting the economy, including poor productivity performance, insufficiently competitive manufacturing industries and too-high real wage levels (Daly, 1982).

The international monetary and financial regime centred on the IMF is today in considerable disarray. A number of countries favour a return to fixed, or at least managed, exchange rates, while others, the United States in particular, are strong exponents of floating rates determined by market forces. Economists tend to favour floating rates because, in theory, they permit countries to follow more autonomous fiscal and monetary policies than fixed rates allow (Eastman, 1984). For example, a country in balance of payments deficit can address this problem by allowing market forces to depreciate its currency, whereas with fixed rates it is probable that domestic demand would have to be depressed to achieve external balance — as frequently happened in Britain in the 1960s while that country futilely sought to defend the exchange value of sterling. However, floating exchange rates do not necessarily offer small, open economies much real autonomy in macroeconomic policy, although they may do so for larger powers less reliant on external transactions. As one eminent economist recently wrote, "the exercise of policy autonomy becomes nearly impossible under flexible rates, because many economies are too small and open to accept the exchange rate variations induced by policy" (Dornbusch, 1983, p. 4). This well describes Canada's dilemma in the face of the escalation of U.S. interest rates in the early 1980s. Had Canadian authorities chosen not to mirror rising U.S. interest rates, the Canadian dollar would have fallen precipitously because of capital outflows. Among other things, this would have had serious consequences for domestic price performance.

In analyzing Canada's position and policies in relation to international monetary and financial questions, what matters most is not so much the international regime as it is the nature of exchange-rate relations with the United States and the state of the two economies. The world continues to rely on the U.S. dollar as its primary reserve asset and currency for international commerce. U.S. dollars still account for some 80 percent of the international reserves of IMF members (Cameron, 1978–79, pp. 90–91). Nor is there any real indication that the U.S. dollar's unique role in the international monetary system will soon end. Like other countries, Canada probably gained a modest measure of macroeconomic policy autonomy as a result of the flexible exchange rates of the 1970s and early 1980s (Dunn, 1978, p. 7). However, the degree of economic integration in North America, the disparity in size of the two economies, and Canada's continuing reliance on large volumes of U.S. capital all suggest that the overriding importance of the United States in Canada's international financial policy will not change for the foreseeable future, and that the scope for autonomous policy will continue to be restricted by Canada's payments relationship to the United States.

Foreign Investment

The growth and impact of foreign investment in Canada's economy have engendered much controversy and scholarly interest during the past 20 years, and only a cursory overview of the subject is possible here. Beginning in 1957 with the Royal Commission on Canada's Economic Prospects headed by Walter Gordon, a number of official reports and academic treatises began to appear on the scene which questioned the need for, and the consequences of, high levels of foreign investment in Canada. Especially important were the reports of the Watkins task force in 1968 and of Herb Gray in 1972 (Canada, 1968, 1972). Both of these built upon the earlier work of the Gordon Commission, but went much further in documenting the extent and exploring the impact of direct foreign investment. By the mid-1970s, direct foreign ownership of Canadian industry outside the financial sector had reached high levels. Some two-thirds of all foreign investment in Canada prior to World War I was indirect or portfolio investment, but this began to change rapidly and, by the late 1960s, more than 60 percent of foreign ownership was direct (Canada, 1972, pp. 13–14). The distinction is important; direct investment entails legal control of the underlying assets, while portfolio investment — i.e., purchases of public and corporate bonds and debentures, as well as minority holdings of equities — does not confer such legal control (Globerman, 1979, p. 6). Thus the increasing concern in Canada in the late 1960s and 1970s about foreign ownership stemmed not simply from the fact that Canada was the world's largest importer of foreign capital, but also because a growing proportion of this was in the form of direct investment.

The debate over the effects of high levels of direct foreign investment has a fairly long history. According to economic nationalists and others opposed to the growth of foreign investment, it has several negative consequences for Canada:

- Canadian subsidiaries of foreign-owned firms often fail to undertake research and development, are restricted in many instances from exporting their products, lack vigorous, entrepreneurial management, and have a high import propensity.
- Subsidiaries also tend to obtain the bulk of their supplies from firms in their country of origin rather than in Canada. In many cases, they may be required to purchase materials from the parent firm at inflated prices.
- The repatriation of profits, dividends, and interest to foreigners associated with foreign ownership creates a major deficit item in Canada's balance of payments and undermines Canada's policy autonomy.

- Foreign-owned firms provide a means by which foreign-country laws are applied in Canada. This extra-territoriality harms Canadian sovereignty and may force subsidiaries to act at variance with Canadian policy and laws.
- The development of an indigenous Canadian culture is undermined by the presence and power of foreign-owned firms in most Canadian industries.
- In general, the range of policy instruments available to public authorities is restricted, and the scope of policy options reduced, by the existence of so many foreign-owned firms. This is another way of saying that national autonomy and independence are lessened as a result of extensive foreign ownership of the country's industries. (See, on the allegedly negative effects of direct foreign investment, Government of Canada, 1972, Part four; Levitt, 1970; Rotstein, 1984; Williams, 1983, especially Chapter 6; Science Council, 1978 and 1979; and Robinson, 1980, Chapter 6.)

For many political scientists, these criticisms appear to be articles of faith. It is worth noting therefore that, among economists interested in foreign ownership of Canadian industry, there is a less uniformly critical view. According to a number of analysts, Canada's economic growth, productivity, and capital investment performance have all benefitted from foreign ownership. Moreover, because Canada is a large, resource-rich, sparsely populated country, substantial inflows of foreign investment are needed to develop the national economy. A number of economists have also quarrelled with the contention that foreign-owned firms are less prone than Canadian-owned firms to export products, to invest in research and product innovation, and to develop indigenous management and entrepreneurial expertise (for generally favourable reviews of foreign investment, see Globerman, 1979 and 1984; Dunn, 1978; Safarian, 1966, 1969 and 1979; and English, 1977, pp. 177–79). Recent studies by some Canadian economists suggest that Canada's efforts to control and screen direct foreign investment since the mid-1970s have imposed net costs on the Canadian economy (Beckman, 1984; Globerman, 1984). This runs counter to the conclusions reached by most political scientists who have examined the subject.

Following the Gray Report (Canada, 1972), and in the context of a minority Liberal government, Ottawa moved to create the Foreign Investment Review Agency in 1974. FIRA was established to monitor and assess foreign investment proposals, both those involving takeovers of existing firms and those involving the creation of new firms. It was not given the power to review the performance, on an ongoing basis, of foreign-owned entities operating in Canada. Although foreign investors have complained about FIRA's review process, which can be lengthy, complicated and involve considerable arm-twisting, the fact of the matter is that more than

85 percent of proposals put to FIRA eventually have been approved. Foreign ownership has declined since FIRA's inception, but the figures suggest that this was happening before 1974 (Lyon and Tomlin, 1979, pp. 101–104). In the 1960s, the absolute volume of U.S. capital invested in Canada continued to grow, and total investment increased from C$16.7 billion in 1960 to C$36.3 billion in 1971. However, U.S. control of Canada non-financial corporations did not increase, remaining in the 25 to 26 percent range, and U.S. investment as a percentage of Canada's GNP declined from 44 percent in 1960 to 30 percent in 1973 (p. 103); it has continued to fall since then. Thus, even as concern was mounting in Canada in the late 1960s and early 1970s about the growth and impact of U.S. investment, the inflow of U.S. capital was already beginning to level off, and foreign ownership of non-financial corporations was beginning to decline. Nonetheless, by any international standard the degree of non-resident ownership of Canadian industry remains high. Moreover, since the 1960s provincial governments and Crown corporations have been borrowing increasing amounts of U.S. capital through the flotation of debt securities in the United States. Although such borrowings do not give the lenders ownership of Canadian industries or assets, they do put pressure on Canada's balance of payments because of the outflow of funds required to service these debts.

Since the establishment of FIRA in 1974, Canada's treatment of foreign investment has been a persistent source of tension in bilateral economic relations with the U.S. That FIRA has approved most applications made by prospective foreign investors does not appear to have lessened U.S. concerns, which are primarily directed at the length of time required for decisions, the commitments extracted from foreign investors to deal with Canadian suppliers, and obligations required of applicants in respect of exports (Hufbauer and Samet, 1982, pp. 114–23). The United States also alleges that, because of FIRA's practices, Canada is in breach of a 1976 OECD code governing the treatment of multinational corporations which obligates signatories to apply "national treatment" to such entities operating in their territories, by which is meant that they treat foreign firms no less favourably than domestic firms in like circumstances. Canada signed the code, but reserved its right to take action to deal with foreign ownership, pointing to the high relative levels of such ownership as justification (Macdonald, 1982, pp. 397–98). The United States has also complained that FIRA's policies violate the national treatment rule of the GATT. In a recent decision, a GATT adjudicatory panel largely agreed with this U.S. charge, but there has as yet been no final resolution of the matter either in the GATT or bilaterally.

Another investment-related issue that has caused problems for many years is the extra-territorial application of U.S. laws in Canada through the presence of U.S.-owned companies here. This matter really goes to the heart of the sovereignty of the host nation. In the 1950s and 1960s, the U.S. Trading with the Enemy Act prevented U.S. subsidiaries in Canada from doing business with Cuba and China. More recently, extra-territorial application of U.S. anti-trust law has been the most contentious issue falling under this category (Clarkson, 1982, pp. 101–102; Leyton-Brown, 1980–81). U.S. courts and legislators have shown no disposition to revise the doctrine of extra-territoriality, despite the plethora of complaints emanating from Canada and other countries, and this issue is certain to remain a serious irritant in bilateral relations.

Although foreign ownership will continue to be important in both Canadian domestic politics and policy debate and Canada–U.S. economic relations, several trends suggest that it may well attract less concern than in the past. First, the degree of foreign ownership of Canadian industry has been slowly but steadily falling for the past several years, and the inflow of foreign direct investment has also declined since the mid-1970s (Beckman, 1984, pp. 11–12). In 1970, the percentage of foreign ownership in the manufacturing sector was 61 percent, while the comparable figures for the oil and gas industry and the mining and smelting industry were 76 percent and 70 percent, respectively. Ten years later, foreign ownership levels had fallen to 53 percent in manufacturing, 51 percent in oil and gas, and 48 percent in mining and smelting (p. 12). A second trend is the sharp increase in Canadian direct investment abroad since the early 1970s. Most of this Canadian investment is concentrated in the United States. Major Canadian firms anxious to assure access to the U.S. market, such as Northern Telecom, have strong reasons to invest in the United States. To date, the Canadian government has not put policies in place to stem outflows of investment, despite complaints from organized labour, the New Democratic Party and other groups that Canadian jobs are being exported because of these investment outflows. Over time, Canada's views on foreign investment may alter as the country becomes more involved in exporting capital. For the foreseeable future, however, Canada will continue to have a much higher level of direct foreign ownership than other major industrial nations. Finally, recent evidence indicates that prospective foreign investors and their governments have become less concerned about FIRA and Canada's policies toward foreign investment (Beckman, 1984). This trend is unlikely to be reversed soon in view of the Conservative government's decision to abolish FIRA and welcome additional foreign direct investment.

Canada and North-South Relations

Canada has been one of the developed industrial countries most rhetorically sympathetic to the demands of the Third World for basic changes in the world economy, and a few comments on Canada's role and policies in this respect are offered here. (On Canadian policies toward Third World economic concerns see Lyon and Tomlin, 1979, Chapter 8; Biggs, 1980; Sanger, 1976; Helleiner, 1978; and Economic Council of Canada, 1978.)

In the area of international aid (or "official development assistance," as it is known in the lexicon), Canada has been generous in comparison with most other developed countries. In absolute volume of aid given, Canada ranked fifth among Western countries in the mid- and late 1970s; as a proportion of GNP, it ranked second, surpassed only by France (Lyon and Tomlin, 1979, pp. 142–43). The countries of the OECD officially set 0.7 percent of GNP as a target for their future aid disbursements to the Third World in 1970, but so far no major developed country has reached this level. Canada has been close to 0.5 percent of GNP, and has been more generous than the United States, Japan, the United Kingdom and West Germany (p. 143; Helleiner, 1978, p. 398). Moreover, overseas development assistance has been the fastest growing area of federal government spending since 1980, and the previous government indicated in 1980 that it hoped to reach the 0.7 percent target by the end of the decade. Despite Canada's quite generous record on foreign aid, critics have pointed out that much of Canada's bilateral aid (given directly to recipient countries rather than to multilateral institutions) is "tied," which means that Canada requires that the aid be used by the recipient to purchase Canadian goods and services. In 1980 Ottawa untied 20 percent of bilateral aid, but critics have argued that no obligation to purchase Canadian goods and services should be attached to foreign aid disbursements (Sanger, 1976, pp. 280–89). Other observers have disagreed with the targetting of Canadian aid, arguing that it has been insufficiently directed toward reaching those people most desperately in need — the rural poor. Case studies have highlighted both the difficulty of ensuring that Canadian aid reaches those who have the greatest need for it, and the problems and distortions that result from linking aid to the purchase of Canadian products (Ehrhardt, 1983; and Young, 1983).

Canada's relatively generous aid performance has not been duplicated in other economic issues on the North-South agenda. Canada's trade barriers against "low-cost" Third World imports increased sharply in the 1970s, and there is no evidence that trade protectionism against such Third World exports as textiles, clothing and footwear is about to be reversed (Biggs, 1980). Canada was the second-last developed country to introduce a preferential tariff system for imports from the Third World in the 1970s and,when Ottawa drew up the list of products eligible for favourable tariff treatment, a number of manufactured goods in which Third World states have a comparative advantage were left off. With respect to international monetary policy discussions, Canada has usually joined with the United States, West Germany and other conservative major powers in rebuffing Third World pleas for a major restructuring of the IMF's system for providing assistance to developing countries with balance of payments problems. Some modest reform of the IMF was agreed to in the 1970s, but it remains a major source of concern in the Third World (Helleiner, 1978, pp. 396–97).

Finally, a key Third World objective since the mid-1970s has been to obtain the agreement of the developed countries to establish a number of international commodity agreements (ICAs) in order to stabilize commodity prices and to increase the export earnings of Third World commodity producers. Although Canada is a major commodity exporter itself, it has been reluctant to support the Third World's demand for ICAs because it sees such agreements as technically and economically unworkable. During the negotiations in the last half of the 1970s on reforming international commodity trade, Canada's position was similar to that of the United States, Britain and West Germany, all of which were basically opposed to the demands of the Third World. One reason for Canada's position on commodity issues may be the hostility of Canada's resource industries to intergovernmental commodity control. Canada's opposition to the creation of ICAs for iron ore and copper, both produced in abundance in this country, was probably the result in part of the strong dislike of the relevant Canadian industries for market-regulating ICAs. In the case of other commodities of which Canada is an importer, Ottawa's position during the talks in the late 1970s was indistinguishable from that of most other developed importers.

Canadian International Economic Policies: Concluding Comments

Canada is a medium-sized economic power heavily involved with and dependent on external economic developments. With some 30 percent of domestic product derived from exports and a history of dependence on external sources of capital, Canada has had to fashion its policies in full awareness of the importance of these dependencies. At the same time, however, Canada is not, despite the views of some observers, an underdeveloped, non-industrialized country similar to the nations of the Third World. The analogy is misleading; although it has scarcely 25 million people, Canada has the seventh-largest GNP in the non-communist world, and is also among the top dozen nations in terms of GNP per capita. Along the numerous other conventional dimensions by which development is measured, including infant mortality rates, telephones per capita, and educational attainment of the population, Canada ranks as a highly advanced industrial country. To be sure, it is more reliant on raw and semi-processed natural resources than most other advanced countries, but this alone does not invalidate the argument that Canada is an advanced rather than an underdeveloped nation, particularly in comparison with those nations that unambiguously fall into the category of underdeveloped.

Canada's major problem with respect to international economic policy is not that it is extremely weak or underdeveloped, but rather that its options are constrained by its dependence on the global economy in general, and its markedly asymmetrical interdependence with the United States in particular. The consequences of growing economic interdependence have been debated extensively in the recent international relations and international political economy literature, and were discussed earlier. According to some scholars, increasing interdependence allows small and medium powers to exert more influence in world affairs, even though they lack much overall or "structural" power in the international system as a whole. This notion has been applied to the Canadian-American relationship, and a number of studies have argued that, despite its relative weakness in comparison with the United States, Canada has been able to bargain successfully on a wide range of bilateral economic issues. Keohane and Nye, for example, report that the outcomes of 40 high-level conflicts between Canada and the United States in the years from 1920 to 1969 favoured Canada on 16 occasions, the United States on another 16, and neither country on the other eight occasions. In the 1960s, however, Canada was favoured in 8 of 11 conflict outcomes. They explain Canada's successes in the 1960s by invoking the notion of "complex interdependence" and the important roles of transnational and transgovernmental relations. They argue that transnational and transgovernmental allies, such as U.S. corporations with plants in Canada and the U.S. Department of State, were of great assistance to Canada during conflicts with the United States in the 1960s. They also point to the intensity and coherence of Canada's bargaining strategies — understandable given the critical importance of the U.S. economy to Canada's welfare — and to the fact that, on some issues, Canada possessed the capacity to harm U.S. interests (Keohane and Nye, 1977, Chapter 7, especially pp. 202–207). An earlier study in the same vein was that of Leyton-Brown (1974), who explored 27 instances of bilateral conflict involving U.S. subsidiary firms based in Canada. Outcomes are said to have favoured Canada in 12 cases and the United States in 13, with the remaining two outcomes being neutral. Of the five "high-intensity" cases, two were resolved in Canada's favour and three were not. Leyton-Brown found that in only 2 of 27 cases did multinational corporations ally with the U.S. government against Ottawa.

Both the Leyton-Brown and the Keohane and Nye studies cover cases only up to 1970 or so. It would be useful to have further empirical work similar to these studies undertaken in order to determine the pattern of bargaining outcomes in the 1970s and early 1980s. Some recent research indicates the United States may be more willing now to acquiesce to certain Canadian government policies that formerly prompted very strong protests. Molot and Laux, for example, suggest that the relatively weak U.S. reaction to the Saskatchewan government's decision in 1975 to nationalize several U.S.-owned potash firms confirms that the state in Canada has considerable room to take initiatives of this sort without precipitating serious conflict with the United States (Molot and Laux, 1979). Even in the case of the National Energy Program (NEP), the Canadian government achieved victory in the dispute in that its major elements were left intact with little or no real retaliation from the United States. Clarkson, however, maintains that fear of the possible U.S. reaction convinced Ottawa not to proceed with an industrial strategy and with further strengthening of FIRA in the early 1980s (1982, Chapter 4).

In assessing Canada's future options and its scope for autonomous policy choices, it may be useful to examine the experiences of so-called "self-directed" small industrial states (Keohane, 1982). Such states are small in terms of the overall international economic system. In Keohane's words,

> . . . these states are small because they have little capacity to affect the international economic system as a whole, or the international economic regimes that provide rules to regulate the imposition of national controls on international transactions. They are "price takers" in economic terms, and "subjects" politically: they do not make the rules but merely have to decide whether to accept them, for instance by joining such arrangements as the General Agreement on Tariffs and Trade or the International Monetary Fund, or to accept the costs of not belonging. (p. 50)

Another characteristic of states falling into this category is that "their most significant economic ties are with countries that are much larger than themselves" (p. 49). Keohane goes on to enumerate the disadvantages of such small industrial powers:

- Their economies are more open, and thus more sensitive, to external economic disturbances than those of larger powers;
- They exert little influence over the "rule structures" of the international economy by which state behaviour is regulated;
- They are weak in terms of bilateral relations with their major economic partner, partly because of relative size and power, and partly too because such larger powers are likely to be more autonomous and less dependent on the external economic world (p. 52).

Keohane argues that small industrial states have four basic strategies available to them to secure additional autonomy and independence. One is diversification of economic ties, particularly export markets and sources of imports. Canadian policy makers and intellectuals have been attracted to this idea for some time, but little diversification away from the United States has in fact been achieved in the past ten years. A second strategy is to improve the capacity for internal adjustment. Mobility of resources was identified as a critical advantage of large economic powers by Hirschman in his treatise written almost four decades ago, and little has changed since then to invalidate this insight (Hirschman, 1945). Recent work on Switzerland suggests that it has been extremely successful in adjusting policies and redirecting economic activity in response to external economic pressures and shocks (Katzenstein, 1980).

A third strategy suggested by Keohane is "invisibility," by which he means that small states can take advantage of the fact that "what they do is less likely to be noticed than are the actions of larger countries, and is less likely, therefore, to invite retaliation" (Keohane, 1982, p. 56). It could be argued that Canada was able to gain as a result of its relative invisibility in the context of its economic relations with the United States in the 1950s and 1960s. However, more recent developments, especially U.S. criticism and threatened retaliation over the National Energy Program and FIRA, suggest that invisibility is no longer of much benefit to Canada. Finally, Keohane identifies "manipulation" as another strategy open to a small state involved in a close economic relationship with a much larger one. He notes Israel's success in mobilizing a strong pro-Israeli constituency in U.S. politics, and observes that "the small state has the advantage that it can concentrate its energy on a single country, while the great power's attention is inevitably dispersed in several directions at once" (p. 58). In the case of Canada's relations with the United States, it is obvious that Canadian policy will be more focussed on and more sensitive to the United States than vice versa, and thus Canada may in some circumstances be successful because its bargaining and diplomatic strategies are more coherent and better thought out.

Most of the literature on small, self-directed industrial states deals with such countries as Austria, Norway, Finland and Switzerland. It is worth asking how Canada has fared in comparison with these states and whether in fact Canada's situation is analogous to that of such countries. Comparative work that addresses these issues would be extremely useful to scholars who wish to explore the question of Canada's future policy options in the changing global economy.

Bibliography

Ahearn, Raymond. 1982. "Political Determinants of U.S. Trade Policy." *Orbis* 26, (Summer).

Ahearn, Raymond, and Alfred Reifman. 1983. "Trade Policymaking in the Congress." In *Recent Issues and Initiatives in U.S. Trade Policy*, edited by Robert E. Baldwin. New York: National Bureau for Economic Research.

Aho, C.M., and T.O. Bayard. 1982. "The 1980s: Twilight of the Open Trading System?" *The World Economy* 5 (December).

Aliber, Robert. 1979. *Stabilizing World Monetary Arrangements*. London: Trade Policy Research Center, Thames Essay no. 18.

Allison, Graham. 1971. *The Essence of Decision*. Boston: Little, Brown.

Balassa, Bela. 1978. "The 'New Protectionism' and the International Economy." *Journal of World Trade Law* 12 (September-October).

———. 1979. *The Changing International Division of Labor in Manufactured Goods*. Staff Working Paper no. 329. Washington, D.C.: World Bank.

Beckman, Christopher. 1983. *Strategies of Industrial Adaptation: A Review of the Debate*. Ottawa: Conference Board of Canada, Executive Bulletin.

———. 1984. *The Foreign Investment Review Agency: Images and Realities*, Ottawa: Conference Board of Canada.

Bergsten, C. Fred. 1975. *The Dilemmas of the Dollar: The Economics and Politics of U.S. International Monetary Policy*. New York: New York University Press.

———. 1977. "The International Economy and World Politics in the Postwar Era." In *Economic Foreign Policies of Industrial States*, edited by Wilfrid Kohl. Lexington: Lexington Books.

Bergsten, C. Fred, and William Cline. 1982. *Trade Policy in the 1980s*. Washington, D.C.: Institute for International Economics, Policy Analyses in International Economics.

Bernier, Ivan. 1979. *State Trading and the GATT*. Montreal: École des Hautes Études Commerciales (June).

Biggs, Margaret. 1980. *The Challenge: Adjust or Protect*. Ottawa: North-South Institute.

Bird, Graham. 1978. *The International Monetary System and the Less Developed Countries*. London: Macmillan.

Blackhurst, R., N. Marian, and J. Tumlir. 1977. "Trade Liberalization Protectionism and Interdependence." *GATT Studies in International Trade* 5 (November).

Bliss, Michael. 1970. "Canadianizing American Business: The Roots of the Branch Plant." In *Close the 49th Parallel*, edited by I. Lumsden. Toronto: University of Toronto Press.

Bolin, William, and Jorge Del Canto. 1983. "LDC Debt: Beyond Crisis Management." *Foreign Affairs* 61 (Summer).

Brown, Seyom. 1974. *New Forces in World Politics*. Washington, D.C.: Brookings Institution.

Cameron, Duncan. 1978–79. "The Reform of International Money." *International Journal* 34 (Winter).

Campbell, Colin, and George Szablowski. 1979. *The Superbureaucrats*, Toronto: Macmillan.

Canada, 1968. *Foreign Ownership and the Structure of Canadian Industry*, Ottawa: Minister of Supply and Services Canada.

———. 1972 *Foreign Direct Investment in Canada*, Ottawa: Minister of Supply and Services Canada.

Canada. Department of External Affairs, 1982. *Task Force on Trade in Services: Background Report*. Ottawa: The Department.

———. 1983. *A Review of Canadian Trade Policy*. Ottawa: Minister of Supply and Services Canada.

Canadian Manufacturers' Association. 1984. *A Future That Works*. Toronto: CMA.

Caporaso, James. 1981. "Industrialization in the Periphery: The Evolving Global Division of Labor." *International Studies Quarterly* 25 (September).

Caves, Richard. 1977. "Economic Models of Political Choice: Canada's Tariff Structure." *Canadian Journal of Economics* 10 (May).

Caves, R.E. 1981. "Intra-Industry Trade and Market Structure in the Industrial Countries." *Oxford Economics Papers* 33.

Clark, S.D. 1939. *The Canadian Manufacturers' Association*. Toronto: University of Toronto Press.

Clarkson, Stephen. 1982. *Canada and the Reagan Challenge*. Ottawa: Canadian Institute for Economic Policy.

Cline, William R. 1982. *'Reciprocity': A New Approach to World Trade Policy?* Washington, D.C.: Institute for International Economics.

Cohen, Benjamin. 1977. *Organizing the World's Money: The Political Economy of International Monetary Relations*. New York: Basic Books.

———. 1983. "Balance of Payments Financing: Evolution of A Regime." In *International Regimes*, edited by Stephen D. Krasner. Ithaca: Cornell University Press.

Cohen, Stephen. 1977. *The Making of United States International Economic Policy*. New York: Praeger.

Coleman, William, and Henry Jacek. 1983. "The Roles and Activities of Business Interest Associations in Canada." *Canadian Journal of Political Science* 16 (June).

Cooper, Richard. 1968. *The Economics of Interdependence*. New York: McGraw-Hill.

———. 1972–73. "Trade Policy is Foreign Policy," *Foreign Policy* (Winter).

———. 1975. "Prolegomena to the Choice of an International Monetary System." *International Organization* 29 (Winter).

———. 1984. "A Monetary System for the Future." *Foreign Affairs* 63 (Fall).

Corden, W. 1971. *The Theory of Protectionism*. Oxford: Oxford University Press.

Courchene, Thomas. 1982. *No Place to Stand*. Toronto: C.D. Howe Institute.

Cuff, R.D., and J. Granatstein. 1978. *American Dollars — Canadian Prosperity*. Toronto: Samuel Stevens.

Curzon, Gerard, and Victoria Curzon. 1976. "The Management of Trade Relations in the GATT." In *International Economic Relations of the Western World, 1959–1971: Politics and Trade*, edited by Andrew Shonfield. Oxford: Oxford University Press.

Dales, J.H. 1966. *The Protective Tariff in Canada's Development*. Toronto: University of Toronto Press.

Daly, Donald. 1982. *Canada in an Uncertain World Economic Environment*. Montreal: Institute for Research on Public Policy.

Dam, Kenneth. 1970. *The GATT — Law and International Economic Organization*. Chicago: University of Chicago Press.

Destler, I.M. 1980. *Making Foreign Economic Policy*. Washington, D.C.: Brookings Institution.

Diebold, William. 1980. *Industrial Policy as an International Issue*. New York: McGraw-Hill.

Doern, G. Bruce, and Allan Tupper, eds. 1981. *Public Corporations and Public Policy in Canada*. Montreal: Institute for Research on Public Policy.

Dolan, Michael. 1978. "Western Europe as a Counterweight." In *Canadian Foreign Policy: Analysis and Trends*, edited by Brian Tomlin. Toronto: Methuen.

Dornbusch, Rudiger. 1983. "Flexible Exchange Rates and Interdependence." *IMF Staff Papers* 30 Washington, D.C.: International Monetary Fund.

Drummond, Ian. 1977. "The Implications of American Economic Nationalism." In *A Foremost Nation: Canadian Foreign Policy and a Changing World*, edited by Garth Stevenson and Norman Hillmer. Toronto: McClelland and Stewart.

Dunn, Robert M. 1978. *The Canada–U.S. Capital Market*. Montreal: C.D. Howe Institute and the National Planning Association.

Eastman, H.C. 1984. "Interdependence and the International Monetary System," *International Journal* 39 (Summer).

Economic Council of Canada. 1975. *Looking Outward — A New Trade Strategy for Canada*. Ottawa: Minister of Supply and Services Canada.

———. 1978. *For a Common Future: A Study of Canada's Relations with Developing Countries*. Ottawa: Minister of Supply and Services Canada.

———. 1983. *The Bottom Line: Technology, Trade, and Income Growth*. Ottawa: Minister of Supply and Services Canada.

Ehrhardt, Roger. 1983. *Canadian Development Assistance to Bangladesh*. Ottawa: The North-South Institute.

English, R.E. 1977. "Canada." In *Economic Foreign Policies of Industrial States*, edited by W. Kohl. Lexington: Lexington Books.

Finlayson, Jock, and Mark Zacher. 1981a. "The GATT and the Regulation of Trade Barriers." *International Organization* 36 (Autumn).

———. 1981b. "International Trade Institutions and the North-South Dialogue." *International Journal* 36 (Autumn).

Finlayson, Jock, and Paul Marantz. 1982. "Interdependence and East-West Relations." *Orbis* (Spring).

Finlayson, Jock, and David G. Haglund. 1984. "Oil Politics and U.S.-Canada Relations." *Political Science Quarterly* 99 (Summer).

Flatters, F.R., and R.G. Lipsey. 1983. *Common Ground for the Canadian Common Market.* Montreal: Institute for Research on Public Policy.

Fowke, V. 1957. *The National Policy and the Wheat Economy.* Toronto: University of Toronto Press.

French, Richard. 1980. *How Ottawa Decides.* Ottawa: Canadian Institute for Economic Policy.

Gilpin, Robert. 1975. *U.S. Power and the Multinational Corporation.* New York: Basic Books.

Globerman, Steven. 1979. *U.S. Ownership of Firms in Canada.* Montreal: C.D. Howe Institute.

———. 1984. "Canada's Foreign Investment Review Agency and the Direct Foreign Investment Review Process in Canada." *Canadian Public Administration* 27 (Fall).

Gordon, Marsha. 1981. *Government in Business.* Montreal: C.D. Howe Institute.

Grey, Rodney. 1981. *Trade Policy in the 1980s: An Agenda for Canadian-U.S. Relations.* Montreal: C.D. Howe Institute.

———. 1982. *United States Trade Policy Legislation: A Canadian View.* Montreal: Institute for Research on Public Policy.

Grubel, H.G., and P.J. Lloyd. 1975. *Intra-Industry Trade: The Theory of Measurement of International Trade in Differentiated Products.* New York: John Wiley and Sons.

Haas, Ernst. 1975. "Is There a Hole in the Whole? Knowledge, Technology, Interdependence and the Construction of International Regimes." *International Organization* 29 (Summer).

Halperin, Morton. 1974. *Bureaucratic Politics and Foreign Policy.* Washington, D.C.: Brookings Institution.

Hay, Keith. 1982. "Canada's Trade Policy in the 80s." *International Perspectives* (July/August).

Helleiner, G.K. 1978. "International Development Eight Years On." *International Journal* 33 (Spring).

———. 1981. *Intra-Firm Trade and the Developing Countries*, New York: St. Martin's Press.

Hieronymi, Otto. 1980. *The New Economic Nationalism.* London: Macmillan.

Hirsch, Fred, and Michael Doyle. 1977. *Alternatives to Monetary Disorder.* New York: McGraw-Hill.

Hirschman, Albert O. 1945. *National Power and the Structure of Foreign Trade.* Berkeley: University of California Press.

Holsti, K.J. 1978. "A New International Politics?" *International Organization* 32 (Spring).

———. 1980. "Change in the International System: Interdependence, Integration and Fragmentation." In *Change in the International System*, edited by Ole Holsti, Randolph Siverson, and Alexander George. Boulder: Westview Press.

Holsti, Kal, and Thomas Levy. 1974. "Bilateral Institutions and Transgovernmental Relations Between Canada and the United States." *International Organization*, 28 (Autumn).

Hudson, Michael. 1978. *Canada in the New Monetary Order.* Toronto: Butterworth.

Hufbauer, Gary, and Andrew Samet. 1982. "Investment Relations Between Canada and the United States." Atlantic Council Working Group on the United States and Canada, *Canada and the United States: Dependence and Divergence.* Cambridge, Mass.: Ballinger.

Hufbauer, Gary, and Joanna Shelton Erb. 1984. *Subsidies in International Trade.* Cambridge, Mass.: MIT Press for the Institute of International Economics.

Hunter, W.T. 1978. "Toward Free Trade? The Dilemma of Canadian Trade Policy." *Journal of Canadian Studies* 13 (Spring).

———. 1979. "The Decline of the Tariff." *Journal of Canadian Studies* 14 (Autumn).

International Monetary Fund. 1982. *IMF Survey.* Washington, D.C.: IMF, August 16.

Jackson, John. 1978. "The Crumbling Institutions of the Liberal Trade System," *Journal of World Trade Law* 12 (March-April).

Johannson, P.R. 1978. "Provincial International Activities." *International Journal* 33 (Spring).

Katzenstein, Peter. 1975. "International Interdependence: Some Long Term Trends and Recent Evidence." *International Organization* 29 (Autumn).

———. 1976. "International Relations and Domestic Structures: Foreign Policies of Advanced Industrial States." *International Organization* 30 (Winter).

———. 1977a. "Introduction: Domestic and International Forces and Strategies of Foreign Economic Policy." *International Organization* 31 (Autumn).

———. 1977b. "Conclusion: Domestic Structures and Strategies of Foreign Economic Policy." *International Organization* 31 (Autumn).

———. 1980. "Capitalism in One Country? Switzerland in the International Economy." *International Organization* 34 (Autumn).

Keely, Jim. 1983. "Cast in Concrete for all Time? The Negotiation of the Auto Pact." *Canadian Journal of Political Science* 16 (June).

Keohane, Robert, and J.S. Nye. 1977. *Power and Interdependence*. Boston: Little Brown.

Keohane, Robert. 1982. "Economic Dependence and the Self-Directed Small State." *The Jerusalem Journal of International Relations* 6.

Kindleberger, Charles. 1969. *American Business Abroad*. New Haven: Yale University Press.

———. 1973. *The World in Depression*. Berkeley: University of California Press.

———. 1981. "Dominance and Leadership in the International Economy." *International Studies Quarterly* 25 (June).

Kostecki, M.M. 1979. *International Implications of State Trading By the Advanced Countries*. Montreal: École des Haute Études Commerciales, March.

Krasner, Stephen. 1976. "State Power and the Structure of World Trade." *World Politics* 28 (April).

———. 1979. "The Tokyo Round: Particularistic Interests and Prospects for Stability in the Global Trading System." *International Studies Quarterly* 23 (December).

Kuczynski, Pedro-Pablo. 1983. "Latin American Debt: Act Two." *Foreign Affairs* 62 (Fall).

Laux, Jeanne Kirk. 1978. "Global Interdependence and State Intervention." In *Canadian Foreign Policy: Analysis and Trends*, edited by Brian Tomlin. Toronto: Methuen.

Lazar, Fred. 1981. *The New Protectionism: Non-Tariff Barriers and Their Effects on Canada*. Ottawa: Canadian Institute for Economic Policy.

———. 1982. "Canadian Industrial Strategy: A. U.S. Impediment." *Journal of World Trade Law* 16 (May-June).

Leach, Richard, Donald Walker, and Thomas Levy. 1973. "Province-State Transborder Relations." *Canadian Public Administration* 16 (Fall).

Levitt, Kari. 1970. *Silent Surrender*. Toronto: Macmillan.

Leyton-Brown, David. 1974. "The Multinational Enterprise and Conflict in Canadian-American Relations." *International Organization* 28 (Autumn).

———. 1980–81. "Extraterritoriality in Canadian-American Relations." *International Journal* 36 (Winter).

Lipson, Charles. 1982. "The Transformation of Trade: The Sources and Effects of Regime Change." *International Organization* 36 (Spring).

Lyon, Peyton, and Brian Tomlin. 1979. *Canada As An International Actor*. Toronto: Macmillan.

Macdonald, Honourable Donald S. 1982. "Canadian Industrial Policy Objectives and Article III of GATT: National Ambitions and International Obligations." *Canadian Business Law Journal* 6 (August).

Matthews, Roy. 1983. *Canada and the Little Dragons*. Montreal: Institute for Research on Public Policy, Essays in International Economics.

McDougall, Ian. 1983. *Marketing Canada's Energy*. Ottawa: Canadian Institute for Economic Policy.

McMillan, Charles. 1978. "The Changing Competitive Environment of Canadian Business." *Journal of Canadian Studies* 13 (Spring).

Meissner, Charles. 1984. "Debt: Reform Without Governments." *Foreign Policy* 56 (Fall).

Mendelsohn, M.S. 1979. *Money on the Move*. New York: McGraw-Hill.

Molot, Maureen Appel. 1976a. "The Domestic Influences on Canadian Commercial and Monetary Policy." Unpublished paper.

———. 1976b. "Intergovernmental Relations Between Canadian Provinces and U.S. States: The Canadian View." Paper presented to the annual conference of the Institute of Public Administration of Canada, Halifax, September.

Molot, Maureen Appel, and Jeanne Kirk Laux. 1979. "The Politics of Nationalization." *Canadian Journal of Political Science* 12 (June).

Morici, Peter. 1984. *The Global Competitive Struggle: Challenges to the United States and Canada*. Toronto: C.D. Howe Institute and the National Planning Association.

Morici, Peter, Arthur Smith, and Sperry Lea. 1982. *Canadian Industrial Policy*. Washington, D.C.: National Planning Association, June.

Morse, Edward. 1976. *Modernization and the Transformation of International Relations*. New York: Free Press.

Nossal, K. 1979. "Allison Through the (Ottawa) Looking Glass: Bureaucratic Politics and Foreign Policy in a Parliamentary System." *Canadian Public Administration* 22 (Winter).

Organization for Economic Cooperation and Development. 1979. *Facing the Future*, Paris: OECD.

Organization for Economic Cooperation and Development. 1981. *International Investment and Multinational Enterprises*. Paris: OECD.

———. 1981. "OECD and the NICs: The Current Trade Pattern." *OECD Observer* (November).

———. 1982. "World Interdependence: Trade." *OECD Observer* 114 (January).

———. 1982. *External Debt of Developing Countries*. Paris: OECD Secretariat, December.

———. 1983. *Positive Adjustment Policies*. Paris: OECD.

Palda, Kristian S. 1979. *The Science Council's Weakest Link*. Vancouver: The Fraser Institute.

Pastor, Robert. 1980. *Congress and the Politics of U.S. Foreign Economic Policy*. Berkeley: University of California Press.

———. 1983. "The Cry-And-Sigh Syndrome: Congress and U.S. Trade Policy." In *Making Economic Policy in Congress*, edited by Allen Schick. Washington, D.C.: American Enterprise Institute for Public Policy Research.

Paterson, Robert, and Michael Hicks. 1983. "Official Export Financing: A Canadian Perspective." Paper presented to the Conference on Canada and International Trade, June 5–6. Vancouver: University of British Columbia.

Pattison, J.C. 1978. *Financial Markets and Foreign Ownership*. Ottawa: Occasional Paper 8. Ontario Economic Council.

Pearson, Charles, and Gerry Salembier. 1983. *Trade, Employment and Adjustment*. Montreal: Institute for Research on Public Policy.

Perry, Ross. 1982. *The Future of Canada's Auto Industry*. Ottawa: Canadian Institute for Economic Policy.

Phidd, Richard, and G. Bruce Doern. 1978. *The Politics and Management of Canadian Economic Policy*. Toronto: Macmillan.

———. 1983. *Canadian Public Policy*, Toronto: Methuen.

Phillips, Paul. 1979. "The National Policy Revisited." *Journal of Canadian Studies* 14 (Autumn).

Plumptre, A.F.W. 1977. *Three Decades of Decision*. Toronto: McClelland and Stewart.

Preeg, Ernest. 1970. *Traders and Diplomats: An Analysis of the Kennedy Round of Negotiations*. Washington, D.C.: Brookings Institution.

Protheroe, David. 1980. *Imports and Politics*. Montreal: Institute for Research on Public Policy.

Proulx, Pierre-Paul. 1984. "Trade Liberalization and Industrial Adjustment Policy for Canada." Paper presented to a conference on Canada–U.S. Trade Relations, March 30. Provo, Utah: Brigham Young University.

Redekop, John. 1978. "Continentalism: The Key to Canadian Politics." In *Approaches to Canadian Politics*, edited by John Redekop. Scarborough: Prentice-Hall.

Reich, Robert. 1983. "Beyond Free Trade." *Foreign Affairs* 61 (Spring).

Robinson, H.L. 1980. *Canada's Crippled Dollar*. Ottawa: Canadian Institute for Economic Policy.

Rosecrance, Richard, Arthur Stein, and Alan Alexandroff. 1977. "Whither Interdependence?" *International Organization* 31 (Summer).

Rotstein, Abraham. 1984. *Rebuilding From Within: Remedies for Canada's Ailing Economy*. Ottawa: Canadian Institute for Economic Policy.

Ruggie, John Gerard. 1983a. "International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order." In *International Regimes*, edited by Stephen D. Krasner. Ithaca: Cornell University Press.

Ruggie, John. 1983b. "Political Structure and Change in the International Economic Order: The North-South Dimension." In *Antinomies of Interdependence*, edited by John Ruggie. New York: Columbia University Press.

Safarian, A.E. 1966. *Foreign Ownership of Canadian Industry*. Toronto: McGraw-Hill.

———. 1969. *The Performance of Foreign Owned Firms in Canada*. Montreal: Canadian-American Committee.

———. 1974. *Canadian Federalism and Economic Integration*. Ottawa: Information Canada.

———. 1979. "Foreign Ownership and Industrial Behaviour." *Canadian Public Policy* 3 (Summer).

Sanger, Clyde. 1976. "Canada and Development in the Third World." In *Canada and the Third World*, edited by P. Lyon and T. Ismael. Toronto: Macmillan.

Science Council of Canada. 1978. *The Weakest Link*. Ottawa: Minister of Supply and Services Canada.

———. 1979. *Forging the Links: A Technology Policy for Canada*. Ottawa: Minister of Supply and Services Canada.

———. 1980. *Multinationals and Industrial Strategy*. Ottawa: Minister of Supply and Services Canada.

Canada. Senate Standing Committee on Foreign Affairs. 1982. *Canada–U.S. Relations*. Vol. III: Canada's Trade Relations with the United States, Ottawa, March.

Sharp, Mitchell. 1972. "Canada–U.S. Relations: Options for the Future." *International Perspectives* (Autumn).

Sigler, John, and Dennis Goresky. 1974. "Public Opinion on United States–Canada Relations," *International Organization* 28 (Autumn).

Smiley, Donald. 1980. *Canada in Question*. Toronto: McGraw-Hill.

Smythe, Elizabeth. 1980. "International Relations Theory and the Study of Canadian-American Relations." *Canadian Journal of Political Science* 13 (March).

Spero, Joan. 1981. *The Politics of International Economic Relations*. New York: St. Martin's Press.

Staris, Denis. 1976. "The Foreign Policy of Canada." In *World Politics*, edited by J. Rosenau, G. Boyd, and K. Thompson. New York: The Free Press.

Stevenson, Garth. 1974. "Continental Integration and Canadian Unity." In *Continental Community*, edited by Andrew Axline, Maureen Molot, J. Hyndman and Peyton Lyon. Toronto: McClelland and Stewart.

———. 1977. "Canada in the United Nations." In *A Foremost Nation: Canadian Foreign Policy in a Changing World*, edited by Garth Stevenson and Norman Hillmer. Toronto: McClelland and Stewart.

Stone, Frank. 1984. *Canada, the GATT and the International Trade System*. Montreal: Institute for Research on Public Policy.

Strange, Susan. 1979. "The Management of Surplus Capacity." *International Organization* 33 (Summer).

Swanson, Roger Frank. 1978. *Intergovernmental Perspectives on the Canada–U.S. Relationship*. New York: New York University Press.

Thompson, Fred, and William Stanbury. 1979. "The Political Economy of Interest Groups in the Legislative Process of Canada." In *The Canadian Political Process*, 3d edition, edited by Richard Schultz, Orest Kruhlak and John Terry. Toronto: Holt-Rinehart, Winston.

Tsoukalis, Loukas, and Antonio da Silva Ferreria. 1980. "Management of Industrial Surplus Capacity in the European Community." *International Organization* 34 (Summer).

Tucker, Michael. 1980. *Canadian Foreign Policy: Contemporary Issues and Themes*. Toronto: McGraw-Hill.

Vernon, Raymond. 1971. *Sovereignty at Bay*. New York: Basic Books.

Von Riekhoff, Harald. 1978. "The Third Option in Canadian Foreign Policy." In *Canadian Foreign Policy: Analysis and Trends*, edited by Brian Tomlin. Toronto: Methuen.

Von Riekhoff, Harald, John Sigler, and Brian Tomlin. 1979. *Canada–U.S. Relations: Policy, Environments, Issues and Prospects*. Montreal: C.D. Howe Institute.

Walleri, R.D. 1978. "The Political Economy Literature on North-South Relations." *International Studies Quarterly* 22 (December).

Weinert, Richard. 1984. "Coping With LDC Debt." *Journal of International Affairs* 38 (Summer).

Wilgress, Dana. 1963. *Canada's Approach to Trade Negotiations*, Montreal: Private Planning Association.

Wilkinson, Bruce. 1982. "Canada-U.S. Free Trade and Some Options." *Canadian Public Policy* 8 (October).

Williams, Glen. 1983. *Not for Export: The Political Economy of Canada's Arrested Industrialization*. Toronto: McClelland and Stewart.

Williamson, John. 1983. *The Exchange Rate System*. Washington, D.C.: Institute for International Economics.

Winham, Gilbert. 1978–79. "Bureaucratic Politics and Canadian Trade Negotiation." *International Journal* 34 (Winter).

Wonnacott, Paul. 1972. *The Floating Canadian Dollar*. Washington, D.C.: The American Enterprise Institute.

Wonnacott, R.J. 1975. *Canada's Trade Options*. Ottawa: Minister of Supply and Services Canada for the Economic Council of Canada.

———. 1984. *Aggressive U.S. Reciprocity*. Montreal: Institute for Research on Public Policy.

Wonnacott, P., and R.J. Wonnacott. 1982. "Free Trade Between Canada and the United States: Fifteen Years Later." *Canadian Public Policy* 8 (October).

Wright, Gerald, and Maureen Appel Molot. 1974. "Capital Movements and Government Control." *International Organization* 28 (Autumn).

Young, J.H. 1957. *Canadian Commercial Policy*. Ottawa: Queen's Printer for the Royal Commission on Canada's Economic Prospects.

Young, Oran. 1969. "Interdependencies in World Politics." *International Journal* 24 (Autumn).

Young, Roger. 1983. *Canadian Development Assistance to Tanzania*. Ottawa: The North-South Institute.

Zysman, John, and Stephen S. Cohen. 1983. "Double or Nothing: Open Trade and Competitive Industry." *Foreign Affairs* 61 (Summer).

3

Canadian Export Trade in a Changing International Environment

MICHAEL C. WEBB AND MARK W. ZACHER

Introduction

Canada's is an open economy. Goods, services, and capital flow relatively freely across Canadian borders. International transactions account for a higher proportion of economic activity in Canada than in most advanced industrialized nations, particularly the larger ones. Foreign ownership and control of the economy through foreign direct investment is much higher in Canada than in any other Western industrialized country, and foreign trade accounts for a higher proportion of production and consumption in Canada than in most other developed countries.

The open nature of the Canadian economy brings with it the benefits of access to foreign investment, technology, raw materials, capital and consumer goods, and markets for goods produced in Canada. On the other hand, it also makes the country highly sensitive and vulnerable to conditions in the international economy and to policies of foreign governments, especially those of the United States, which dominates virtually all sectors of Canada's foreign economic transactions. Furthermore, the Canadian economy is too small relative to other major economies to influence international economic conditions or foreign government policies. These factors combine to make autonomous management of the Canadian economy extremely difficult.

Canadians have traditionally believed that, given their country's small population and market relative to its physical size and natural resources, an open economy is necessary for achieving the high standard of living enjoyed in other advanced industrial nations. The open nature of the Canadian economy is also related to Canada's historical development as a colony of Britain and, more recently, to its economic dependence on the United States. The needs and preferences of these dominant countries have been important in encouraging a high level of internationally related economic activity in Canada, and in shaping the nature of Canada's economic development and international linkages.

Canada's export trade is concentrated both sectorally and geographically. While Canada's economy has matured considerably over the years, resources and resource-based products still account for an unusually high percentage of Canada's total exports (see Table 3-1). This has traditionally been seen to create two problems. First, international markets for primary resources such as crude minerals and grains, and resource-based manufactured goods such as primary metals and lumber, tend to be much more volatile than international markets for more advanced manufactured goods. The result is instability and insecurity for resource-dependent regions in Canada and for the economy as a whole. Second, resource extraction and resource-based manufacturing tend to be more capital intensive and less labour intensive than secondary manufacturing. Consequently, resource and resource-based exports are seen to generate less employment than would exports of more advanced manufactured goods.[1]

At the same time, Canadian export markets are concentrated overwhelmingly in the United States (see Table 3-2). As a result, Canada is very sensitive and vulnerable to developments in the U.S. economy and to the economic policies of its government. The trade linkages create worrisome dependencies for Canada and exacerbate problems of domestic economic management.

The sectoral and geographic concentration of Canada's exports have given rise to three central trade policy goals. Political leaders, government officials, and the attentive public are committed to (a) promoting low trade barriers and stable markets for primary commodities in their raw and processed forms; (b) diversifying the content of Canadian exports, particularly into manufactured goods with high value-added; and (c) diversifying the direction of Canadian exports.

With respect to the first of these goals, even before Confederation Canadian leaders sought to negotiate reductions in foreign trade barriers that impede resource exports on a secure and preferential basis whenever possible. In the past decade, considerable attention has been devoted to trying to persuade foreign countries to reduce barriers that discriminate against exports of processed resources in favour of unprocessed resources. Canada has also supported international market management schemes such as the international wheat agreements, the uranium cartel, and the international lead and zinc study group in the hope that these will help to stabilize prices and earnings from important Canadian resource exports.[2]

In an effort to diversify the content of Canada's exports, the Canadian government has implemented a number of programs to assist exporters of manufactured goods. Two of the most important have been subsidized export financing and tied aid, both of which have promoted exports by sectors that the government wants to support, such as services, capital

TABLE 3-1 Share Of Primary Commodities In Total Export Earnings, Selected Countries and Regions, 1965–80

	World	Canada	Developed Market Economies	United States	European Economic Community	Australia and New Zealand	Japan	Developing Countries Excluding OPEC	OPEC
					(percent)				
1965									
Including fuels	39.0	52.6	27.7	32.5	20.3	83.6	7.5	n.a.	97.7
Excluding fuels	29.4	47.5	24.3	29.0	16.2	81.1	7.1	n.a.	15.5
1975									
Including fuels	38.8	48.0	23.3	30.1	19.6	76.8	3.4	63.9	98.5
Excluding fuels	19.4	31.5	18.2	25.9	14.3	64.7	3.0	45.8	3.2
1980									
Including fuels	40.9	42.8	23.8	29.8	21.7	70.2	2.8	55.1[a]	97.0[b]
Excluding fuels	16.9	28.5	16.9	26.0	13.6	61.1	2.4	35.8[a]	3.6[b]

Source: Calculated from United Nations, Department of International Economic and Social Affairs, Statistical Office, *1980 Yearbook of International Trade Statistics, Vol. 1: Trade by Country*. (New York: United Nations, 1981 and 1982).

Note: Primary commodities include Standard International Trade Classification (SITC — revised) categories 0 to 3, which comprise chiefly food, beverages and tobacco, crude materials, and mineral fuels and related materials.

a. Also excluding Mexico, by this time a major non-OPEC oil producer.

b. Including Mexico.

goods and high-technology, advanced manufactures.[3] Canada has given strong support to the liberalized multilateral international trading system and its institutions, primarily the General Agreement on Tariffs and Trade (GATT), throughout the postwar period. Behind this support lies the belief that such a system could enhance Canada's bargaining power, and that

TABLE 3-2 Canada's Main Trading Partners, Selected Years, 1900–84

	Distribution of Canada's Export and Import Trade with:				
	United States	Britain	Japan	European Economic Community	Developing Countries
	(percent)				
1900					
Exports	38.3	52.3	0.1	2.9[a]	—
Imports	60.2	24.1	0.9	10.7[a]	—
1910					
Exports	37.5	49.5	0.2	4.1[a]	—
Imports	61.1	24.3	0.5	7.2[a]	—
1920					
Exports	37.4	39.4	0.6	13.8[a]	—
Imports	75.1	11.8	1.2	2.4[a]	—
1939					
Exports	41.1	35.5	2.5	6.3[a]	—
Imports	66.1	15.2	0.7	4.9[a]	—
1948					
Exports	65.1	15.1	0.2	13.4[a]	—
Imports	76.7	7.4	0.2	2.2[a]	—
1960					
Exports	55.8	17.4	3.4	8.3[b]	7.9
Imports	67.2	10.7	2.0	5.3[b]	11.8
1970					
Exports	64.7	9.0	4.8	7.2[b]	8.6
Imports	71.1	5.3	4.2	5.8[b]	8.5
1975					
Exports	65.1	5.5	6.5	12.6[c]	10.6
Imports	68.0	3.5	3.5	9.5[c]	14.5
1978					
Exports	70.2	3.8	5.9	9.3[c]	10.4
Imports	70.5	3.2	4.6	9.3[c]	11.9

	Distribution of Canada's Export and Import Trade with:				
	United States	Britain	Japan	European Economic Community	Developing Countries
	(percent)				
1981					
Exports	66.2	4.0	5.4	10.7[c]	11.9
Imports	68.6	3.0	5.1	8.1[c]	14.4
1984[d]					
Exports	77.4	2.4	4.8	6.3[c]	8.2
Imports	72.6	2.4	5.4	8.6[c]	10.6

Source: Statistics Canada, *Trade of Canada* (various issues and years); Statistics Canada, *Canada Year Book* (various years).

a. Total for Europe excluding the United Kingdom.
b. Total for six member countries of the EEC.
c. Total for nine member countries of the EEC (including the United Kingdom, Ireland and Denmark, which joined in 1973).
d. January to May 1984.

it holds the best promise over the long term for reducing foreign trade barriers to expansion and diversification of Canadian exports.

Canada has also been willing to turn to bilateral trade management, particularly with the United States, when the multilateral system has been unable to produce desired outcomes. At times, the bilateral discussions have come into conflict with the multilateral thrust of Canadian policy and have even increased Canada's dependence on the United States. For example, in the period immediately following World War II, arrangements to balance Canadian-American trade on a bilateral basis were negotiated to enable Canada to overcome a serious balance-of-payments crisis.[4] In the 1960s, the Canada–United States Automotive Products Agreement created a bilateral free trade area that permitted the automobile industry to rationalize on a continental basis. Interestingly, Canadian negotiators insisted on the inclusion of production and employment assurances in the agreement to ensure that the auto producers did not withdraw from production and sourcing in Canada in favour of supplying the North American market from the United States.[5] As in the cases of Canadian participation in international resource market management schemes, Canadian officials apparently felt a need to intervene to ensure that Canada received its share of the benefits of international trade. They feared that international markets could not be trusted to do this if left free and unfettered.

A final noteworthy characteristic of Canadian trade policy is that it has reflected ongoing debate in Canada over the costs and benefits of Canada's economic dependence on the United States. During certain periods, policy makers have favoured closer ties through freer bilateral trade, while in other periods greater emphasis has been put on diversifying Canada's trading relationships to reduce its dependence on the United States. Proposals for reciprocity with the United States around the turn of the century and the current emphasis on bilateral sectoral free trade are examples of the former strategy. By contrast, the emphasis on expanding links with Europe and Japan during the mid-1970s, the so-called "third option" in Canadian foreign economic policy, is an example of the latter. The issue has always been politically divisive. It has been suggested that support for freer bilateral trade tends to be greater during periods of economic difficulty in Canada, when the public and politicians pay more attention to the presumed economic benefits and less to the political costs. During periods of economic prosperity, trade diversification tends to come into greater favour.[6]

The purpose of this study is to explore the external constraints on Canadian trade. The focus is on Canada's export trade, arguably the aspect of foreign economic relations of greatest direct relevance to the achievement of such objectives as the promotion of economic growth and efficiency, a high standard of living, and maximum employment. Given the relatively small size of the domestic Canadian market, foreign markets are necessary as outlets for the natural resources that have been produced in abundance in Canada. Exports provide opportunities for achieving economies of scale, and they generate export earnings needed to purchase capital and consumer goods not produced domestically. The government has therefore developed policies intended to maximize the benefits and minimize the costs of integration into the international economy.

The remainder of the study is divided into three sections. The next section focusses specifically on those characteristics and trends that encourage barriers to Canadian exports, that is, which influence the level of foreign protectionism. The third section examines those trends and characteristics which affect the ability and proclivity of foreign purchasers to import goods from Canada. While our analysis of each characteristic or trend should promote an understanding of that factor itself, it is also hoped that our attempt to systematically identify and categorize these factors will facilitate a structured discussion of the issues facing Canadian foreign economic policy.

The two sections provide an overview of trends and characteristics in the international political economy that influence the prospects for Canadian exports in all goods-producing sectors. Canadian trade policy is formulated in the context of a wide variety of constraints and opportunities imposed by the wider international political and economic environment. A vast amount has been written about this environment (although much less on its specific implications for Canada), and to do this literature justice would require far more space and time than we have available. Our intention in these sections, therefore, is to briefly identify, describe, and discuss the implications for Canada of the most important trends and characteristics in the international politico-economic system and in Canada's relationship to this system.

The concluding section discusses several policies for promoting Canadian exports. It asks what policy initiatives to diversify and expand Canadian exports can be undertaken with a realistic chance of success in the medium term given international political and economic realities.

Trends That Affect Protectionist Barriers to Canadian Exports

Changing Perceptions of Benefits of Trade Liberalization

Trade liberalization is generally credited in the Western industrialized countries with contributing to the prosperity and rapid economic growth of the 1950s, 1960s, and early 1970s. During most of that period, international trade grew faster than world production, leading to a view of trade as an "engine of growth." There is still a strong commitment among the leaders of most countries belonging to the Organization for Economic Cooperation and Development (OECD) to the principle of an open international trading system. At the Williamsburg summit in June 1983, the leaders of the seven largest Western industrialized nations committed themselves "to halt protectionism, and as recovery proceeds to reverse it by dismantling trade barriers. . . . We should work to achieve further trade liberalization negotiations in the General Agreement on Tariffs and Trade (GATT). . . ."[7] At a more concrete level, the belief in the benefits of a liberalized international trading system and "the fearful risks of undermining an extensive network of trade relationships in which all advanced economies are embedded" have contributed to the widespread reluctance of governments to submit to protectionist pressures from domestic groups.[8]

While the belief in the importance of a liberal trading system to national economic prosperity still encourages policy makers to resist protectionist measures, there is little doubt that the commitment to the maintenance of such a system has weakened in recent years. Decision makers of the 1940s and 1950s, particularly in the United States, Britain, and Canada, were concerned above all with avoiding a recurrence of the breakdown of international trade which they believed had contributed to the Depression, the rise of totalitarian governments, and, ultimately, to war. However, by the 1970s, the "generation of decision makers who remember the problems of the 1930s from personal experience had largely passed from power," and the commitment to principles based on those experiences had thereby inevitably been weakened.[9] In recent years, even the strongest supporters of the liberal trading system among the OECD governments have demonstrated by their actions, if not always by their words, a desire to limit and control the impact of multilateral liberalization. Developing countries, which have become much more significant players in international economic relations, have never been committed to the principle of a liberal international trading system, at least as practised by the Western industrialized countries.[10]

One factor supporting the leaders' commitment to maintain an open international trading system has been the growth of powerful economic actors with a strong interest in international trade in all of the OECD countries.[11] Transnational corporations and international banks have benefitted tremendously from trade and financial liberalization in the post-1945 period, and they tend to oppose government actions that threaten to interfere with their international operations.[12] Export-oriented sectors in virtually all national economies have expanded as trade has grown relative to national production and income in most OECD nations. Transnational corporations producing goods that are both technology intensive and capital intensive have become dependent upon access to international markets.[13] Trade-dependent firms and industries oppose protectionist policies by foreign governments that curtail their exports, as well as similar policies by their own governments, since such actions often raise the costs of their own products and provoke retaliatory action by other states. These groups include some of the largest businesses and employers, who have considerable political influence in most OECD countries.

The combination of a continuing, if weakened, commitment among the leaders of the major industrialized nations, as well as among powerful domestic groups in virtually all countries, to the principle of an open international trading system should be sufficient to ensure that it will not soon "collapse in a final orgy of protectionism."[14] Nevertheless, many current trends do pose significant threats.

Changes in Competitive Advantage

The international structure of competitive advantages which facilitated the trade liberalization of the 1940s, 1950s and 1960s has changed radically during the past two decades. Trade liberalization in the earlier period was facilitated by the fact that only the Western industrialized countries were involved. The developing countries served as sources of raw materials and only rarely competed with industrialized countries in manufactured exports. Also, the East European countries were excluded from the trading system by the Cold War. Among the industrialized countries, competitive advantages were "perceived to depend upon differences in the relative abundance of capital," labour, natural resources, and technology. While competitive advantages were expected to change as the relative abundance of these factors of production changed, it was assumed that these shifts "would be evolutionary, . . . slow, regular and predictable," giving time for countries to adjust.[15] The United States supported trade liberalization largely because it had an overwhelming competitive advantage over its nearest competitors in technology-intensive manufacturing industries.[16] Thus, it believed that freer international trade would provide American manufacturers (and, later, their European counterparts) with access to much larger markets, thus enabling them to capture significant economies of scale.[17]

Multilateral tariff negotiations in the GATT in the 1940s, 1950s and 1960s focussed on cutting tariffs on manufactured goods traded primarily among the Western industrialized countries. The major trading partners all appeared to benefit from rapidly increasing trade. Much of this was intra-industry trade, especially between the United States and Europe; that is, growing imports by each trading partner in one sector were matched by growing exports from the same sector, based on product differentiation and specialization in particular lines. This intra-industry trade facilitated liberalization. Any protectionist sentiment among industry sectors in the United States and Western Europe that faced import competition was neutralized by the increasing export opportunities in foreign markets as a result of GATT negotiations.[18] Sectors in the major trading countries that faced serious import competition without compensating export opportunities were excluded from multilateral trade liberalization from the start. For example, textiles and agriculture were excluded because American producers anticipated severe burdens of adjustment had the U.S. market been opened to foreign countries whose competitive advantage lay in those products.[19]

Of interest to Canada, which had a competitive advantage in mineral production and processing, were the escalating tariffs imposed on processed minerals. These tariffs remained higher than tariffs on manufactured goods because the major Western industrialized countries anticipated that their domestic mineral-processing industries would face increased import competition without experiencing offsetting increases in export opportunities. In other words, the competitive advantage of mineral-producing countries like Canada was felt to be so great that processing industries in mineral-importing countries would contract if their protection was removed.

The characteristics of the international structure of competitive advantages have all changed rapidly in recent years. As a result, shifts in trade today tend to impose much greater burdens of adjustment on importing countries. They also give rise to much more serious domestic political opposition than formerly. Three main changes are of interest to us here:

- the high-tech catch up in Japan and Western Europe to the former supremacy of the United States as international leader in industrial technology and innovation in many sectors;
- the rapidly developing competitive advantages in certain developing countries in many standardized, traditional manufacturing sectors; and

- the "industrial convergence" in certain major industrialized countries which has changed the traditional nature of competitive advantage and the basis for international trade.

Since the implications for Canada's export prospects of the shift in competitive advantage in favour of Japan are very similar to those resulting from the shift to certain developing countries, the implications of both shifts will be dealt with simultaneously after the discussion of the shifts themselves.

Many commentators have remarked on the loss by the United States of its status as the undisputed world leader in industrial technology and innovation. Western Europe and Japan reduced this gap during the 1960s with the help of foreign direct investment by U.S. transnational corporations (TNCs), imported and licensed U.S. technology and, especially in the case of Japan, supportive government policies. Since the 1970s, Japan has increasingly become the world's industrial pacesetter as a result of government industrial strategies aimed at developing international pre-eminence in selected advanced manufacturing sectors.[20] The development of advanced Japanese industry has not encouraged trade liberalization because it has not been accompanied by intra-industry trade to any significant extent. Japan's competitive advantage has been so strong and its domestic market has been so highly protected that Western European and North American industries have generally not experienced enhanced export opportunities to offset the threat posed by Japanese exports to their home markets. The regional and sectoral impacts of and the burdens of adjustment imposed by Japanese exports are therefore much greater, and protectionist sentiment is correspondingly higher.[21]

In North America, protectionist sentiment against Japanese imports is tempered by countervailing pressures; primary commodity sectors in both the United States and Canada have very strong interest in access to the Japanese market and therefore "provide countervailing pressure against restrictionist sentiments from manufacturing sectors." For Europe there are no such countervailing pressures. Europe's exports of primary commodities to Japan are minor, and Europe consequently has taken more vigorous action to block Japanese imports.[22]

The second major change in competitive advantage has been the emergence of the newly industrializing countries (NICs) as producers and exporters of certain high-volume, standard technology, manufactured goods that require relatively large inputs of low-skilled labour relative to capital and natural resources. Textiles, clothing, and footwear were among the first sectors affected by competition from these new producers. To these, the NICs have since added competitive advantages in steel, shipbuilding, automobile parts, consumer electronics, and other relatively simple consumer goods. The range of goods that can be competitively produced in the NICs is expected to broaden further during the 1980s as their technology becomes more widely diffused, capital more abundant, and labour more highly skilled.[23]

The overall employment impact in the Western industrialized countries of trade with the NICs has probably been neutral, as growing exports from certain sectors have compensated for employment losses in sectors that compete with imports from the NICs. Furthermore, the impact of competition from the NICs should not be exaggerated. In 1977, NICs accounted for only 8.1 percent of total OECD imports of manufactured goods and just over 1 percent of total OECD consumption of manufactures.[24] While these shares have certainly increased since 1977, it is apparent that the impact of competition from the NICs on overall manufacturing production and employment in the industrialized countries has been limited, particularly in relation to such other factors as the recent recession and the introduction of labour-saving technologies. Nevertheless, the unemployment problem associated with competition from the NICs in certain sectors has been serious. Job losses are concentrated in labour-intensive industries, and the low skill level of the displaced workers makes it difficult for them to find alternate employment. The concentration of the threatened industries in specific regions has heightened the political sensitivity of the issue, while the "very high and rapidly changing market penetration by specific products which characterizes NIC exports" has helped to focus attention on unemployment caused by exports from the NICs.[25] In Canada, one estimate has put the number of jobs threatened by current or near-term potential competitive pressure from the NICs at close to one-third of total manufacturing employment in 1980.[26]

Canada has been strongly influenced by these shifts in competitive advantage in favour of Japan and the NICs. Most obviously, Canadian manufacturing industries have faced strong import competition from Japan in a variety of more advanced manufacturing sectors, such as autos and electronic equipment, and from the NICs in a wide variety of labour-intensive sectors, such as textiles, clothing, and footwear. Competition from the NICs poses a growing threat to other important Canadian sectors as well, particularly to automobile parts. Furthermore, it threatens Canadian exports of manufactured goods to other developing countries, most of which consist of products such as machinery and transportation equipment for which "increasing export competition from some developing countries [i.e., the NICs] must be anticipated over the longer term."[27] Certain Canadian exporters of manufactured goods have lost their positions in foreign markets to Japanese and NIC exporters.[28] The extent of the loss suffered by Canadian exporters is limited, however, by the low export presence in many of the sectors in which Japan and the NICs have developed their strong competitive advantages. The most significant direct loss of export markets to date occurred during the late 1970s, when Canadian auto exports suffered badly from Japanese auto exports to the United States. However, the loss may have been temporary. In the early 1980s, Canadian exports rebounded strongly as energy prices fell and U.S. consumer demand revived, while voluntary export restraints negotiated between the United States and Japan restricted auto imports from Japan.

Perhaps the more important consequences for Canada's export trade have been indirect. Protectionist pressures stimulated by increased imports from Japan and the NICs into the United States and Western Europe have spilled over to affect competing Canadian exports to the same markets. Steel is the most notable example of this effect; protectionist barriers erected or demanded to defend U.S. producers against stiff import competition from the NICs, Japan, and Western Europe have incidentally also posed a serious threat to Canadian exports. Another indirect effect has been on Canadian exports of resource inputs required by threatened manufacturing industries in other industrialized countries. Again, steel is the most notable example, as Canadian exports of iron ore to the U.S. steel industry and coal to the Japanese steel industry have been restricted by the contraction and slower growth, respectively, experienced by those industries in the face of competition from the NICs. At a broader level, the shift to Japan and the NICs has been one of the most important causes of the weakening of the GATT-centred, multilateral, rule-based liberal international trading system, and thus has influenced the prospects generally for all Canadian export-oriented sectors.

It should be noted that Canada has not shared equally in the recent growth in exports of manufactures to the NICs that have offset growing imports into most OECD countries. Canada and the United States are the only two major OECD countries to have experienced a growing trade *deficit* in manufactures with the NICs during the 1970s, since increased OECD exports to the NICs have come predominantly from Japan, Germany, and Italy.[29] Canada's failure to increase exports at the same rate as imports probably reflects the international weakness of Canadian manufacturing industries in general and the weakness of the capital goods sectors in particular. Thus, while Canada's trade surplus with Japan based on exports of raw materials exerts strong countervailing pressures against restrictions on imports from Japan, there are few countervailing pressures of similar magnitude in Canada's trade with the NICs.

The third type of shift in the international structure of competitive advantage is a product of the phenomenon of "industrial convergence." What this refers to is the "convergence in the industrial structures and underlying resource endowments of the major industrialized countries in recent years."[30] The services sector has become more important and the agriculture, mining, and manufacturing sectors have tended to become less important in all the industrialized countries. Linked to the convergence of industrial structures is the tendency for overall factor endowments to become increasingly similar. Intra-industry trade and specialization, rapid capital accumulation, the acceleration of international transfers of finance and technology, converging labour skill levels, and national industrial development policies pursued by many Western governments have all reduced differences in endowments of capital, labour and technology that traditionally provided the basis for competitive advantage among the industrialized countries.[31] The similarity extends in some respects to the NICs; the international mobility of capital and technology has led to the concentration of the competitive advantage of industrialized countries in those sectors which depend on the much less mobile factor of skilled labour.[32] This has encouraged the convergence of the industrialized countries at the "high-technology end of the manufacturing spectrum."[33]

The consequences of industrial convergence for international trade are profound. "If industrial structures and resource endowments are converging, the unit gains from trade among developed countries will tend to decline."[34] This does not mean that individual firms will not continue to benefit from exports (rather, exports provide important opportunities for achieving economies of scale), but rather that the convergence of factor costs in different countries reduces the gains to national or global welfare from trade. Correspondingly, industrial convergence means that "small changes in cost conditions can potentially cause large shifts in trade, sectoral production and employment."[35] It is precisely these sorts of rapid shifts in competitive advantage that give rise to the strongest protectionist pressures, with which the GATT-centred trading system is least able to cope. On the other hand, industrial convergence is also linked to the intra-industry trade which facilitated trade liberalization in the earlier period by generating cross-cutting pressures (i.e., the same sector is faced with both import competition and export opportunities) and encouraging product differentiation and specialization.[36]

Industrial convergence has also contributed to heightened controversy over the role of governments in international trade. Selective government intervention can easily cause minor shifts in competitive advantage which can lead to major shifts in trade and employment among the industrialized countries.[37] The fact that government intervention in all of these countries is focussed on high-technology sectors makes this issue even more politically sensitive and problematic.[38] More broadly, the declining importance of the traditional bases of competitive advantage has increased the role of social choice and organization in determining trade patterns. Government policies can affect the accumulation of human capital and technological capabilities that underlie competitive advantages. Consequently, "national strategy, not natural endowment, is the key to competitive advantage."[39] Industrial convergence therefore tends to make "obsolete the distinction between ostensibly domestic and international trade policies" since an enormous range of government policies can affect the minor shifts in trade patterns.[40]

The likelihood that changing patterns of international trade will give rise to protectionist pressures under conditions of industrial convergence is high. What is clearly required to deal with the new trading environment is greater transparency of domestic policies that have an impact on international transactions and some guidelines or rules regarding support for exporting industries and domestic adjustment policies.[41] The GATT's guidelines in both of these areas are inadequate to deal with the extent of contemporary governments' involvement in trade sectors. There are also strong philosophical and economic differences among the industrialized countries which have prevented the development of an international consensus. It is therefore likely that trade conflicts and protectionism arising out of the tendency toward industrial convergence will continue to escalate.

The problem of trade conflicts arising out of government industrial policy is especially real for Canada in light of its extensive linkages with the United States. The basic "industrial structures of the two countries and the aspirations for the future evolution of these structures are similar, except in size."[42] Furthermore, by tradition and because of the constraints imposed by the small size and the existing structure of the Canadian economy, Canadian industrial policies usually involve a much greater degree of government intervention than do those of the U.S. government. The latter has become increasingly opposed (especially in principle and rhetoric) to government interference with market forces. Consequently,

> government intervention to increase the competitiveness of Canadian manufactured products in foreign markets will almost certainly be regarded as hostile by a U.S. government trying to achieve the same basic objectives, but from the base of a much larger domestic market and with a government that will not intervene as much to retain international cost competitiveness.[43]

The problem is compounded because Canadian firms must in many cases export part of their output if they are to achieve maximum economies of scale, and the United States is the most accessible foreign market. Canadian government incentives and subsidies to encourage efficient, world-scale operations therefore almost inevitably can be viewed as export subsidies, and the goods exported can be subjected to countervailing duties or other forms of retaliation by the United States.[44]

The Canadian government feels that "it will be important throughout the 1980s to monitor U.S. practice and jurisprudence in the area of countervail and continue our efforts, both bilaterally and in the GATT, to circumscribe the extent to which U.S. countervailing duties can frustrate our industrial and regional development policies."[45] A number of cases of alleged Canadian export subsidies necessitating the application of countervailing duties have been heard in the United States, but their outcomes should not give rise to alarm. In 1973, countervailing duties were imposed on exports to the United States of tires produced at a Michelin Tires plant in Nova Scotia, because federal and provincial regional development funds used in establishing the plant were seen to constitute export subsidies. However, in recognition of the fact that these funds were intended only to overcome the disadvantages of the Nova Scotia location as opposed to an Ontario location, the level of the countervailing duties themselves was quite low (approximately one percent) and they do not appear to have had an adverse impact on Michelin's exports to the United States.[46] More recently, a broad coalition of U.S. softwood lumber producers sought to have countervailing duties imposed on what they saw as subsidized Canadian lumber exports, but U.S. authorities eventually decided (after intensive and high-level Canadian lobbying) that, while certain Canadian federal and provincial government programs did confer benefits on exporters, the subsidy was too small (less than one-half of one percent of the selling price) to merit the imposition of countervailing duties.[47] Also on the positive side, during the Tokyo Round negotiations the United States accepted the need to demonstrate injury to domestic producers before applying countervailing duties, reducing fears that countervailing duties would be applied indiscriminately.[48] Nevertheless, the threat of U.S. countervailing duties or other retaliatory measures does impose a significant constraint on Canadian industrial policies. The need to fight countervailing duty actions initiated by American industries imposes a cost on Canadian industry and government in terms of resources that must be devoted to defending Canadian policies in American courts.

Slow Growth Rates and High Unemployment

The performance of the world economy since the early 1970s has been characterized by: slower growth rates compared with the boom years of the 1950s and 1960s; unpredictable periods of recession and weak growth; uncertainty and instability in a wide range of important economic parameters including interest rates, exchange rates, and energy prices; high unemployment; and (until very recently) high inflation. Most of these conditions are expected to persist in the medium term. Virtually no one expects an early return to the rapid and steady economic growth rates of the preceding decades. We will not discuss the causes of this poor world economic performance (even economists have not been able to reach a consensus on this issue, itself a factor inhibiting policy changes that could help to correct the problem), but rather focus on the political consequences for the international trading system.

The success of the liberal international trading system during the 1950s and 1960s was made possible by "tremendous prosperity in all the key national economies."[49] Trade liberalization was facilitated by economic growth which provided new jobs in new and growing sectors for workers displaced by import competition, technological change, or changing patterns of demand. The availability of these new jobs eased the process of structural adjustment and reduced pressures to protect existing jobs. Conversely, the recent prolonged period of slow, uneven growth associated with weak and distorted patterns of capital investment in most of the OECD countries has made the process of adjustment much more difficult. Weak, uncertain growth means that less favoured sectors face decline rather than simply relative stagnation, and that fewer alternative employment opportunities are being created for labour and capital displaced by import competition, technological change, and reduced demand.[50] The resulting domestic economic problems of unemployment tend to spill over into the international system as governments and publics seek to preserve existing jobs and to find scapegoats for domestic problems.[51] The link between slow economic growth and the spread of protectionism was highlighted in the early 1980s. "Unexpectedly rapid disinflation" generated by the macroeconomic policies of the major industrialized countries, "manifested *domestically* in declining output and rising unemployment, operated *systematically* to spawn new and renewed protectionist measures" and a host of other international economic problems.[52]

The link between slow economic growth and the spread of protectionism is also readily apparent in the Williamsburg Declaration on Economic Recovery agreed to by the leaders of the seven largest industrialized countries in June, 1983. They committed themselves "to reverse [protectionism] by dismantling trade barriers" only as the recovery proceeds.[53] This conflicts somewhat with the position of the GATT Secretariat, which understandably argues that trade liberalization was in large part responsible for (rather than depended on) the economic prosperity of the 1950s and 1960s, and that the present extent of protectionism is one of the main impediments to a healthy economic recovery.[54] No doubt trade liberalization made a contribution to the prosperity of earlier decades, but it is equally certain that, given the realities of domestic politics in the major trading nations, protectionist pressures and barriers will decline only if and when economic recovery takes hold in the major trading countries.

The fact that economic growth rates among the Western industrialized countries have been diverging sharply also threatens to add to protectionist pressures.[55] Most Western European countries came out of the 1981–82 recession much more slowly than the United States, Canada, and Japan. Continued slow growth and high unemployment will maintain pressures on European governments to defend existing jobs by blocking imports. On the other side of the Atlantic, the overvalued U.S. dollar and the strong U.S. recovery have fuelled growing import demand, while export demand has been weakened by the overvalued dollar, slow growth in Europe and elsewhere, and the balance of payments and debt problems of many developing countries. As a result, record trade deficits have been accumulated by the United States in the past two years. These, in conjunction with ongoing pressure from industries threatened by import competition, could lead to the raising of protectionist barriers. A precedent for such action would be President Nixon's imposition of a temporary 10 percent import surcharge in 1971, one of a number of measures intended to deal with growing U.S. balance of payments deficits in the context of an overvalued dollar. It is worth noting that Canada tried but failed to get an exemption from this surcharge even though the measures were directed primarily at European trade partners, not at Canada.[56]

Growing Political Power of Domestic Producers

Domestic producers in foreign countries who face threats of import competition stand an increasingly good chance of having their demands for protection met by political leaders. We will look first at certain characteristics and trends that affect the industrialized countries in general and then at some specific problems in the United States and the European Economic Community (EEC), two markets of special interest to Canadian exporters.

Perhaps the most important source of the political power of domestic protectionist interests lies in the distribution of costs and benefits inherent in trade liberalization itself. The costs tend to be concentrated on specific import-competing industries, while the benefits tend to be distributed widely as marginal improvements to the welfare of very large numbers of consumers and to the performance of the economy as a whole. Inevitably, import-competing sectors are much more willing and able to mobilize in opposition to trade liberalization than are the large numbers of potential marginal beneficiaries to mobilize in favour of trade liberalization. The reverse is also true; those groups standing to benefit from specific measures of protection are much more willing and able to mobilize in favour of their implementation than are the potential losers among consumers to mobilize to oppose the implementation of protectionist measures. This inherent bias against trade liberalization is both reflected and enhanced by a bias in domestic trade policy laws and administrative procedures in favour of import-threatened industries. All countries provide extensive formal and informal channels for the representation of the views of import-competing industries, but in most cases no provision is made for consideration of the interests of those domestic groups (i.e., consumers) that benefit from the imports in question.[57]

The political power of import-competing domestic industries has also been strong in recent years because import competition in most industrialized countries has been disproportionately concentrated in sectors characterized by employment of large numbers of unionized workers. This is particularly true with respect to labour-intensive industries in North America and Western Europe facing competition from Japan and the NICs. These industries have considerable political power because they tend to be concentrated regionally, because there are a large number of jobs at stake, and because the existence of unions facilitates the mobilization of protectionist pressure.[58] Canada could suffer from a spillover effect from such pressures even though Canada has few exports that compete directly with those from Japan and the NICs. The best example concerns the extremely important automobile sector. "Local content" legislation proposed in the U.S. Congress to protect the American automobile industry from Japanese imports would, if applied to Canada as called for by some of its backers, have interfered with massive Canadian automobile and parts exports to the United States.

Many observers have also argued that the cumulative effect of past protectionist policies is to enhance the ability of protectionist interests to have their demands met by policy makers. In other words, "protection tends to spread from industry to industry," in particular through "the creation of political precedents giving other industries a claim to equal treatment."[59] However, the impact of this demonstration effect should not be exaggerated:

> Within a country appeals for protection based on government consistency are only one of many variables affecting an industry's position. Virtually all empirical investigations indicate that other factors, such as size, employment level, geographic concentration, and political organization are far more important.[60]

Domestic producers in the United States, Canada's most important export market, have had considerable success in recent years in having protectionist measures enacted on their behalf despite the commitment of successive presidential administrations to freer international trade. This is largely because of the important role that Congress plays in the making of American trade policy. Congress tends "to be more sensitive to particularistic societal pressures than the President or the Secretary of State" because members of Congress must be highly responsive to the specific economic interests of their constituencies.[61] In the past, the administration was often able to appeal to anti-communist and liberal economic ideology to overcome protectionist pressures emanating from specific groups and their representatives in Congress.[62] These appeals no longer carry the weight they once did, since members of Congress have become widely disillusioned with what they perceive as the unwillingness of America's trade partners in Western Europe, Japan, and Canada to make concessions to American exporters comparable to those made by the United States.[63] Another important factor in growing protectionist tendencies in Congress has been the attitude of organized labour. As a result of the spread of import competition, "most of the American labour movement has become protectionist, giving up a long history of support for free trade."[64] As organized labour has turned increasingly protectionist, so has its closest political ally, the Democratic Party.[65] As a result of the strong political pressure from domestic protectionist domestic groups and from Congress, "the Reagan administration has allowed more restrictive measures in the past two years than any administration since the

1930s."[66] Sectors subject to such actions include steel, colour televisions, automobiles, and consumer electronics.

In the European Economic Community (EEC), the domestic political pressure for protectionism of greatest interest to Canadian exporters comes from farmers. The agricultural lobbies are particularly effective in winning generous domestic price supports, protection from foreign competition, and subsidies for the export of their surplus production. Their success can be attributed to a number of factors: farmers and farming regions carry considerable electoral weight in a number of EEC member countries (most notably France); the Common Agricultural Policy (CAP) is central to the EEC and to hopes for European integration; and farming interest groups have developed highly effective organizations and lobbying skills, based on awareness of their total dependence on EEC policies for their continued prosperity.

Changing Politico-Security Relationships

Among the most important factors encouraging trade liberalization among the Western industrialized countries in the postwar era were the fear of Soviet expansionism and the related fear that communist parties would become powerful in certain Western European countries. These fears encouraged trade liberalization in a number of ways. First, in many nations (but particularly in the United States) it was perceived that lower trade barriers would promote economic prosperity and that economic prosperity would undermine the domestic political appeal of communist parties in Western countries and enable these countries to make greater contributions to the anti-communist defence effort. With this rationale in mind, the American government undertook to lower its own trade barriers in the GATT framework and pushed others to do the same as they recovered from wartime dislocations.[67] Many Western officials also felt that international economic liberalization would encourage peaceful politico-security relations among their countries. Liberalization would make each country's economic welfare so dependent on trade with other Western countries that governments would try to discourage politico-security conflicts from escalating to the point where they could undermine Western economic relations. This tradition of thinking has often been associated with the wartime U.S. Secretary of State, Cordell Hull.

The United States was so concerned about the Soviet threat, particularly in the two decades after the war, that it was willing to trade off access to its market for cooperation by foreign countries on security issues. This was extremely important, since the U.S. market was crucial to the exports of most Western nations, especially Canada. Hume Wrong, Canadian Ambassador to the United States, wrote in April 1948 about how the deepening Cold War was providing greater opportunities for Canadian-American cooperation to promote "the common interests of the two countries (chiefly the political interests of the United States and the economic interests of Canada)."[68] Canadian diplomats successfully appealed to the U.S. administration for exemptions from U.S. protectionism on the grounds of Canada's status as a close ally in the Cold War.[69]

Since the late 1960s, however, not only has there been a very real decrease in the concern that communist parties might come to power because of poor economic conditions in Western Europe and Japan, but also there has been a reduction (until very recently) in East-West tensions and in the fear of a military conflict between NATO and Warsaw Pact forces. These developments have lessened the former high commitment to trade liberalization.[70] The change has been most marked in the United States, previously the greatest proponent of liberalization to further politico-security goals, and has had a direct impact on Canada's ability to achieve its foreign economic policy goals in the 1970s and 1980s. According to one Canadian writer, "Ottawa's calculated support for Washington's sanctions against Iran in retaliation against the Iranian seizure of the American embassy did not produce the hoped-for Senate consent for the fisheries and maritime boundaries treaty." Similarly, support for U.S. policy in Central America did little to dampen American criticism of Canada's Foreign Investment Review Agency and the National Energy Program in the early 1980s.[71] The United States no longer appears as willing to trade off economic concessions, including on trade access issues, for politico-security concessions from Canada or other Western allies.

While there has unquestionably been an erosion of the politico-security pillars underlying the liberalized trade system among the Western industrialized countries, some support is still provided. Most Western governments still recognize that there are good political reasons for promoting economic interactions among their countries and encouraging liberalization as a strategy to achieve this goal. An open Western trading system continues to be viewed by many policy makers as a means of strengthening the Western countries in the face of the threat from the Soviet bloc and as a characteristic that distinguishes the free world from the oppressive, authoritarian Soviet system. While the commitment to these beliefs continues, it has weakened in the past two decades and, if this trend continues, support for trade liberalization among the Western nations may weaken correspondingly.

Weakness of International Leadership

In the two decades following World War II, U.S. leadership was crucial to the development of the liberalized international trading system. The enormous economic and military power of the United States enabled it to persuade other countries to accept the international economic arrangements preferred by the United States. Countries which sought to take advantage of U.S. reconstruction aid and access to the American market, as well as military defence by the United States, had little choice but to accept the condition that they support U.S. proposals for an open international economic system. The strength and relative isolation of the American economy (foreign trade played a minor role in the overall U.S. economy in the 1940s and 1950s) enabled the United States to help finance the reconstruction of its European and Japanese trade partners and to make "disproportionate tariff concessions during the GATT's early stages to induce multilateral tariff reductions and incorporate more states within the GATT."[72] The United States was able to absorb the costs of opening parts of its domestic market to foreign competition. Japan retained its barriers to American goods, while the fledgling EEC erected regional barriers that discriminated against U.S. exports. Moreover, the U.S. security interest in strengthening Western Europe and Japan against Soviet expansion and communist subversion, and its industrial economic interest in expanding into international markets, made U.S. leaders willing to accept the costs associated with reconstruction aid and tariff reduction.[73]

These conditions, which made American leadership of an open international economic system possible, have changed considerably during the past two decades. Some of the factors contributing to the relative decline of U.S. leadership have already been discussed. Despite recent concern in the United States about Soviet military growth, American interest in an open international economic system to strengthen Western Europe and Japan against the Soviet threat has declined as perceptions of the Soviet threat have changed and as the economies of Western Europe and Japan have been rebuilt. The U.S. economy has become significantly more dependent on international trade since the 1960s and it has lost its ascendency in many specific issue areas.[74] More and more sectors of the American economy have come under threat from foreign competition (especially from Japan and the NICs) without experiencing compensating increases in exports. Increased import competition came at a time when the domestic economy was suffering from slow growth, high inflation and unemployment, successive energy crises, and other shocks. These changes have given rise to much stronger protectionist pressures.[75] At the same time, the "lack of multilateral progress in areas where the United States retains a clear comparative advantage," including services and agriculture, has impeded the expansion of American exports.[76] Consequently, the public and political leaders in the United States have become less willing to support a liberalized international trading system unless the other major trading countries become more willing to provide reciprocal concessions that further specific American economic interests.[77]

What all of this means is that the United States is no longer willing or able to unilaterally take the lead or pay the price for an open international trading system. This does not mean, as some have argued, that the system will inevitably erode. As long as there is what one analyst has called a "congruence of social purpose among the leading economic powers," that is, that all perceive a relatively open international trading system to be in their individual and common interests, there is no reason why the system should collapse even though its instruments and details will likely change to reflect changed conditions.[78] What is required is that the major industrialized countries learn to work in concert to provide the leadership and the forward momentum that the United States alone is no longer able nor willing to provide. The Tokyo Round of negotiations under the GATT did show, despite its limitations, that some progress can be made on the basis of more equal bargaining among the major industrialized countries, even in the face of difficult economic conditions.[79] There is also a growing consensus among observers of the international political economy that coordination among the industrialized countries in other economic policy areas is also required if the world economy is to perform sufficiently well to permit the maintenance and expansion of the liberal international trading system.[80] International economic interdependence has become so extensive that what were previously considered purely national macroeconomic policies must now be considered as well for their international implications. They must also be made subject to coordination at the international level if they are not to work at cross-purposes.[81] For example, the concurrent implementation of disinflationary monetary and fiscal policies in all of the major industrialized countries in 1981 had a much greater than expected impact on inflation, economic activity, and growth simply because similar actions taken in different countries worked to reinforce each other. The clash between the expansionary fiscal policy currently being pursued in the United States and the restrictive policies being followed in most Western European countries has led to serious international political disputes arising out of divergent growth rates, high U.S. interest rates, and fluctuating and inappropriate exchange rates. As Sylvia Ostry has written, "there is, . . . because of the powerful and pervasive economic linkages in the world, a mismatch between policy instruments and objectives." National governments acting alone cannot achieve national objectives; "much more systematic consultation and cooperative procedures than now exist have to be established."[82]

International coordination of national economic policies is also needed at the microeconomic level of adjustment policies. Measures implemented by one government to assist domestic industries in adjusting to changing technology or shifts in international comparative advantage can easily be thwarted by actions taken by other governments. For example, the application of countervailing duties by an importing country could negate the application by an exporting country of subsidies intended to ease the transition into new product lines. The likelihood that import competition will lead to protectionist pressures often depends on the ease of adjustment for labour and capital out of the import-competing sector, so measures that encourage that adjustment ought to be sanctioned internationally.[83]

International leadership in all of these areas, whether to maintain and expand the liberal trading system or to coordinate national macroeconomic and microeconomic policies that have important international ramifications, must come from the major industrialized countries. However, it is difficult to see how the United States, the EEC, and Japan will be able to achieve the necessary degree of consensus among themselves in the foreseeable future.

Perhaps the most intractable obstacle to consensus and action is the divergence of views about the appropriate role for government intervention in the economy. The United States, particularly under the Reagan administration, favours limiting government intervention to indirect measures designed to make markets work better. The rationale is that a freely functioning marketplace will ensure, via the invisible hand, the maximization of individual and social welfare. At the other extreme is the view of France and Japan that extensive direct and indirect government intervention is needed to create national competitive advantages in specific industrial sectors and to achieve other economic, social, and political goals. Other industrialized countries tend to fall somewhere in between. The difference in viewpoints is readily apparent in concrete issues such as exchange rates, energy prices, and industrial adjustment.[84] Differences among Western governments over the appropriate role for government in the economy are perhaps more apparent at the level of rhetoric than action, but they do reflect "growing intellectual disarray" among policy-making elites in the Western industrialized world.[85]

A second broad factor making it difficult to achieve consensus leadership among the industrialized countries is the "erosion of national sovereignty" that all industrialized countries have already experienced as a result of international economic interdependence.[86] Greater coordinated leadership by the major industrialized countries would require that each accept some constraints on its own freedom of action in return for the benefits that would presumably come from having some influence over the policies of other countries. They would probably be reluctant to accept such constraints, since all are currently struggling to cope with domestic economic instability and reduced policy-making autonomy attributable to the pervasive domestic impact of international economic transactions.

Another important factor impeding joint international economic leadership and coordination at the present time is the tendency for the major industrialized nations to be "caught up in their own internal social and economic tensions."[87] This is especially true of the EEC. European leaders are still struggling to bring the dream of unity to fruition in the face of difficult domestic and international economic conditions. The priority they attach to intra-European issues makes them reluctant to accept "international constraints [that] may impose too great a strain on the delicate EEC process."[88] There is a feeling among many in Europe itself that "without a renewed and imaginative effort at European cooperation . . . there will be little hope of reaching a satisfactory and stable relationship among the industrial democracies."[89] However, as a *Financial Times* (London) correspondent wrote in the wake of the collapse of the Brussels EEC summit in March 1984, "the growing sense of internal [EEC] crisis will absorb energies that might otherwise be devoted to global economic and political issues."[90]

Finally, the nature of the problems facing the international trading system have not been conducive to cooperative leadership. The emergency international response to the debt crisis in the summer of 1982 was catalyzed by the scale and immediacy of the loan defaults by troubled developing countries. In contrast, the most serious threat to the international trading system comes from the slow erosion of liberal access and the gradual reinforcement of deep-seated domestic rigidities to structural adjustment. Such a slow, undramatic process may never give rise to the fear needed to stimulate action until it is too late.[91] The dangers to Canada of such a breakdown are obvious.

Inadequacies of the GATT Negotiating System

Traditionally Canada has been a strong supporter of the multilateral, rule-based international trading system centred on the GATT. Such a system is believed to hold the best promise of reducing trade barriers that inhibit Canadian exports and to provide certain advantages over a bilateral, power-based system for a small country like Canada in a world dominated by much larger countries and trading blocs.[92] Canada's bargaining power may be greater in multilateral negotiations than in bilateral negotiations with a larger trading partner because in the former setting Canada can "increase its individual leverage by allying itself with other states whose interests may be similar on particular issues in a negotiation."[93] International rules and norms with a multilateral forum to back them up impose constraints on the more powerful countries that go beyond the constraint imposed by the threat of Canadian retaliation.[94] The most-favoured-nation (MFN) principle incorporated into the GATT may also work to Canada's advantage. It enables Canada to benefit from tariff reductions negotiated by other countries without having to offer reciprocal concessions, since concessions offered by one GATT member to another must in most cases be extended to all other GATT members. In consequence, Canada has tended to gain more in terms of access to other countries' markets than it has given up in terms of protection for domestic industries. For example, during the Kennedy Round of GATT negotiations during the mid-1960s, Canada benefitted from the linear tariff cuts negotiated primarily between the United States and the EEC without having to offer reciprocal concessions.[95] Even during the 1970s and 1980s, Canada has benefitted from concessions Japan made on import barriers under pressure from the United States and the EEC, concessions that Canada certainly could not have negotiated bilaterally, given the large Canadian surplus in trade with Japan.[96]

However, the benefits to Canada from the multilateral trading system may have been overrated. Power in the GATT is linked primarily with "the size of domestic markets to which improved access can be offered in a trade bargaining context."[97] The GATT negotiating rounds have all been dominated by the major countries, while smaller countries have found it difficult to negotiate the trade barrier reductions that interest them.[98] Consequently, while Canada has been granted improved access to foreign markets negotiated by other suppliers and then extended to Canada by virtue of the most-favoured-nation principle, it is often not for goods of primary export interest for Canada. Canada therefore has often been unable to negotiate reductions on the trade barrier items of greatest interest to its exporters. For example, the MFN principle ensures that recent trade barrier reductions made by Japan in response to pressure from the United States and the EEC are also extended to Canada. Yet Canada can expect little benefit because the product categories affected are those which the United States and the EEC had targetted for greater exports and which are of little interest to Canadian exporters. Conversely, Canada has been unable to win trade concessions from Japan in its areas of interest, primarily resource upgrading.[99]

The main institution of the multilateral trading system, the GATT, is also suffering from certain problems arising out of its institutional and negotiating structures which tend to constrain its usefulness for Canadian exporters. Most importantly, GATT rules are extremely difficult to amend to take account of changing trade patterns and problems. "The amending process of GATT is cumbersome," while the "voting structure is blunt and subject to abuse."[100] This discourages countries from bringing issues to the GATT and encourages the proliferation of ad hoc bilateral or small-group multilateral agreements which may violate GATT rules and principles.

Certain GATT principles and procedures which were crucial to its earlier successes are also currently impeding progress. The principle of reciprocity, which requires "that a country that benefits from another country's lowering of trade barriers should reciprocate, preferably to an equivalent extent,"[101] has been necessary to make trade concessions negotiated in the GATT acceptable in domestic political terms. However, it has also impeded the negotiation of rule changes in the GATT, because no government wants to have to pay for such reforms with trade concessions, and therefore none will take the lead in pressing for those reforms.[102]

The procedural innovation of massive multilateral negotiating rounds such as the Kennedy and Tokyo rounds has permitted the GATT to make significant progress in liberalizing trade barriers. Furthermore, while these rounds have been under way, participating countries have been constrained from introducing new protectionist measures by the fear that such actions would hurt their bargaining positions in the multilateral trade negotiations. These rounds have also provided a focal point for the mobilization of normally diffuse domestic forces in favour of liberalized trade in the major industrialized countries, which has made it easier for governments to resist protectionist demands.[103] On the other hand, the mechanism of large-scale multilateral negotiating rounds can be extremely slow and cumbersome. In combination with the principle of reciprocity, such rounds encourage countries to save up bargaining chips in the form of tariffs and NTBs that can be traded away for concessions from others in the package deal that will be negotiated. This tendency to wait for the major rounds before making concessions "has stymied even relatively simple issues for years."[104] Consequently, some participants and observers feel that Canada could have made more progress in such areas as petrochemicals, government procurement, and other NTBs in bilateral negotiations with the United States than it did in the Tokyo Round of multilateral trade negotiations.[105] In reference to NTBs in general, one Canadian trade association official expressed the view that, in light of the huge number of countries and measures involved in GATT negotiations, progress "will take too long for Canada."[106]

These weaknesses in its institutional and negotiating structures mean that

> the GATT, which has been called flexible, is actually very rigid. Its flexibility lies in the ease with which parties can evade its rules. Because of the rigidity, it has been impossible to keep the trade rules up to date, and in the face of fast changing international developments we find that almost every rule of GATT is inadequate to the present problems of world trade . . . . The result has been flagrant rule violations tolerated by the GATT community.[107]

It is difficult to envisage how these institutional weaknesses could be overcome in the near future. More concrete international economic problems attract much more attention, while the present climate of strong domestic protectionist pressures in virtually all countries makes an international initiative to reform GATT institutions and procedures so as to promote trade liberalization unlikely.

Proliferation of Protectionist Measures

Escalating Tariffs

The tariff structures in virtually all countries, including Canada, incorporate tariffs on primary commodities that rise as the level of processing rises. This practice encourages the import of resources in their least processed forms so as to capture the benefits of resource processing for domestic industries and workers. While other factors, such as distance from industrial consumers, foreign ownership and corporate strategies, the small size of the Canadian market, and lower transportation costs for bulk commodities as compared with processed products, have all inhibited the development of resource-processing industries in Canada, there is no doubt that escalating foreign tariffs have long constituted "a major obstacle to the further processing" of Canadian resources prior to export.[108] Escalating tariffs have inhibited Canada's ability to increase the value of its exports and to develop a more diversified, industrialized national economy.

Attention devoted to the issue of resource upgrading has focussed on minerals and metals. The existence of escalating tariff barriers helps to explain why the growth of processed mineral exports from Canada has failed to keep pace with the growth of crude mineral exports. While the volume of processed mineral exports from Canada has grown in absolute terms since the 1950s, the share of crude minerals in total mineral sector exports also grew from approximately 15 percent in 1950 to approximately 40 percent by the early 1970s.[109] Much of this growth can be attributed to "a sharp increase in mineral exports to Japan, particularly from the West," most of which are in the form of ores and concentrates.[110] Other resource and resource-based sectors such as petrochemicals and forest products also face escalating tariffs in major foreign markets.

Escalating tariffs and other barriers to the export of processed commodities tend to be more significant in the EEC and Japan than in the United States.[111] This situation presents Canadian trade policy makers with a dilemma; the goal of exporting resources in more highly processed forms would be easiest to realize by encouraging exports to the United States in preference to exports to Japan and Europe, but this would conflict with the desire to reduce Canada's overwhelming trade dependence on the United States.

The Canadian government has long sought to reduce foreign barriers to processed Canadian resource products through bilateral and multilateral trade negotiations, but it has had little success. During the Tokyo Round of the GATT, Canada promoted the idea of sectoral negotiations which would tackle the problem of trade barriers by focussing on particular commodities in all stages of processing rather than on specific highly fabricated end products.[112] However, none of the major OECD trading countries was interested in adopting the sectoral approach, and the Tokyo Round was conducted in the traditional manner. The EEC and Japan made no significant concessions on tariff escalation, leaving Canada with improvements in access only to the U.S. market for certain forest products and nonferrous metals.[113] Canada also pressed hard for commitments to improve access for processed Canadian resources during negotiations in 1976 that led to the signing of framework agreements with the EEC and Japan, but

European negotiators in particular were reluctant to give explicit recognition to this Canadian objective. Both agreements do make vague reference to the Canadian desire to upgrade its resources prior to export, but no concrete commitments were made; and the agreements appear to have had no influence in this area.[114]

Canada's failure to make any significant progress in reducing tariff escalation in the EEC and Japan, and the limited nature of its success in the United States, can largely be attributed to two enduring factors. First, none of these countries has an interest in reducing escalating tariffs in either its own or foreign markets. All are predominantly importers and processors of resource products, so that reduced tariff escalation could only lead to the loss of market shares and employment among their own domestic processing industries. The Canadian government has seen a ray of hope in Japan. "The Japanese government, . . . in the face of declining self-sufficiency, security of supply concerns, environmental problems, and increasing energy prices, has recently expressed renewed interest in the possibility of importing resources from Canada in more processed forms."[115] However, this hope was also expressed in 1974,[116] and the lack of progress since then must raise some doubts about the reality of the shift in Japanese policy. Even with such a shift, it is not clear that Canada would derive significant benefits in competition with the large number of other suppliers seeking shares of the Japanese market.

Second, Canada has little bargaining leverage with which to persuade the major industrialized countries to import more of their resources in processed forms. During the commodity booms and fears of resource scarcity of the 1970s, Canadian leaders felt that they could use Canada's strong position as a reliable supplier of scarce resources as just such a bargaining lever.[117] The lack of significant results in the Tokyo Round and in bilateral negotiations with the EEC and Japan indicates that the strength of that lever was overestimated even in the 1970s. Under current conditions of oversupply in world resource markets shrunken by recession, and severe competition from low-cost producers in the Third World and elsewhere, Canada's bargaining power as a resource supplier is negligible. Barring an unexpected explosion of demand for resource products, this leverage is unlikely to increase in the foreseeable future.

Discriminatory Practices

Non-discriminatory tariff barriers have been replaced over the past two decades by discriminatory, selective non-tariff barriers (NTBs) as the most important trade barrier impediments to international trade. Most existing tariff barriers are currently being reduced as a result of agreements negotiated during the Tokyo Round of the GATT. With a few notable exceptions, such as escalating tariff barriers to imports of resource products in more processed forms, tariffs can no longer be counted as significant barriers to trade among the industrialized countries.[118] However, NTBs (especially of the bilateral, discriminatory, and selective types) have proliferated; various estimates now indicate that as much as 40 percent of world trade is "managed" by NTBs.[119]

Both the declining importance of tariffs and the increasing resort to NTBs can be attributed in part to trade negotiations conducted in the GATT since the late 1940s. The very success of these negotiations in reducing tariff barriers to generally insignificant levels has encouraged governments to resort to NTBs outside the scope of the GATT when they feel it necessary to restrict imports.[120] Associated with this trend is the important shift in emphasis on trade policy measures in all industrialized countries, especially the United States:

> One of the basic assumptions of the trade policy system — from [the late 1940s until the 1960s] — was that the tariff was the central instrument by which the governments of advanced industrialized countries intervened to regulate the flow of imports . . . . One can now see that the Kennedy Round signaled the switch . . . from a commercial policy system centered on the published schedule of rates of duty to what one might call a system of "contingent" protection. We have moved from a system in which domestic producers were protected by tariffs (with some exceptions, such as agriculture, textiles and clothing, and emergencies) to a quite different system in which producers obtain protection when they can make a legal or political case for it.[121]

Such a case could be made on the grounds of dumping, unfair trade practices, or injury to domestic producers.[122] The shift to contingency protection is in part a consequence of the rapidly changing international structure of competitive advantages discussed earlier. Fixed tariff schedules were obviously more appropriate in a period of slowly changing competitive advantages and stable exchange rate relationships, while contingency protection measures are more likely to be used in a period such as the present when rapid, major shifts in competitive advantage and exchange rates have immediate effects on trade patterns.

The most prominent forms of NTBs in recent years have been the so-called voluntary export restraints (VERs) whereby exporting countries "voluntarily" agree to restrict exports to certain markets in the face of threats by the importing countries to impose more severe import restrictions. Most VERs have been targetted at Japan or the NICs. Their popularity among importing countries can be attributed in large part to the fact that they are outside the scope of GATT rules, which prohibit restrictions on discriminatory or selective bases and require reciprocal imposition of higher barriers to the exports of the initiatory state.[123]

Other increasingly popular NTBs include subsidies to import-competing and export-oriented domestic industries, private international industrial cartels tolerated and supported by governments, government procurement, trade-distorting investment policies and other measures, some of which are detailed below. Like VERs, these NTBs are often selective and discriminatory and are usually applied in such a manner as to evade GATT rules. Taken together, the proliferation of NTBs represents a major retreat from the principles of multilateralism, transparency, and non-discrimination that underlie the GATT-centered international trade system.[124] As the GATT secretariat has pointed out,

> as against quantitative restrictions, non-prohibitive/ non-discriminatory tariffs are an instrument of liberal trade policy. They make the degree of protection readily apparent, and they do not prevent *changes* in international competitiveness from affecting the pattern of production and trade.[125]

This trend in global protectionism poses a serious threat to the continued existence of the multilateral, liberalized trading system. "The rapid proliferation of practices not covered by the GATT contributes to the perception that the GATT system is inflexible and therefore is ineffective in dealing with [trade] problems. The tendency is [increasingly] to circumvent the GATT entirely and to rely on bilateral solutions to multilateral problems."[126] As more and more countries successfully evade GATT rules and procedures, the credibility of the system suffers, the constraints felt by the major trading countries become weaker, and the "belief that trade problems touching on GATT rules should be studied and resolved within its forums no longer has the bite it once had."[127] But more than the rules and institutions of the GATT itself are at stake; the world trading system is threatened with slow erosion as trade barriers and the domestic structural rigidities they serve to protect continue to accumulate, necessitating ever-increasing measures of protection.[128]

The dangers for Canada posed by the growth of discriminatory NTBs are obvious. To date, most VERs and similar bilateral discriminatory protectionist measures have been aimed at exports from Japan and the NICs in a fairly narrow range of manufacturing sectors, most of which are suffering from worldwide surplus capacity.[129] While Canada has occasionally suffered from the spill-over effects of these actions (e.g., steel in the United States), Canadian manufacturing industries generally do not have the competitive edge that would make them likely targets of VER-type protectionism. However, Canadian observers stress that the U.S. system of contingency protection (including anti-dumping and countervailing duties, and safeguards actions to counter injury to domestic producers) poses one of the most serious threats to Canadian exports.[130] While the visible impact of such measures on existing Canadian exports has not yet been dramatic, a wide range of Canadian exports have been threatened by contingency protection measures demanded by American industries, and considerable industry and government resources have been diverted to lobbying in the United States against the imposition of such measures. More important have been the indirect effects; Canadian firms have been forced to locate production facilities in the United States to get around U.S. NTBs and to neutralize the threat of contingency protection actions, while others have decided to voluntarily limit exports to the United States to avoid becoming a target of U.S. contingency protection.[131]

At a more general level, the weakening of the multilateral rule-based trading system poses a serious threat to a relatively small trading country like Canada in the longer run. Multilateral rules and procedures that impose constraints on the freedom of action of larger countries tend to benefit disproportionately those smaller countries that would tend to lose in unconstrained bilateral dispute settlement and negotiation. If the trend toward evasion of GATT rules persists, Canada could find itself subject to more demands for bilateral trade negotiations from its much larger trading partners, the United States, the EEC, and Japan. If the conventional wisdom about bilateral bargaining between vastly unequal partners holds true, the result could be significantly less favourable market access conditions.

Import-Substituting Strategies

Many Third World countries have erected high tariff and non-tariff barriers in order to encourage the development of national industries in the shelter of a protected domestic market. "National development plans and shortage of foreign exchange [also] lead most developing countries to restrict access to their markets" and to use a variety of administrative measures to channel imports into sectors which have priority in their development plans.[132] Interestingly, as part of their import-substituting industrialization (ISI) strategies, a number of developing countries have introduced escalating tariffs on primary commodities to encourage domestic processing.

The restrictive ISI policies of the developing countries have been legitimized in the GATT. In recognition of their special problems, developing countries have been exempted from certain GATT rules. The Tokyo Round agreements, concluded in 1979, expanded the scope of restrictive policies considered legitimate within the GATT. Of greatest interest here were provisions exempting developing countries from the obligation to offer reciprocal tariff concessions in return for those extended by the developed countries. The Tokyo Round revision thus gave developing countries "wide latitude in imposing trade restrictions to promote industrial development," along with exemptions from most of the provisions of the NTB codes agreed to in the Tokyo Round.[133] Canada, along with most other Western industrialized countries, has supported the concept of "graduation," whereby developing countries that have reached an appropriate level of industrialization (primarily the NICs) would "start assuming obligations commensurate with the benefits they derive from the open multilateral trading system. This would mean progressive withdrawal of preferential treatment and a gradual opening up of their markets to foreign goods and services, in conformity with GATT rules."[134] However, graduation is unlikely to be accepted by the developing countries until the industrialized countries accept some constraints on their freedom to impose discriminatory restrictions on imports of those goods in which developing country suppliers have a competitive advantage.[135] Since that is not likely to happen soon, trade barriers blocking access to markets in the developing countries will remain high in the foreseeable future.

Government Procurement Regulations

As government expenditures have grown both in absolute terms and as a proportion of total national expenditures, government procurement policies have become increasingly important non-tariff barriers to trade. National, regional, and local governments in all countries give varying degrees of preference to national (or, as in Canada, provincial) suppliers and use government procurement to promote a wide range of economic and social objectives.[136] Of particular importance to Canada are those policies favouring national suppliers of the advanced technology manufacturing sectors that all governments are seeking to promote. Much of the demand for equipment from such industries as urban transportation, telecommunications, power generation and transmission, and aerospace comes from government agencies or government-owned corporations such as utilities, telephone companies, and defence departments. Consequently, competitive Canadian suppliers of these goods find their access to foreign markets severely restricted by foreign government procurement policies which favour national suppliers.[137] One oft-cited example of such policies impeding Canadian export efforts is the Surface Transportation Assistance Act passed in the United States in 1978. This act "gave subsidies to municipalities for modernization of their urban transit systems, provided their purchases were assembled in the U.S." Even though Canadian urban transportation equipment often has high U.S. content, this act has "seriously cut back Canadian sales in the American market."[138] Another example outside the advanced manufacturing sector was the ban imposed by the United States on the use of foreign-made cement in highway and bridge reconstruction programs financed by federal and state governments between 1982 and early 1984.[139] While attention in Canada has focussed on U.S. government procurement policies because of the proximity and importance of the U.S. market to Canadian exporters, the problem is worse in Europe and Japan where government procurement policies are more restrictive and less transparent.

The GATT has not been able to deal effectively with this problem. The Tokyo Round accords of 1979 included an Agreement on Government Procurement, which sought to deal with this serious NTB. However, agreement was reached on the code only by excluding most government agencies and purchases from its scope! For example, only 15 percent of U.S. government purchases are covered by the code, and government purchases of transportation equipment, power generators, and telecommunications equipment (all areas of prime interest to Canadian exporters) are all excluded from the scope of the code in the EEC.[140] Even though Canada itself uses discriminatory government procurement policies to assist domestic industries, the government would have preferred a more extensive government procurement code and will seek in future discussions to broaden the coverage of the agreement.[141]

Government Assistance to Industries

With high-technology industries increasingly seen as the key to future prosperity and to the expansion of exports, governments in all industrialized countries are intervening extensively to promote the development of their high-technology sectors. Canada is no exception. But the policies chosen to implement such strategies tend to reduce export opportunities for these industries regardless of the potential exporter's competitiveness. The threat comes not from tariff barriers so much as from subsidization of import-competing industries, or government procurement policies (military or civilian) that give preference to domestic suppliers, and subsidies to potential exporters.[142]

Canada is at a significant disadvantage in this area compared with the United States, Japan, and the EEC. Because the Canadian market is relatively small, Canadian industries of efficient size must often export a part of their output. Consequently, if the Canadian government wants to subsidize the development of a particular industry, it runs the risk of retaliation from the major industrialized countries for what they perceive as injurious subsidized exports. Retaliation of this kind is sanctioned by GATT rules. By contrast, the markets of the United States, Japan, and the EEC are sufficiently large to support industries of efficient scale producing only for the domestic market. These countries can therefore subsidize the development of particular industries to produce only for the domestic market without running the risk of retaliation against export subsidies. Subsidies for import-competing industries do not violate any GATT rules, even if they seriously injure exporters from other countries such as Canada. This bias in the rights and obligations of the GATT puts Canada and other small countries at a serious disadvantage in the area of industrial development policies.[143]

The Canadian government is concerned that "foreign government practices restricting competitive Canadian exports of advanced-technology products and services [are seriously impeding Canada's efforts to build] upon its areas of international strength."[144] Foreign governments can and do make the same criticisms of Canadian policies. The national prestige invested in these industries is so great, and the attachment of all Western industrialized countries to high-tech as the way ahead from current domestic economic problems is so strong, that the likelihood of any of these countries accepting significant constraints on their freedom to subsidize and protect their national high technology sectors must be rated as very low.

Extensive government intervention has also exacerbated trade conflicts because of disagreement among the major industrialized countries regarding the legitimacy of various forms of government intervention. Specifically, the United States has been moving toward less government intervention and regulation (especially at the level of rhetoric), while Western Europe, Japan, and Canada have maintained or increased their traditionally more extensive government intervention and regulation. This leads to attacks by the United States on foreign government trade-related intervention which it feels is unfair and illegitimate. Since GATT rules are premised largely on the assumption of economic decision making by decentralized, private actors, they provide inadequate guidelines for the resolution of conflicts involving government-owned firms or firms that are directly assisted by governments. Growing economic interdependence has increased the range of government policies that have international ramifications, bringing the issue of government intervention to the forefront of international discussions.[145]

Countertrade

Countertrade involves linking the importation of goods and services to agreement by the exporting firm or country to take part or full payment in goods rather than in cash. The most common forms today are counterpurchases and industrial compensation arrangements. The former "link the value of exports and the value of imports of unrelated products transaction by transaction" by means of separate yet linked parallel contracts. "Import compensation arrangements link exports and imports of related products." Exports of industrial machinery and managerial and technical services are initially financed with export credits which are repaid in part or full over a number of years with goods produced by the exported equipment and services.[146]

Modern forms of countertrade originated in Eastern Europe, but have been adopted by an increasing number of developing countries in recent years. Countries use countertrade as a device to overcome hard currency shortfalls and balance-of-payments deficits, to assist industrial development programs by creating new markets in industrialized countries for manufactured goods, to overcome a lack of marketing skills among potential exporters, and to maximize their bargaining leverage with Western suppliers. The OECD has estimated that a maximum of 15 to 20 percent of Western trade with Eastern Europe and over 40 percent of Western trade with developing countries is covered by countertrade arrangements. The importance of countertrade in East-West and North-South trade is more important than these figures would indicate because demands for countertrade are most frequent in sales of machinery and industrial equipment, areas of particular interest to the West.[147] Furthermore, the hard currency shortfalls of the Eastern European countries and the balance of payments deficits of many developing countries have been getting much worse since the late 1970s, and demands for countertrade can therefore be expected to become more frequent and harder to meet.

The Western industrialized countries have acceded to these growing demands for countertrade despite their almost universal dislike for what they view as "a regressive trading practice."[148] One reason is the heightened competition for export markets at a time of generally weak international demand, particularly for the products of the advanced manufacturing sectors that all industrialized countries are trying to promote. If demands for countertrade are not accepted, the buyer can often switch to alternative suppliers.[149] The second main reason is that many developed countries have used countertrade arrangements to ensure security of supply for essential raw materials or industrial inputs.[150]

While countertrade is certainly not the most pressing international trade issue, it does pose some very real problems for Canada. "Until recently, Canada managed to avoid the complications of countertrade because its exports of food and raw materials generally have a high priority in the developing countries and that usually means a cash sale." However, the balance of payments problems of many developing countries have deteriorated to the point where even Canadian resource exporters are facing more and more demands for countertrade.[151] The growth of countertrade raises a number of issues of concern. First, representing as it does a return to bilaterally oriented, discriminatory, barter-type trade practices, its expansion threatens the progress made toward an open, multilateral world trading system since 1945.[152] Second, demands for countertrade constitute a sort of non-tariff barrier to trade, because they greatly increase the complications, risks, and transaction costs associated with export trade. These barriers pose a particular problem for small and medium-sized companies.[153] Third, from Canada's perspective, they confer a non-economic advantage on those countries that have a stronger tradition of direct state involvement in foreign trade, have greater experience with countertrade, and are for various political reasons preferred as suppliers by the importing country. Fourth, the increasing use of countertrade arrangments poses a direct threat to Canadian mineral exports. France, Germany, and Japan have taken the lead in arranging "develop-for-import projects" in resource-rich developing countries. The former supply capital equipment and project financing and are repaid with the resulting output. The most important minerals to date have been (in descending order of volume) iron ore, nickel, manganese, bauxite and alumina, aluminum, copper, chromite, and tungsten.[154] Most of these minerals are also exported by Canada.

On the positive side, some analysts have argued that countertrade agreements are trade-creating, in that bartering goods for goods enables countries facing foreign exchange constraints to import more than they otherwise could. Furthermore, trade flows dependent upon countertrade can be more stable than flows dependent more directly upon market conditions and the ability to pay in cash.[155] Whether or not Canada can benefit from this trade creation depends on the willingness and ability of business and government to adapt to countertrade.

Trends That Affect the Ability and Proclivity of Foreign Purchasers to Buy Canadian Goods

Economic Growth Rates

The weak performance of international trade in recent years is undoubtedly due in large part to the slow economic growth in the major industrialized countries. Barring a total collapse of the liberalized trading system, "changes in the level of trade reflect primarily underlying demand conditions" in the major industrialized countries which account for the bulk of world economic activity and trade.[156] "Studies of the recent stagnation and (in 1982) actual decline in overall world trade reveal no significant causal factor other than the recession itself."[157]

Canada's export trade has been directly affected by the recession in its major foreign markets. Total exports stagnated during 1981 and 1982, but picked up strongly in 1983 and early 1984 as the industrialized world began to pull out of the recession. Even more revealing of Canada's dependence on international growth rates is its export performance in various markets. Exports to the United States, Japan, and certain other high-growth Asian countries have grown rapidly in the past two years in parallel with the relatively rapid growth of the domestic economies of these countries. Exports to Western Europe, on the other hand, have been declining since 1980, primarily as a result of slow growth rates and the relatively weak recovery to date in most Western European economies.[158]

For a variety of reasons, including market structures and the importance of recession-sensitive construction and capital spending in total demand for resource-based goods, recessions tend to hit exports of resource-based goods harder than those of manufactured goods. The relatively high proportion of resource-based goods in Canada's total export trade makes it especially sensitive to economic growth rates in foreign markets. This is evident from a sectoral breakdown of Canada's export trade performance during the recent recession. In 1981 and 1982, exports of primary commodities (most notably forest products and non-fuel minerals and metals) dropped sharply, while its exports of manufactured goods continued to grow, albeit slowly.[159]

Slow economic growth rates also have a secondary indirect effect on export prospects. Because competition for available foreign markets intensifies when those markets shrink, export revenues drop even if volumes are maintained. This leads governments to expand their support for export-oriented industries in all countries. In particular, governments of industrialized countries have frequently provided subsidized export financing to promote sales of agricultural produce and capital goods in foreign markets weakened by the recession.[160] Certain Third World countries have been accused by Canadian mining firms and the Canadian government of subsidizing mineral exports in order to maintain employment and export earnings in the face of weak international demand.[161] The preliminary findings of a research project commissioned by the Centre for Resource Studies at Queen's University, however, suggest that the true level of support given by Third World governments to their mineral industries may be no greater than that given by the governments of industrialized countries (including Canada) to their mineral exporters.[162]

It should be apparent from this brief discussion that the future course of economic growth rates in those countries that absorb major shares of Canadian exports are of absolutely critical importance to Canada's export prospects. At present, most forecasters are predicting a continuation of the relatively slow and uncertain growth rates (compared with the 1950s and 1960s) that have characterized the past decade. Exceptions to this trend include Japan, certain South-East Asian countries, and the United States, although it is uncertain whether the rapid recent growth rates in the United States can be maintained in the face of huge budget and trade deficits, high interest rates, and an overvalued dollar.

Third World Debt Repayment Problems

During the 1970s, a number of developing countries, most of which are in Latin America and can be classified as NICs, borrowed heavily from private Western banks thus beginning an international debt repayment crisis. Their total indebtedness and debt-service ratios rose dramatically, and the resulting debt problems reached a crisis point in mid-1982.[163] Rising interest rates since the late 1970s led to spiralling debt service costs at a time when recession and growing protectionism in the Western industrialized countries was limiting export earnings needed to service foreign debts and to finance essential imports. A rash of reschedulings and other emergency measures since 1982 have allowed debtor countries to avoid default, but the longer-term problem has not been successfully tackled. Total Third World foreign debt now stands at approximately U.S. $700 billion.[164] The debtor countries must still devote a very high proportion of their export earnings to debt service obligations, and upward pressure on interest rates has sparked renewed concern about the threat of default. Domestic austerity programs (imposed in some cases at the behest of Western governments and creditors) have triggered political unrest and recessions in some of the major debtor countries, thereby eroding their ability to repay foreign debts. Growing dissatisfaction in the debtor countries with the sacrifices required by Western creditors and with the net transfer of resources out of developing countries has revived fears of a "debtors' cartel."[165]

The problems for Canada's export prospects arising out of Third World debt problems are threefold. First, because deeply indebted developing countries have been forced to severely curtail imports from the industrialized countries in order to free up scarce export earnings to meet debt-service obligations, imports by all developing countries have declined in volume by about 4 percent in 1982. "In a few cases, the decline in imports was particularly abrupt, because of a sudden contraction in credit or as part of a debt rescheduling programme. This was particularly so in three Latin American countries, Argentina, Chile and Mexico, imports into each of which were nearly halved in value in 1982."[166]

For Canada, the impact of import cutbacks/curtailment by indebted developing countries was fairly severe because these countries had become quite promising export markets. Over the past decade, "developing countries increased in importance as trade partners for Canada to the point . . . where they now buy more of Canada's manufactured exports than Western Europe and Japan combined."[167] A large proportion of these exports have gone to countries that are now experiencing severe debt repayment problems, and Canada's exports have suffered. Exports to Mexico, Venezuela, and Argentina (three of the most seriously indebted developing countries) peaked in 1981 after a few years of rapid growth at $968 million, but have since fallen to only $452 million in 1983. Most of the lost exports have been capital goods, machinery, and equipment, as the debtor countries have been forced to cancel major capital goods projects and to divert funds to debt repayment. Canadian exports of foodstuffs and other essential raw materials have held up much better than exports of manufactures. Exports to Brazil consist mainly of wheat, potash, sulphur, coal, newsprint, and other goods which Brazil requires but cannot produce itself, and have actually increased in 1983 to a level slightly above that of 1981 (after a slight dip in 1982).[168]

Second, Canada faces a danger that creditor countries like the United States could decide to increase the export earnings of the major debtor countries in order to enhance their ability to repay their foreign debts, by diverting some trade away from Canada. Concern has been expressed that creditor countries are tending to increase their imports of minerals from debtor countries like Brazil, Mexico, Argentina, and Chile to the detriment of Canadian suppliers.[169]

Third, while fears have receded somewhat since 1982, there is still a (most would say remote) danger that a default by one or more of the most heavily indebted developing countries could seriously damage the international banking and financial systems. If this were to happen, it could result in a serious international liquidity shortage associated with a retreat by private banks from international lending even to credit-worthy countries and firms. Since a well functioning international financial system is virtually a prerequisite for international trade, this could lead ultimately to a contraction of world trade commensurate with the seriousness of the international financial problems.[170]

Export Subsidies

Governments in all industrialized countries have become deeply involved in official export credit programs. These programs were initially established to insure private exporters and lenders against commercial and political risks associated with exporting to often unfamiliar markets, but they soon developed into an element in international competition for export sales. The attractiveness of the financing offers extended by exporters and their governments became especially important to successful bidding on very large, long-term contracts for turnkey plants and major resource development projects that private lenders are reluctant to finance.[171]

The recession of 1974–75 intensified competition for capital goods exports among the industrialized countries, and government-subsidized export financing became much more prevalent. In 1976, an informal consensus was reached among the seven major industrialized countries on guidelines to control the increasingly costly and trade-distorting competition in export-credit terms. In 1978, the guidelines regarding minimum interest rates, maximum maturities, and other export credit terms were broadened and incorporated into an Arrangement on Guidelines for Officially Supported Export Credit by the Organization for Economic Cooperation and Development (OECD). However, the minimum interest rates specified in the arrangement soon became the norm, and the element of subsidy in official export credits spiralled as market interest rates rose during the late 1970s and early 1980s and as the recession and slow growth in the industrialized countries heightened competition for shrunken markets. By 1981, the annual total OECD export credit subsidy was estimated by the International Monetary Fund to have reached US $7 billion.[172] The minimum rates specified in the arrangement were revised upward in 1981 and 1982, but the subsidy element remained high.[173] In October 1983, agreement was reached on a more complex arrangement that included a new schedule of minimum interest rates tied more closely to market rates; if it is respected by the signatories, this agreement will gradually lead to a narrowing of the differential between market rates and official export credit rates.[174] At the time of the agreement, however, the problem had already receded somewhat as market interest rates had dropped substantially from the very high levels of 1981 and 1982.[175]

Attempts to introduce stricter controls on the use of subsidized export credits have been impeded by widely divergent views on the appropriateness of government-subsidized export finance. Canada and the United States run commercially oriented programs and have objected to the shift toward government-subsidized export credits. Certain European countries, however, particularly France and Italy, have viewed subsidized export credits as a legitimate tool to promote exports and to overcome the advantage given to North American exporters by easy access to the very large North American capital market.[176]

Canada has introduced costly export credit subsidies through the Export Development Corporation, the Canadian International Development Agency, the Canadian Wheat Board, and other agencies to ensure that Canadian producers are not placed at a disadvantage in export markets and to help Canadian manufacturers make the foreign sales they need to achieve economies of scale. The need to provide subsidized export financing to remain competitive imposes a heavier burden on Canada than on other industrialized countries. Canada is much less wealthy in absolute terms and, because of its unusually high dependence on exports, has a wider range of exports that might require export subsidies.[177]

Two categories of Canadian exports have been affected or threatened most seriously by foreign government export subsidies. The first is exports from the advanced manufacturing and capital goods sectors that all industrialized countries are seeking to promote. Foreign aid funds are often used to subsidize export of such goods to developing countries.

The second category is agricultural goods, especially wheat. Governments have long used export subsidies (not all of which take the form of export credits) to help dispose of agricultural surpluses generated by domestic farm price or income support programs. In recent years, the biggest threat to Canadian wheat exports has come from export subsidies by the European Economic Community (EEC) under its common agricultural policy and from U.S. moves to match EEC export subsidies. The EEC has refused in successive rounds of negotiations under the General Agreement on Tariffs and Trade (GATT) to restrict the use of export subsidies which enable it to dump surplus domestic production on world markets.[178] In order to pressure the EEC to limit its subsidized foreign sales, the United States has made a number of well publicized sales in traditional EEC markets with the assistance of generous export credit subsidies. This development has alarmed Canadian exporters and trade officials even though the United States has assured Canada and others that its subsidized sales will not affect the sales of nations whose exports are unsubsidized. An all-out grain export subsidy war between the United States and the EEC could prove very damaging for Canada, which simply could not afford to match the subsidies offered by its much larger competitors. While the likelihood of such competition developing is limited by the costs to the two main protagonists and by the threat of EEC retaliation against very large U.S. exports to the EEC of feedgrains and soybeans, any continuation of grain export subsidies will undoubtedly cut into Canadian sales and depress prices and earnings.[179]

Exchange Rate Constraints

The competitiveness of Canadian exports in foreign markets is affected critically by the international value of the Canadian dollar. A lower dollar value tends to enhance Canadian competitiveness, while a higher value tends to reduce competitiveness. This has led many commentators to call for devaluation as a measure to increase Canadian exports (and to increase the cost of imports, thereby providing some protection for domestic import-competing industries).

As a result of the transition of the international financial system from a regime of fixed exchange rates to one of floating exchange rates since the early 1970s, exchange rate movements in the short and medium term are now dominated by changes in relationships between real interest rates in the different countries.[180] Consequently, if a government like Canada's seeks to devalue its currency in order to enhance the international competitiveness of its exporters, the primary means by which it can do so is through the use of monetary policy levers to influence interest rates.[181] Less restrictive control of the rate of growth in the supply of money would tend to lower interest rates, thereby reducing the international value of the Canadian dollar as individuals and firms withdraw liquid funds from Canada and seek higher-yielding investments abroad. However, several drawbacks militate against such exchange rate manipulation. They include the integration of the Canadian and American capital markets, the dependence of governmental and private borrowers in Canada on U.S. and other foreign capital markets, the implications of monetary and exchange rate policies for other economic policy areas (notably inflation), doubts about the impact of devaluation on the trade balance, and international commitments. A few words on each of these factors are in order.

Capital flows virtually unrestricted across the Canadian-American border. Extensive cross-border corporate links and the expansion of financial institutions from each country into the other have facilitated rapid cross-border financial transfers. Analysis of recent cross-border capital movements has shown that for every one percentage point shift in the difference between Canadian and American interest rates, $400 million of short-term capital crossed the border in three months. It was recently estimated that "there was $133 billion of interest-sensitive capital in Canadian banks that could take flight in . . . anticipation of lower interest rates or the devaluation that would ensue."[182] This indicates that a move to lower interest rates to devalue the dollar could trigger an unmanageable downward spiral as investors sought to unload investments denominated in Canadian dollars that were losing their value. The integration of the Canadian and American capital markets means in a more general sense that Canadian macroeconomic policy makers must be extremely sensitive to trends in U.S. macroeconomic policies and to the implications of their actions on investor perceptions.[183] Other countries with floating exchange rates are also highly sensitive to trends in the United States — witness European concerns in recent years about very high U.S. interest rates. However, the problem for those countries is less severe than for Canada because the integration of the American and overseas capital markets is less extensive than that of the Canadian and American markets.

Canada's foreign debt is massive. It is attributable in part to extensive foreign direct and portfolio investment in Canada but, during the 1970s, was due mainly to foreign borrowings by the federal and provincial governments, Crown corporations, and public utilities. The debt service burden associated with these borrowings has grown rapidly; net outflows of interest by all borrowers amounted to $11.6 billion in 1983, up from $5.6 billion in 1982. Since most of the debt is denominated in U.S. dollars, any decline in the value of the Canadian dollar relative to the U.S. dollar adds enormously to debt repayment costs. This situation has served as a powerful incentive to maintain the value of the Canadian dollar close to that of its U.S. counterpart.[184]

Monetary and exchange rate policies have implications in a variety of non-trade policy areas which must be taken into account in the overall determination of such macroeconomic policies. These other implications may outweigh trade-related considerations. In particular, policy makers have viewed restrictive monetary policies and high interest rates as useful policy instruments for reducing inflation, an objective accorded a high priority by the Canadian government since the mid-1970s. Canadian policy makers fear that relaxed control of the supply of money and lower interest rates intended to lower the value of the Canadian dollar would rekindle inflation. A lower dollar itself would add inflationary pressure, as it would increase the cost of imports, enable domestic firms to raise prices by giving them increased protection from foreign competition, and "weaken management's resolve to resist inflationary wage demands" by enabling "wage costs [to] be passed on in higher prices without endangering markets."[185]

There are also serious doubts among Canadian policy makers that devaluing the Canadian dollar would have the desired effect.[186] This is in part because the consequences of the devaluation for trade performance depend crucially on the reaction of private corporate actors whose behaviour is beyond government control. As is discussed in more detail below, a high proportion of Canada's external trade consists of intra-corporate transfers within transnational corporations, which are not very responsive to short-term changes in the value of the Canadian dollar. Additionally, many of Canada's resource-based exports are priced on world markets in U.S. dollars. This means that, while a devaluation of the Canadian dollar relative to the U.S. dollar would increase the profitability of Canadian resource exporters (whose costs are measured largely in Canadian dollars), demand for Canadian resources would not necessarily increase.[187] Furthermore,

> there are secondary or indirect effects [of devaluation] which typically run counter to the direct effects. For example, an improvement in the trade balance following a depreciation serves to raise employment and output in Canada. This in turn raises the demand for imports and dampens the initial improvement in the trade balance.[188]

Similarly, if devaluation was accompanied by an increase in inflation, the rise in prices in Canada would soon offset the improvement in international competitiveness resulting from the devaluation.[189]

Finally, diplomatic considerations also inhibit moves to devalue the Canadian dollar. Competitive devaluations are widely viewed as having worsened the Depression of the 1930s and were one of the kinds of state behaviour proscribed by the post-1945 international monetary system. Consequently, "deliberate action to force the exchange rate down in order to gain a competitive advantage would run counter to international commitments and would encourage retaliatory action by other countries."[190]

All of these factors militate against devaluation as a device to enhance Canada's export performance. The Canadian government has been preoccupied with preventing the Canadian dollar from falling too far below the value of the U.S. counterpart, given the overwhelming importance of Canada's financial and trade ties with the United States. A lower Canadian dollar would increase the debt service burden carried by Canadian borrowers of foreign capital and add inflationary pressures. Canadian interest rates have traditionally been kept at levels somewhat above those in the United States to attract sufficient investment funds to keep the Canadian dollar at an acceptable level, although in the past two years the dollar has been allowed to fall somewhat, as policy makers have sought to avoid maintaining interest rates at extremely high levels.[191]

The focus on the relationship between the Canadian and American currencies has left the Canadian government powerless to help Canadian exporters in overseas markets who have become less competitive in the face of the rise of the Canadian dollar in step with the rapid rise of the U.S. dollar. Canadian resource exporters have pointed to the anomaly of their loss of overseas markets due to an over-valued Canadian dollar when most domestic observers, preoccupied with the Canada-U.S. relationship, have worried about the weakness of the Canadian dollar.[192] These macroeconomic policy and exchange rate relationships have probably also contributed to the increase in the proportion of Canada's exports going to the United States in the past few years when the U.S. dollar has been very strong relative to the Canadian and overseas currencies (see Table 3-1 above).[193]

Falling World Demand for Canadian Resources

An important factor contributing to Canada's declining share of world trade is the concentration of Canadian exports in commodities for which world demand is growing relatively slowly. Long-run income elasticities of demand are noticeably lower for most primary and semi-processed resource products than they are for most manufactured goods, particularly those incorporating advanced technology. This means that, as incomes rise in foreign countries, demand for resource-based goods rises relatively slowly compared with demand for advanced manufactured goods. Canada's exports tend to be concentrated disproportionately in these slow-growth product sectors.[194]

A number of other trends have also tended to reduce demand for resource-based goods in foreign markets. Technological advances have reduced the input of primary resources required per unit of output in certain industries such as iron ore and steel. Synthetic substitutes have been developed for applications previously dominated by resource-based goods; for example, fibre optics are replacing copper in electrical transmission. The capital-intensive postwar reconstruction of Europe and Japan required large inputs of resource-based products, but it has long since been completed. Changing consumer tastes, including such shifts as those toward smaller automobiles and toward multi-unit dwellings from single-family dwellings in North America, have also reduced demand for resource-based goods. Minerals have been the most susceptible to these changes. Canadian exports of copper, nickel, and iron ore have all suffered, although other factors including the recession and the development of alternative foreign sources of supply have probably been more important in the short term. In aggregate, GATT figures indicate that world exports of non-fuel minerals have "increased less rapidly than those of other product categories, their proportion of world exports of all commodities . . . fall[ing] from 6 percent in the early 1970s to 4 percent in 1979."[195] This continued a trend already apparent in the 1950s and 1960s. These figures indicate that widespread hopes in Canada during the 1970s that worldwide mineral resource scarcities would put Canada in a strong position as an exporter were overly optimistic.

Foreign Investment and Internationalization of Business

The high degree of foreign ownership of the Canadian economy has a strong influence over Canada's export patterns and prospects in both negative and positive directions. Extensive foreign ownership has resulted in a high proportion of Canadian trade accounted for by intra-corporate transfers between branches of a single transnational corporation (TNC). U.S. Department of Commerce figures show that about 56 percent of Canada's exports to the United States in recent years consist of intra-corporate transfers.[196] While comparable precise figures for Canada's trade with other regions are not available, indications are that intra-corporate transfers also play a smaller but still significant role in Canada's overseas trade.

The "growing importance of inter-affiliate trade means that an increasing proportion of total Canadian exports result from quasi-administrative decisions of a corporation in response to corporate interests and marketing strategy."[197] This is of crucial importance for Canadian trade policy, since it means that a large proportion of Canada's trade is not easily influenced by government policies intended to enhance Canada's international competitiveness or export performance. For example, macro-economic policies may not have the expected impact. Some have argued that a devaluation of the Canadian dollar intended to enhance Canada's export competitiveness could have a less than intended impact because of the importance of non-market considerations in determining intra-corporate trade flows.[198] However, there has as yet been no conclusive evidence on this point.

Similarly, the trade concessions negotiated by Canada may not have the desired effect of increasing Canadian exports if domestic producers are uninterested in exporting.[199] In many cases, subsidiaries were established behind Canadian tariff barriers solely to supply the domestic Canadian market. These producers may be prohibited from exporting (or restricted in the markets to which they can export) by administrative arrangements with the parent corporation arising out of its own strategy for supplying various world markets.[200] Licensees of foreign technology, even if Canadian-owned, may similarly be restricted by the terms of their agreements with patent holders to the domestic market.[201] Furthermore, "many Canadian subsidiaries will only engage in foreign trade if this trade is supported by special federal export or financing assistance. If this special help is not available through the Canadian Export Development Corporation or CIDA . . ., subsidiaries are frequently told to leave foreign sales to their head offices."[202]

It is virtually impossible to determine the importance of the phenomenon of export blocking. Detailed, reliable data for recent years are, as far as we are aware, unavailable. Studies conducted by the Department of Industry, Trade and Commerce during the 1950s and 1960s found administrative intra-corporate restrictions to be a major factor inhibiting the growth and diversification of Canada's exports, particularly with respect to manufactured goods.[203] Officials in the Department of Regional Industrial Expansion argue that Canadian subsidiaries have become increasingly competitive, independent, and self-motivating.[204] However, recent newspaper reports indicate that export blocking continues to be a factor in some industries.[205]

World product mandates have been viewed as one possible solution to the problem of limited exports from foreign-owned manufacturing subsidiaries in Canada. The federal and Ontario governments encourage foreign-owned manufacturing subsidiaries to specialize in a small number of product lines and to export a portion of the resulting output to all of the parent company's markets; this move is designed to replace the common current practice of reproducing all of the parent company's product lines on a small, inefficient scale for sale only in the protected domestic market. In return for rationalizing production and increasing exports, the federal government offers duty remission schemes, whereby the subsidiary with a world product mandate is permitted to import required inputs and other products needed to fill out its product line at reduced rates of duty.[206] However, this policy thrust has not been notably successful. The number of Canadian subsidiaries that have been granted meaningful world product mandates is very small; one expert has put the number at four or five. Canadian subsidiaries are frequently awarded mandates for the production of goods nearing the end of their product life cycle. "Many mandates are for North America only, and don't truly offer the wider scope of the world market where future growth lies." Often the Canadian subsidiary only produces one component of an equipment "package," while responsibility for such important backward and forward linkages such as research, product development, and marketing are retained by the foreign parent.[207]

Foreign ownership and intra-corporate trade also inhibit attempts by Canadian governments to encourage resource upgrading prior to export. "Many subsidiaries operating in [the resource] sector were established as part of vertically integrated corporate structures and exist solely to supply American-based parents and affiliates with raw materials" which are then processed and fabricated in the United States or overseas.[208] Foreign-owned resource extracting firms often oppose government initiatives to shift the location of resource processing from abroad to Canada.[209]

The transfer of industrial decision-making power to foreign centres inherent in foreign ownership and control means that subsidiaries respond to foreign government policies as well as (and sometimes in preference to) Canadian government policies.[210] During the 1960s, the extra-territorial application of the American Trading With the Enemy Act to subsidiaries of American firms operating in Canada prevented them from exporting to Cuba and China at a time when the Canadian government was much more willing to permit trade with these countries.[211] The problem received little attention during the 1970s, largely because the U.S. attitude became more relaxed and the countries in the Western alliance were able to reach a consensus on export controls on strategic goods. However, the Reagan administration has tightened its own strategic export controls in recent years in parallel with renewed concern about the Soviet threat, and is putting pressure on other Western countries to follow suit.[212] This has begun to cause problems for certain Canadian exporters of high-technology goods that incorporate U.S. components or technology,[213] just as it already has for Western European and Japanese suppliers of pipeline equipment, and could lead to renewed U.S. attempts to block exports from subsidiaries of U.S. companies operating in Canada.

Another problem arising out of the high level of American ownership of Canadian industries is that virtually any government policies intended to improve the export performance of Canadian subsidiaries would impinge on U.S. interests and provoke a reaction from American political leaders. From the Canadian point of view, the export performance commitments extracted by the Foreign Investment Review Agency (FIRA) from potential foreign investors are justified by the need to overcome some of the non-market disincentives to export imposed by foreign corporate parents. From the American point of view, such performance commitments are themselves non-market distortions that inevitably have adverse effects on U.S. interests (if, for example, they encourage a firm to export overseas from Canada rather than from the United States). There have been strong pressures from the American business community and from Congress for retaliation against Canadian government initiatives designed to improve the export performance of U.S. subsidiaries.[214]

Finally, the high degree of American ownership of Canadian industry and the tendency for American and Canadian branches of the same firm to trade among themselves have contributed to Canada's dependence on the United States as a trading partner and have inhibited government efforts to diversify the destination of Canada's exports.[215]

While the high degree of foreign, especially U.S., ownership of industry in Canada has contributed to the lack of diversification in Canada's export trade, it would be a mistake to see foreign ownership as the primary cause of Canada's export problems or even as a wholly negative factor. The use of a foreign parent's technology, brand name, and marketing organization may enhance the subsidiary's ability to make foreign sales; sales orders generated by the parent are sometimes filled in whole or in part by the subsidiary; once assigned a foreign market, a subsidiary does not have to compete against its parent or its affiliates for that market; and the "parent company and other affiliates often provide guaranteed markets for exports from the Canadian subsidiary, markets which tend to be much less risky than those acquired through arm's length dealings."[216] For example, Canada has become one of the world's largest arms exporters in part because extensive corporate links between U.S. and Canadian arms industries have permitted Canadian producers "to contribute to systems made and marketed through the United States."[217] In the resources sector, most Canadian iron ore is produced by firms affiliated with U.S. steel producers. During the 1970s, these links were seen to depress Canadian iron ore prices and to inhibit the processing of Canadian iron ore prior to export, but with the weakness of demand for iron ore in the United States, and elsewhere in recent years, these intra-corporate links have come to be valued for the protection they afford the Canadian industry. "Without U.S. parent linkages and the protection of their heavy investment in Canada, the [high-cost] Quebec-Labrador mines would be hard pressed to compete in today's market. They certainly would not be developed in today's economic circumstances in comparison with other world developments."[218]

The global production and marketing strategies increasingly being adopted by the trans-national corporations (TNCs) that dominate high-technology, advanced manufacturing industries worldwide have increased the importance of foreign direct investment (FDI) to Canada's participation in rapidly growing international trade in this sector. Production technology in these industries tends to be complex, highly capital intensive, and prone to quick obsolescence in the face of accelerated technological change. Thus it often becomes imperative that capital investments in production be recouped quickly, and this can be done only by selling on the large and increasingly homogeneous international market. A high proportion of the international trade conducted by these industries tends to be intra-firm, as component production is farmed out internationally in search of lower costs and as governments trade access to their markets for commitments from such firms to undertake some production locally. Intra-firm trade in advanced technology manufacturing industries, particularly in intermediate products such as components, has consequently become one of the fastest growing areas of international trade.[219]

The global nature of the production processes of advanced technology manufacturing sectors means that, if Canada wants to participate in these industries, it must in many cases do so as part of the international production systems of TNCs. These could be Canadian-owned, but given the dominance of foreign-based TNCs in these industries, it is much more likely that they will be foreign-owned. This in turn means that, if Canada is going to be a major participant in these sectors, it will have to accept the constraints that often accompany FDI (as outlined above) as a cost against the benefits that would presumably result in terms of access to strong, stable foreign markets with affiliated firms for technology-intensive manufactured goods with high value-added.

If Canada seeks to attract FDI in these or other sectors, it must do so in competition with other countries. Given the importance of TNCs and intra-firm trade in advanced manufacturing and many other sectors, Canada's export prospects may depend to an important degree on its ability to persuade TNCs to locate production facilities within its boundaries to supply foreign markets. However, foreign competition for FDI is stiff, as many governments are currently seeking the jobs and exports that it may bring at the same time as there has been a marked slowdown (noticeable since the mid-1970s) in the rate of expansion of FDI.[220] In Canada's case, the stiffest competition has been between Canadian federal and provincial governments on one side, and American federal and state governments, on the other, in offering incentives to TNCs. The cost of this intergovernmental competition for FDI to the public treasuries of the two countries has grown rapidly as TNCs have been able to play one side's offers off against the other's. This has happened even though there is considerable evidence that questions the effectiveness of incentives compared with other factors affecting the location of investment.[221]

How potential foreign investors perceive Canada is another factor influencing Canada's ability to attract export-generating FDI, and their perceptions have been changing in ways not entirely favourable to Canada. Recent surveys of foreign-owned TNCs show that Canada is still generally well regarded as a place to invest. Canadian government policies toward FDI, particularly those carried out under FIRA, are perceived by some TNCs as having contributed to a deteriorating investment climate.[222] However, the number of firms citing such policies as major factors in decisions not to locate in Canada was quite small (16 percent in one survey), and whatever deterrent FIRA has provided is probably a worthwhile price to pay for having foreign investment screened to ensure that it provides benefits for Canada. On a separate issue, investment by TNCs often depends on secure access to large, high-growth markets, and this may be a disadvantage to Canada if TNCs perceive that Canadian access to the U.S. market (or the EEC or Japanese markets) is not secure.[223]

Retaliation Against Canadian Protectionism and Industrial Assistance

Protectionist measures implemented to defend Canadian industries and jobs from foreign competition affect Canada's export prospects in two ways. First, Canadian import barriers raise the costs of production in export-oriented industries, thereby reducing their competitiveness in foreign markets. Import barriers do this directly by raising the costs of imported industrial inputs, and indirectly by putting upward pressures on wages and prices in the economy as a whole.[224]

Second, retaliation by foreign governments against protectionist Canadian moves can reduce Canadian exporters' access to foreign markets. This issue has recently been prominent in discussions of Canada's trade with the NICs and other developing countries. Canadian trade officials have looked to the NICs as promising markets for Canadian exports, particularly for goods with higher value-added.[225] However, these countries are also the main sources of low-cost exports of textiles, clothing, and footwear that have posed such a serious threat to these labour-intensive industries in Canada. They have been the main target of voluntary export restraints and other quantitative restrictions imposed by the Canadian government. Such restrictions imposed by all of the industrialized countries have inhibited the growth of exports from the NICs, thereby inhibiting the ability of the latter to import from the industrialized countries. More specifically, the high degree of government involvement in the economy and in import trade in the NICs provides them with a means to retaliate against specific measures of protection enacted by the Canadian government. Gerald Regan, former minister for external trade, recently told reporters that "we constantly are confronted by situations where . . . [we] find that when we are being tough on them in relation to quantitative restrictions on imports of their products, they make it quite clear that these are factors to be evaluated in their decisions in the awarding of contracts for projects."[226] Given the large number of jobs at stake in the import-competing Canadian industries, the lack of alternative employment opportunities, and the concentration of the industries in politically sensitive regions, one cannot expect an early removal of Canadian barriers to imports of labour-intensive manufactured goods from the developing countries. Consequently, Canada's exports to these areas will continue to be limited by their reaction to protectionism in Canada and other industrialized countries.

Much more important in terms of Canada's overall trade performance is retaliation from the United States and other major industrialized countries against Canadian protectionism and other Canadian policies perceived to be injurious to their interests and inconsistent with Canada's international obligations. States have always had the right under the GATT's safeguards provisions to impose selective measures of protectionism aimed at the exports of countries which had themselves raised protectionist barriers. This has constrained the resort to protectionist measures in Canada and abroad.[227].

Of greater concern in recent years has been the threat of retaliation against non-tariff barriers and non-trade policies intended to strengthen and diversify the Canadian economy. The development of internationally competitive industries in Canada often requires government intervention to overcome the disadvantages of the small Canadian market, the technological backwardness of much of Canada's secondary manufacturing industry, and the high import propensity and lack of interest in exporting that characterize many foreign-owned manufacturing subsidiaries in Canada. Foreign government trade retaliation can negate the impact of this intervention (e.g., through the application of countervailing duties) or impose costs on Canadian exports in other sectors that outweigh the benefits in the assisted sector. The threat of such retaliation has come primarily from the United States because the extensive economic linkages between Canada and the United States mean that a wide range of Canadian policies intended to improve the performance of Canadian industry will impinge on U.S. interests. Canada is quite vulnerable to the threat of U.S. retaliation because of its big surplus in trade with the United States in recent years, the importance of the U.S. market for existing exports of manufactured goods which are subjected to more protectionist pressure than resource goods, and the importance of access to the U.S. market for new industries in Canada that must capture economies of scale in order to become internationally competitive.[228] Examples of Canadian policies that have sparked retaliation or threats of retaliation against Canadian exports to the United States include: government procurement policies used to strengthen selected advanced manufacturing sectors; preferential treatment for Canadian suppliers to energy megaprojects under the National Energy Program; regional and industrial development subsidies to industries that export part of their output; trade performance commitments extracted by FIRA from U.S.-based foreign investors; and Bill C–58, which makes Canadian advertising on U.S. border television stations nondeductible for corporate tax purposes, and which sparked threats of retaliation against Canadian exports of Telidon and other telecommunications equipment.[229]

The threat of retaliation from the United States has increased in recent years as a result of growing dissatisfaction in the United States with the multilateral trading system and especially with the perceived failure of America's trade partners to open their markets to American goods to the same extent as the United States has opened its market to foreign goods.[230] Congress has been the focus of the dissatisfaction and the efforts to force the United States' trade partners to reduce their protectionist barriers. Reciprocity legislation has been introduced that, in its most extreme forms, would attempt to force U.S. trading partners "to accord American goods, services, and investments essentially the same treatment as the partner's goods, services, and investments are accorded in the U.S. market." Reciprocal treatment would be achieved through threats or the use of retaliation within sectors or against imports into the United States in different sectors.[231] The Reagan administration initially opposed the various proposals for reciprocity legislation, but since June 1982 has worked with Congress on a milder proposal which focusses on foreign investment and trade in services and high-technology goods. The administration has supported such legislation primarily as a threat to bring the United States' trade partners to the bargaining table where less restrictive agreements can be negotiated.[232] Reciprocity legislation has not yet been passed, but if it is passed and implemented vigorously, it could pose a serious threat to Canadian exports. FIRA, the National Energy Program, and other Canadian trade and investment restrictions have attracted considerable unfavourable attention in U.S. business and political circles and would be a likely target of any legislation to encourage reciprocal treatment or facilitate retaliation.

In sum, the threat of retaliation by foreign governments has seriously constrained the Canadian government's ability to intervene so as to expand

and diversify Canada's exports. However, the same constraints imposed on Canada by the threat of retaliation against protectionism and export promotion, and by the international rules that legitimize and codify that threat, also assist Canadian exporters to the extent that they similarly impose limits on foreign countries.

Growth of Regional Trading Blocs

Regional trading blocs have grown in importance since the 1950s despite the commitment of all states in the GATT to the principle of non-discrimination. By far the most important of these are the European Economic Community (EEC) and its associates, which now include many Mediterranean countries and developing countries in Africa, the Caribbean, and the Pacific. More than one-fifth of total world trade now takes place within the huge EEC-centred preferential trade system. Other noteworthy preferential trading systems include the Association of South-East Asian Nations (ASEAN), the Caribbean Common Market (CARICOM), and the Generalized System of Preferences schemes accorded by most Western industrialized countries to developing countries. These arrangements all share discrimination by tariff and non-tariff barriers in favour of trade among their members at the expense of non-members. This discrimination virtually always departs from the rules and spirit of the GATT, but has in most cases been legitimized by waivers from GATT obligations.[233]

The trend toward regionalization in the world trading system holds considerable dangers for Canada. Canada is not a member of any preferential trading bloc, and is therefore the only major "industrial country without free access to a market whose population numbers over one hundred million."[234] The small size of the domestic market puts Canada at a competitive disadvantage vis-à-vis the EEC countries, the United States, and Japan, all of which have domestic markets large enough to provide a strong base for developing competitive exports.

The EEC's discrimination against non-associated suppliers has directly affected Canadian exports to Europe. Resource exports have been the most severely affected, since Canada has never developed a strong export trade in manufactures with Europe. One notable example is wheat; the CAP has severely reduced Canadian access to what were once large markets in Britain and certain continental European countries. Newsprint exports have also been affected by a preferential trade agreement negotiated between the European Free Trade Association countries and the EEC.[235] Concern has also been voiced in Canada that tariff and NTB preferences granted to developing countries associated with the EEC could cut into Canada's exports of minerals and processed mineral products. To date, however, there is no evidence that this has happened, since few of such developing countries produce significant quantities of the minerals exported by Canada to the EEC.[236]

One final negative consequence for Canada of the trend to regionalism is the increasing tendency for world trade policy issues to be settled in trilateral negotiations involving the United States, Japan, and the EEC. When this happens, Canada may lose the opportunity even to voice its concerns on a particular issue.[237] Furthermore, even when Canada is involved, the tendency of the EEC to act as a unit reduces the opportunities for Canada to influence the outcome by allying itself with other medium-sized countries. There is also a tendency in such tripartite negotiations "to throw Canada arbitrarily into the U.S. orbit,"[238] impeding Canadian efforts to establish a distinct voice in international economic relations. Canada can do little to influence the trend toward regionalism in the world political economy, "since the process essentially relates to relationships between third parties."[239]

Conclusions

Canada's export trade faces a number of adverse trends in the international political economy. Protectionist pressures and trade barriers in foreign markets have been increasing. Major trends contributing to the increased pressures, as outlined in the second section of this paper, are:

- changes in the international structure of competitive advantages;
- slow world growth rates accompanied by high unemployment;
- the increasing domestic political strength of import-threatened industries;
- a reduced commitment to liberalization among countries in the Western alliance;
- the absence of strong international leadership; and
- the difficulties of adapting the General Agreement on Tariffs and Trade (GATT) to the changes in the international trading environment.

On the other hand, protectionist barriers are not likely to rise to a point where they begin to choke off international trade. All countries and many influential industries have a clear economic interest in maintaining and expanding trade flows. And many important Western countries view an open international economic order as a key to maintaining national security. Thus, world trade flows have continued to grow (despite a brief decline in 1982 due to the recession) even in the face of rising protectionist pressures.

Trends in foreign protectionism do not reflect a rejection of the open trading system by the major industrialized countries. Instead, they reflect the desire of governments to *manage* trade flows, to minimize domestic instabilities arising out of changes in competitive advantage and trade patterns, and to maximize trade-related domestic employment and income.

This desire to balance the benefits of international trade against the costs in terms of domestic instability and adjustment burdens is nothing new. The GATT-centred multilateral trading system has always recognized the need for such a compromise. Rights to initiate safeguards action and exemptions from the non-discriminatory tariff reductions included in GATT regulations have always been necessary to make multilateral tariff reductions acceptable to governments concerned with domestic stability.[240] Two characteristics distinguish the present period. First, the recent prolonged period of economic instability has encouraged governments to focus more on managing the domestic impacts of international trade and less on the need for further liberalization than was the case during the prosperous 1960s. Second, recent protectionism has departed significantly from the multilateral and non-discrimination principles of the GATT, with a proliferation of bilateral and small-group multilateral trade-managing arrangements. Some analysts, however, have argued that a network of such arrangements may prove more capable of sustaining international trade flows than the GATT-centred multilateral trading system.[241]

Of the factors considered in the third section of this paper, the most important one limiting foreign purchases of Canadian goods is international growth rates. If the slow and uneven growth rates of the past decade persist, the prospects for export growth will not be good, as competition for smaller markets and for internationally mobile investment funds increases. Slow growth rates may also worsen Third World debt repayment problems, encourage more foreign export subsidies, and trigger foreign retaliation against Canadian protectionist measures; all these effects could constrain Canadian export opportunities. Next, the growth of regional trading blocs interferes with the expansion and diversification of Canadian exports. The creation of the EEC has had an important impact on Canadian sales in Western Europe, and the proliferation of such common market schemes could further limit foreign markets.

Canada's ability to influence these largely adverse trends in the international politico-economic system is extremely limited. Despite arguments that Canada is a "foremost nation" or a "principal power,"[242] the bulk of the evidence attests to Canada's lack of influence compared with that of the United States, Japan, and the EEC. This is especially true in light of the increasing tendency noted earlier for major international economic issues to be settled in tripartite negotiations involving only these three actors. Most authors emphasize their paramount role in shaping the international trading system and in generating sufficient growth to sustain it. By contrast, according to one political scientist, small states like Canada

> have little capacity to affect the international economic system as a whole or the international economic regimes that provide rules to regulate the imposition of national controls on international transactions. They are "price takers" in economic terms, and "subjects" politically: they do not make the

rules but merely have to decide whether to accept them, for instance by joining such arrangements as the General Agreement on Tariffs and Trade or the International Monetary Fund, or to accept the costs of not belonging.[243]

Such states can hope to influence the system only at the margins, most likely by combining forces with other states of all sizes to push in a certain direction. Compounding the difficulty is the extent to which domestic politics in the major countries shape the international economic system.[244] Canada's ability to influence the structure of the international economic system by first influencing domestic political debates in the United States, Japan, and Western European countries is obviously negligible.

Being small does, however, offer certain partially compensating advantages. What small states do "is less likely to be noticed than are the actions of larger countries, and is less likely, therefore, to invite retaliation."[245] Canada appears to have benefitted from a degree of "invisibility" for much of the postwar period, and was able to maintain trade barriers that were in many cases higher than those of its major trading partners. In recent years, however, restrictive Canadian policies have attracted increasing attention from the United States, perhaps because U.S. policy makers are becoming more interested in the role of international economic transactions in creating and resolving persistent problems of the U.S. economy. Some observers now argue that Canada is serving as a "test case" for more assertive U.S. foreign economic policies.[246] Though threats of U.S. retaliation have sparked intense concern in Canada, most of these threats have not been carried out. For a country in Canada's position, "patience is in order: the attention span of any great power is small, and new events will soon arise to sweep the small country in question back into benign obscurity."[247]

Some suggestions for desirable policy directions for Canada were hinted at in the various subsections of this paper discussing particular trends affecting the level of foreign protectionism and the ability or proclivity of foreign purchasers to buy Canadian goods. In the remainder of the paper, we would like to highlight some of the most important of these policy implications.

First, Canada should be wary of placing too much reliance on export growth as a panacea for the problems of the Canadian economy. The prospects for the expansion and diversification of Canadian exports are not good. This means that we cannot expect much stimulus for the economy to come from export trade, especially if the current U.S. recovery (accompanied as it is by massive government budget and trade deficits) does not hold. Limited export prospects do not mean Canada should adopt an autarkical foreign economic policy, however. The size of Canada's current export trade indicates that many Canadian industries have international competitive advantages, and the international trading system does not appear about to collapse. Consequently, exports will continue to play an important role in the Canadian economy. Government efforts to negotiate better access to foreign markets and its provision of assistance to Canadian firms seeking to develop foreign markets will continue to be worthwhile. What we are suggesting is simply that Canada must not rely on export growth to solve its economic problems.

Second, Canadian trade negotiators should be careful not to waste their energies and Canada's limited bargaining leverage on attempts to negotiate new measures of trade liberalization in particular sectors in the multilateral arena. Given the strength of protectionist forces in most foreign countries, such liberalization is not likely to be negotiable without excessive cost to Canada in other sectors. New measures of sectoral trade liberalization are also unlikely to result in expanded market access on a secure basis unless a much stronger international consensus is first reached on the issue of industrial policies, as explained below.

This general judgment regarding the inadvisability of attempts to secure sectoral liberalization does not apply as strongly to bilateral negotiations, especially with the United States, but even here the obstacle posed by the need to negotiate balanced and politically acceptable concessions should not be underestimated.

The only area in which Canadian negotiators should clearly continue to press for new measures of trade liberalization is that of processed raw materials. Canada has an undeniable comparative advantage in certain processed raw materials, and foreign tariffs are obviously a major impediment to the exploration of this advantage. Nevertheless, given the long and largely unsuccessful history of Canadian attempts to persuade countries (other than the United States) who import raw materials to reduce escalating tariffs, one should not expect much progress.

Third, Canada should work strongly to preserve access to foreign markets that have already been opened to Canadian exports. Canadian negotiators should press for stricter international guidelines and discipline to control the introduction of new protectionist measures. Contingency protection and voluntary export restraints seriously threaten continued Canadian access to foreign markets, most notably in the United States. Canada should also work for procedural reforms in GATT to make it more relevant to contemporary trade problems and to encourage countries to bring trade disputes back into GATT negotiations. This would help to strengthen multilateral constraints on the introduction of new forms of protectionism. Canada should also continue to try to persuade other countries to reduce the use of costly export subsidies. There is some hope of progress in this area, as indicated by a recent agreement on export subsidies adopted by the Organization for Economic Cooperation and Development. The conclusion of this agreement was facilitated by the need for the major industrialized countries to reassess their export subsidy programs in view of their growing budget deficits.

A fourth thrust of Canadian policy should be toward encouraging coordination of national economic policies having international implications. At the microeconomic level, this means developing a consensus and guidelines for government measures to promote national industrial development and to assist domestic adjustment. Without consensus and guidelines in these areas, trade flows will continue to be threatened by government retaliation in importing countries against what the latter consider unfair government export support measures. At the macroeconomic level, Canada should press for international coordination of fiscal and monetary policies. Many observers believe that such coordination is a prerequisite for the return of world prosperity. As we noted earlier, however, the chances for progress in coordinating either macroeconomic or microeconomic policies are not heartening.

Fifth, a stronger emphasis on bilateral trade agreements, especially with the United States, could prove worthwhile. As we noted earlier, the leader of the Canadian delegation to the Tokyo Round negotiations believed that Canada could have achieved better results in a number of areas (especially those concerned with NTBs) in bilateral negotiations with the United States than it did in the multilateral GATT negotiations. It is also worth remembering that the bilateral Auto Pact has had a greater impact in terms of expanding Canada's exports than any single multilateral trade agreement signed by Canada. These considerations point to the need to consider seriously the potential of bilateral negotiations with the United States and other trading partners on an issue-by-issue basis.[248]

While multilateral negotiations may be more appropriate for many issues, bilateral negotiations provide one context in which Canada could use its small size to advantage. Bilateral agreements need not be discriminatory, and they need not impede progress toward preferred multilateral solutions.[249] Since multilateral progress depends primarily on the actions of the major industrialized countries, bilateral agreements concluded by Canada might escape attention. Even if such agreements were inconsistent with multilateral goals, they probably would not significantly impede multilateral progress because of their relatively minor global impacts.

Sixth, Canadian industry must become more adaptable and competitive. Though discussion of internal economic reforms is beyond the scope of this paper, they are needed if Canada is to overcome the adverse trends in the international political economy and its limited power to influence them. In light of the potential value for Canadian exporters of bilateral arrangements, Canada must be able to open its own markets to increased foreign competition if it wants to bargain for better access to foreign markets.

Notes

1. Resource-extracting industries tend to require much more capital and less labour per unit of output than manufacturing industries, although there are exceptions. B.W. Wilkinson, *Canada in the Changing World Economy* (Montreal: C.D. Howe Research Institute, 1980), pp. 34–37; Glen Williams, *Not For Export: Toward a Political Economy of Canada's Arrested Industrialization* (Toronto: McClelland and Steward, 1983), pp. 10–11.
2. Michael C. Webb and Mark W. Zacher, "Canada and International Regulation of Primary Commodity Markets: The Case of Minerals" (Montreal: Institute for Research on Public Policy. Forthcoming).
3. Jeanne Kirk Laux, "Global Interdependence and State Intervention," in *Canada's Foreign Policy: Analysis and Trends*, edited by Brian W. Tomlin (Toronto: Methuen, 1978), p. 127.
4. Frederick H. Weihs, "Canadian Trade Policy 1945–1953" (M.A. Thesis, Department of History, University of British Columbia, September 1976), chaps. 3 and 4; R.D. Cuff and J.L. Granatstein, *American Dollars–Canadian Prosperity* (Toronto: Samuel-Stevens, 1978), pp. 60–82, 137–41.
5. Carl E. Beigie, *The Canada–U.S. Automotive Agreement: An Evaluation* (Montreal and Washington: Private Planning Association of Canada/National Planning Association (U.S.A.), 1970), pp. 46–48.
6. Maureen Appel Molot, "Canada-U.S. Relations: The Politics of Attraction and Distance," *Jerusalem Journal of International Relations* 6 (2) (1982): 101–102.
7. Williamsburg Declaration on Economic Recovery," reprinted in *Economic Impact* 43 (1983/3): 3–4.
8. Charles Lipson, "The Transformation of Trade: The Sources and Effects of Regime Change," in *International Regimes*, edited by Stephen D. Krasner (Ithaca: Cornell University Press, 1983), p. 269.
9. C. Fred Bergsten, "The International Economy and World Politics in the Postwar Era," in *Economic Foreign Policies of Industrial States*, edited by Wilfred Kohl (Lexington, Mass.: D.C. Heath, 1977), pp. 2–3 and 5 (quote).
10. Stephen D. Krasner, "The Tokyo Round: Particularistic Interests and Prospects for Stability in the Global Trading System," *International Studies Quarterly* 23 (4) (December 1979): 527–28.
11. Ibid., pp. 501–502, 527.
12. Lipson, "The Transformation of Trade," pp. 244, 269–70.
13. Susan Strange, "Protectionism and World Politics," paper presented to the Australian National University Research School of Pacific Studies, 19 April 1984, p. 44.
14. C.M. Aho and T.O. Bayard, "The 1980s: Twilight of the Open Trading System?" *The World Economy* 5 (4) (December 1982): 395 (quote); General Agreement on Tariffs and Trade (GATT), *International Trade 1981/82* (Geneva: GATT. 1982), p. 21.
15. Robert B. Reich, "Beyond Free Trade," *Foreign Affairs* 61 (4) (Spring 1983): 777.
16. Albert Bressand, "Mastering the 'Worldeconomy'," *Foreign Affairs* 61 (4) (Spring 1983): 752.
17. Reich, "Beyond Free Trade," p. 778.
18. Krasner, "Tokyo Round," pp. 502–507; Aho and Bayard, "Twilight of the Open Trading System?", p. 384; Gerry Salembier, "Global Adaptability," *Policy Options* 5 (2) (March 1984): 50.
19. Reich, "Beyond Free Trade," p. 779; John Gerard Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," in *International Regimes*, edited by Stephen D. Krasner (Ithaca: Cornell University Press, 1983), p. 219.

20. Bressand, "Mastering the 'Worldeconomy'," p. 754. The United States is still the world leader in many areas of technology, but Japanese industry has become more adept at rapidly incorporating technological developments into industrial production, while the United States tends to focus more on the military applications of new technology; see *Globe and Mail*, June 22, 1984, p. B19.
21. Bressand, "Mastering the 'Worldeconomy'," p. 753; Krasner, "Tokyo Round," pp. 504–507.
22. Krasner, "Tokyo Round," p. 506.
23. Organisation for Economic Cooperation and Development, *The Impact of the Newly Industrialising Countries on Production and Trade in Manufactures* (Paris: OECD, 1979), p. 10 (quote); Wilkinson, *Canada in the Changing World Economy*, pp. 68–69. For factors contributing to the rise of the NICs, see OECD, *Newly Industrialising Countries*, and Colin I. Bradford, "Newly Industrialising Countries in an Interdependent World," *The World Economy* 5 (2) (September 1982): 171–85.
24. OECD, *Newly Industrialising Countries*, pp. 6, 8.
25. Ibid., pp. 10–11.
26. Wilkinson, *Canada in the Changing World Economy*, p. 69.
27. Department of External Affairs, *Review of Canadian Trade Policy: A Background Document to Canadian Trade Policy for the 1980*s (Ottawa: Minister of Supply and Services Canada, 1983), pp. 169–70 (quote); Wilkinson, *Canada in the Changing World Economy*, pp. 68–69.
28. Molot, "Canada–U.S. Relations," p. 89.
29. OECD, *Newly Industrialising Countries*, pp. 28–31.
30. Aho and Bayard, "Twilight of the Open Trading System?" p. 382.
31. Ibid., pp. 382–83; Lipson, "The Transformation of Trade," p. 265; John M. Volpe, "Canada–U.S. Trade Relations: Prospects and Problems in the 1980s," in The Atlantic Council Working Group on the United States and Canada, *Canada and the United States: Dependence and Divergence* (Cambridge, Mass.: Ballinger, 1982), p. 155; Salembier, "Global Adaptability," p. 50.
32. Reich, "Beyond Free Trade," pp. 799, 801–802.
33. Aho and Bayard, "Twilight of the Open Trading System?" p. 382.
34. Ibid., p. 384 (quote); Ruggie, "Embedded Liberalism," pp. 216–17.
35. Aho and Bayard, "Twilight of the Open Trading System?" p. 384.
36. Ibid., p. 384; Salembier, "Global Adaptability," p. 50.
37. John Zysman and Stephen S. Cohen, "Double or Nothing: Open Trade and Competitive Industry," *Foreign Affairs* 61 (5) (Summer 1983): 1119; Volpe, "Canada–U.S. Trade Relations," p. 155.
38. Aho and Bayard, "Twilight of the Open Trading system?" p. 394.
39. Reich, "Beyond Free Trade," pp. 799 (quote), 777–78; Zysman and Cohen, "Open Trade and Competitive Industry," p. 1119.
40. Aho and Bayard, "Twilight of the Open Trading System?" p. 401.
41. Ibid., p. 401; Salembier, "Global Adaptability," p. 50.
42. Volpe, "Canada–U.S. Trade Relations," p. 180.
43. Ibid., p. 181.
44. Stephen Clarkson, *Canada and the Reagan Challenge: Crisis in the Canadian-American Relationship* (Toronto: James Lorimer/Canadian Institute for Economic Policy, 1982), p. 121.
45. Department of External Affairs, *Review of Canadian Trade Policy*, p. 205.
46. Fred Lazar, "Canadian Industrial Strategy: A U.S. Impediment," *Journal of World Trade Law* 16 (3) (May/June 1982): 226; Gary Clyde Hufbauer and Andrew James Samet, "Investment Relations between Canada and the United States," in The Atlantic

Council Working Group on the United States and Canada, *Canada and the United States: Dependence and Divergence* (Cambridge, Mass.: Ballinger, 1982), p. 112.

47. *Financial Post*, March 19, 1983, p. 6.
48. Krasner, "Tokyo Round," pp. 515–16; Department of External Affairs, *Review of Canadian Trade Policy*, pp. 154–55.
49. Bergsten, "International Economy and World Politics," p. 4 (quote); Ruggie, "Embedded Liberalism," p. 219.
50. Salembier, "Global Adaptablity," p. 49.
51. Aho and Bayard, "Twilight of the Open Trading System?" pp. 387, 396–97.
52. Sylvia Ostry, "The World Economy in 1983: Marking Time," *Foreign Affairs* 62 (3) (America and the World 1983) (1984): 546.
53. "Williamsburg Declaration on Economic Recovery," *Economic Impact* 43 (1983/3): 3–4.
54. General Agreement on Tariffs and Trade (GATT), *International Trade 1980/81* (Geneva: GATT, 1981), p. 11; Jan Tumlir, "International Economic Order: Can the Trend be Reversed?" *The World Economy* 5 (1) (March 1982): 33–34. Tumlir is Director of Economic Research and Analysis for the GATT Secretariat.
55. Ostry, "World Economy in 1983," p. 538.
56. David D. Dewitt and John J. Kirton, *Canada as a Principal Power: A Study in Foreign Policy and International Relations* (Toronto: John Wiley and Sons, 1983), pp. 71–72.
57. J.M. Finger, "Incorporating the Gains from Trade into Policy," *The World Economy* 5 (4) (December 1982): 370–72.
58. Lipson, "The Transformation of Trade," p. 245.
59. General Agreement on Tariffs and Trade, "International Trade in 1982 and Current Prospects: First Assessment by the GATT Secretariat," *Press Release 1333* (Geneva, March 1983), p. 13.
60. Krasner, "Tokyo Round," p. 526.
61. Stephen D. Krasner, "U.S. Commercial and Monetary Policy: Unravelling the Paradox of External Strength and Internal Weakness," *International Organization*, Special Issue: "Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States," 31 (4) (Autumn 1977): 646–50 and 668 (quote).
62. Ibid., p. 645.
63. Keith A.J. Hay and B. Andrei Sulzenko, "U.S. Trade Policy and 'Reciprocity'," *Journal of World Trade Law* 16 (6) (November/December 1982): 472–73; Charles F. Doran, "The United States and Canada: Intervulnerability and Interdependence," *International Journal* 38 (1) (Winter 1982–83): 141–43.
64. Krasner, "U.S. Commercial and Monetary Policy," pp. 667–68.
65. Doran, "United States and Canada," p. 143.
66. C. Fred Bergsten, director of the Institute for International Economics in Washington, D.C., cited in *Financial Post*, February 11, 1984, p. 1.
67. Krasner, "Tokyo Round," pp. 494–96; Bergsten, "International Economy and World Politics," p. 2.
68. Cited in Weihs, "Canadian Trade Policy," p. 107.
69. Ibid., chap. 4.
70. Bergsten, "International Economy and World Politics," pp. 3–4; Krasner, "U.S. Commercial and Monetary Policy."
71. Clarkson, *Canada and the Reagan Challenge*, p. 283.
72. Lipson, "The Transformation of Trade," p. 235.
73. This paragraph, except as noted: Krasner, "U.S. Commercial and Monetary Policy"; Krasner, "Tokyo Round," pp. 493–97; Bergsten, "International Economy and World Politics," pp. 3–4; for a European view, Bressand, "Mastering the 'Worldeconomy'," p. 752.
74. Krasner, "Tokyo Round," p. 497.
75. Krasner, "U.S. Commercial and Monetary Policy."

76. Hay and Sulzenko, "U.S. Trade Policy and 'Reciprocity'," p. 472.
77. Ibid., pp. 472–73; Krasner, "Tokyo Round," p. 498; Clarkson, *Canada and the Reagan Challenge*, pp. 116–17.
78. Ruggie, "Embedded Liberalism," p. 200.
79. Lipson, "The Transformation of Trade," pp. 235–36.
80. John H. Jackson, "The Crumbling Institutions of the Liberal Trade System," *Journal of World Trade Law* 12 (2) (March/April 1978), p. 95.
81. For powerful expositions of this view, see Ostry, "World Economy in 1983"; Bressand, "Mastering the 'Worldeconomy'."
82. Ostry, "World Economy in 1983," p. 560.
83. Salembier, "Global Adaptability," pp. 51–52; Reich, "Beyond Free Trade," pp. 788, 794–96.
84. Zysman and Cohen, "Open Trade and Competitive Industry"; Bressand, "Mastering the 'Worldeconomy'," pp. 747–48.
85. Ibid., p. 745.
86. Ostry, "World Economy in 1983," pp. 559–60.
87. Wilkinson, *Canada in the Changing World Economy*, p. 58.
88. Jackson, "Crumbling Institutions of the Liberal Trade System," p. 101.
89. Bressand, "Mastering the 'Worldeconomy'," p. 772. Bressand is Deputy Director of the Institut Français des Relations Internationales.
90. Cited in *Globe and Mail*, March 26, 1984, p. IB3.
91. Ostry, "World Economy in 1983," p. 560.
92. Department of External Affairs, *Review of Canadian Trade Policy*, pp. 200-201.
93. Ibid., p. 175.
94. Jock A. Finlayson and Mark W. Zacher, "The GATT and the Regulation of Trade Barriers: Regime Dynamics and Functions," *International Organization* 35 (4) (Autumn 1981): 601.
95. Ibid, p. 601; Ernst Preeg, *Traders and Diplomats: An Analysis of the Kennedy Round of Multilateral Trade Negotiations* (Washington D.C.: Brookings Institution, 1970), p. 187.
96. *Financial Post*, May 12, 1984, p. 16.
97. Finlayson and Zacher, "GATT and the Regulation of Trade Barriers," pp. 600–601.
98. Ibid., p. 591.
99. *Financial Post*, May 12, 1984, p. 16; *Globe and Mail*, April 28, 1984, p. B3.
100. Jackson, "Crumbling Institutions of the Liberal Trade Order," p. 96.
101. Finlayson and Zacher, "GATT and the Regulations of Trade Barriers," pp. 574–75.
102. Jackson, "Crumbling Institutions of the Liberal Trade Order," p. 103.
103. Lipson, "The Transformation of Trade," pp. 263, 270; Finlayson and Zacher, "GATT and the Regulations of Trade Barriers," p. 600.
104. Jackson, "Crumbling Institutions of the Liberal Trade Order," p. 97.
105. Rodney de C. Grey, *Trade Policy in the 1980s: An Agenda for Canadian-U.S. Relations* (Montreal: C.D. Howe Research Institute, 1981), especially pp. 6–8; Interviews with trade association officials.
106. Interview.
107. Jackson, "Crumbling Institutions of the Liberal Trade Order," p. 97.
108. Donald J. Patton, "The Evolution of Canadian Federal Mineral Policies," in *Natural Resources in U.S.-Canadian Relations*, volume 1: *The Evolution of Policies and Issues*, edited by Carl E. Beigie and Alfred O. Hero, Jr. (Boulder, Co.: Westview Press, 1980), p. 210.
109. D.J. Daly, "Mineral Resources in the Canadian Economy: Macro-Economic Implications," in *Natural Resources in U.S.-Canadian Relations*, volume 1: *The Evolution*

of *Policies and Issues*, edited by Carl E. Beigie and Alfred O. Hero, Jr. (Boulder, Co.: Westview Press, 1980), p. 153.

110. Patton, "Evolution of Canadian Federal Mineral Policies," p. 209.
111. Department of External Affairs, *Review of Canadian Trade Policy*, p. 48.
112. Economic Council of Canada, *Looking Outward: A New Trade Strategy for Canada* (Ottawa: Minister of Supply and Services Canada, 1975), p. 127.
113. Department of External Affairs, *Review of Canadian Trade Policy*, pp. 48–49; Grey, *Trade Policy in the 1980s*, p. 16.
114. Patton, "Evolution of Canadian Federal Mineral Policies," pp. 226–27.
115. Department of External Affairs, *Review of Canadian Trade Policy*, p. 49.
116. Government of Canada, *Towards a Mineral Policy for Canada: Opportunities for Choice* (Ottawa: Information Canada, 1974), p. 46.
117. See Ibid., pp. 45–46.
118. Tariffs remain significant barriers to trade in many developing countries.
119. Ostry, "World Economy in 1983," p. 548; Tumlir, "International Economic Order," p. 29. As the latter points out, such estimates are necessarily highly approximate, since many bilateral arrangements are never reported and the restrictiveness of various measures is difficult to gauge.
120. Aho and Bayard, "Twilight of the Open Trading System?" p. 393.
121. Grey, *Trade Policy in the 1980*s, pp. 13–14.
122. Ibid.
123. Finlayson and Zacher, "GATT and the Regulations of Trade Barriers," pp. 569, 572, 580.
124. Ibid, pp. 566, 598; Tumlir, "International Economic Order," pp. 29–31; GATT, *International Trade 1981/82*, pp. 13–14; GATT *International Trade 1980/81*, p. 11; Aho and Bayard, "Twilight of the Open Trading System?" pp. 397–402.
125. General Agreement on Tariffs and Trade (GATT), *International Trade 1982/83* (Geneva: GATT, 1983), p. 19.
126. Aho and Bayard, "Twilight of the Open Trading System?" p. 399.
127. Finlayson and Zacher, "GATT and the Regulation of Trade Barriers," p. 598.
128. Ostry, "World Economy in 1983," p. 560; Aho and Bayard, "Twilight of the Open Trading System?" pp. 397, 400–401.
129. Ostry, "World Economy in 1983," pp. 546, 548; Finlayson and Zacher, "GATT and the Regulation of Trade Barriers," p. 572; Lipson, "The Transformation of Trade," pp. 258–59.
130. Grey, *Trade Policy in the 1980s*, pp. 13–14; Clarkson, *Canada and the Reagan Challenge*, p. 117; Lazar, "Canadian Industrial Strategy," pp. 223–35.
131. Regarding the latter point, Canadian lumber producers have voluntarily limited sales in the U.S. market (where they are highly competitive due to the exchange rate differential) to avoid triggering a new offensive by U.S. producers to restrict imports from Canada. *Globe and Mail*, August 28, 1984, p. B1.
132. Department of External Affairs, *Review of Canadian Trade Policy*, pp. 156–57.
133. Krasner, "Tokyo Round," pp. 523–24.
134. Department of External Affairs, *Review of Canadian Trade Policy*, p. 225.
135. North-South Institute, "Into 1984: In Search of Security," *Review '83/Outlook'84* (Ottawa: North-South Institute, 1984), p. 7.
136. Krasner, "Tokyo Round," pp. 513–14.
137. Department of External Affairs, *Review of Canadian Trade Policy*, pp. 181, 217; Volpe, "Canada–U.S. Trade Relations," pp. 172–73.
138. Clarkson, *Canada and the Reagan Challenge*, p. 122.
139. *Globe and Mail*, March 13, 1984, p. B1.
140. Krasner, "Tokyo Round," pp. 514–15.

141. Department of External Affairs, *Review of Canadian Trade Policy*, pp. 142, 181.
142. Grey, *Trade Policy in the 1980s*, p. 59; Laux, "Global Interdependence and State Intervention," pp. 125–26.
143. Grey, *Trade Policy in the 1980s*, p. 56.
144. Department of External Affairs, *Review of Canadian Trade Policy*, p. 60.
145. Zysman and Cohen, "Open Trade and Competitive Industry;" Jackson, "Crumbling Institutions of the Liberal Trade System," pp. 94–95; Volpe, "Canada-U.S. Trade Relations," pp. 155–56.
146. James I. Walsh, "Countertrade: Not Just for East-West Any More," *Journal of World Trade Law* 17 (1) (January/February 1983): 4–5 (quotes); J. de Miramon, "Countertrade, A Modernized Barter System," *OECD Observer* No. 114 (January 1982): 13.
147. de Miramon, "Countertrade, a Modernized Barter System," pp. 13–14; Walsh, "Countertrade: Not Just for East-West Any More," p. 3.
148. Canadian trade official cited in *Globe and Mail*, April 23, 1984, p. IB8.
149. *Globe and Mail*, April 23, 1984, p. IB8.
150. de Miramon, "Countertrade, a Modernized Barter System," pp. 12–14.
151. *Globe and Mail*, December 17, 1983, p. B20.
152. de Miramon, "Countertrade, a Modernized Barter System," p. 15.
153. Department of External Affairs, *Review of Canadian Trade Policy*, p. 227.
154. Walsh, "Countertrade: Not Just for East-West Any More," p. 9. Canada has also become involved in countertrade arrangements to assure itself of supplies of an essential resource, in this case oil from Mexico, see Ibid., p. 8.
155. Strange, "Protectionism and World Politics," p. 47.
156. GATT, *International Trade 1980/81*, p. 10.
157. Ostry, "World Economy in 1983," p. 546.
158. GATT, *International Trade 1982/83*, Appendix Table A18; *Globe and Mail*, March 12, 1983, p. IB1.
159. GATT, *International Trade 1982/83*, Appendix Table A18. As we note in a subsequent section, Canada's exports of resources to certain indebted developing countries have held up better in the face of their import cutbacks than have Canada's exports of manufactured goods in these same markets. However, the volumes involved are too small to affect the overall picture.
160. The issue of export financing will be dealt with in greater detail below.
161. Webb and Zacher, "Canada and International Regulation of Primary Commodity Markets."
162. *CRS Perspectives*, Centre for Resource Studies, Kingston, Canada, No. 18 (June 1984).
163. For good discussions of the Third World debt problem, see Pedro-Pablo Kuczynski, "Latin American Debt: Act Two," *Foreign Affairs* 62 (1) (Fall 1983): 17–38; Pedro-Pablo Kuczynski, "Latin American Debt," *Foreign Affairs* 61 (Winter 1982–83): 344–64; North-South Institute, "Into 1984"; Ostry, "World Economy in 1983"; GATT, *International Trade 1980/81, 1981/82, 1982/83.*
164. *Globe and Mail*, May 14, 1984, p. IB2.
165. *New York Times*, March 11, 1984, Section F, pp. 3, 8.
166. GATT, *International Trade 1982/83*, pp. 135–36.
167. North-South Institute, "Into 1984," p. 6.
168. *Globe and Mail*, November 21, 1983, p. B2.
169. Department of Energy, Mines and Resources official cited in *Globe and Mail*, April 19, 1983, p. B4.
170. Strange, "Protectionism and World Politics," p. 27. It was the retreat by private banks from lending to deeply indebted South American NICs that forced them to severely curtail their imports.

171. Robert K. Paterson and Michael B. Hicks, "Official Export Financing: A Canadian Perspective" (paper presented to the conference on Canada and International Trade, University of British Columbia, Vancouver, June 5-6, 1983), p. 2; Department of External Affairs, *Review of Canadian Trade Policy*, pp. 165-66; Laux, "Global Interdependence and State Intervention," p. 126.

172. Department of External Affairs, *Review of Canadian Trade Policy*, p. 166; *Globe and Mail*, May 9, 1983, p. B1.

173. Department of External Affairs, *Review of Canadian Trade Policy*, pp. 166-67.

174. *Globe and Mail*, October 24, 1983, p. B9.

175. Paterson and Hicks, "Official Export Financing," p. 38.

176. Ibid., pp. 3-4; Department of External Affairs, *Review of Canadian Trade Policy*, p. 167; *Globe and Mail*, May 9, 1983, p. B1.

177. Department of External Affairs, *Review of Canadian Trade Policy*, p. 184.

178. Ibid., pp. 65, 67; Nicholas Butler, "The Ploughshares War Between Europe and America," *Foreign Affairs* 62 (1) (Fall 1983): 106-13.

179. Butler, "The Ploughshares War," pp. 117-19; *Globe and Mail*, April 9, 1984, p. IB9.

180. *Financial Post*, May 19, 1984, p. 8.

181. *Financial Post*, January 7, 1984, p. 10. In the longer run, changes in exchange rates tend to be motivated by trends in trade patterns and balances and by changes in purchasing power attributable to comparative inflation rates, income growth, and productivity; see Ibid; *Financial Post*, May 19, 1984, p. 8. These factors are not susceptible to short-term manipulations by governments, although they can be influenced through the application of a broad range of policy instruments over the longer term.

182. Robert Bryce, former deputy minister of Finance, cited in Clarkson, *Canada and the Reagan Challenge*, p. 169.

183. Ibid., p. 164; Molot, "Canada-U.S. Relations," p. 90.

184. Clarkson, *Canada and the Reagan Challenge*, pp. 170-71; *Globe and Mail*, April 24, 1984, p. B18.

185. *Financial Post*, March 24, 1984, p. 2.

186. Ibid.

187. *Globe and Mail*, March 13, 1984, p. B19; *Globe and Mail*, March 9, 1984, p. B1.

188. Department of External Affairs, *Review of Canadian Trade Policy*, p. 36.

189. Ibid., p. 38.

190. Ibid., pp. 36-37.

191. Ibid., p. 38; *Financial Post*, January 7, 1984, p. 10.

192. *Financial Post*, March 17, 1984, pp. 1-2.

193. The strength of the U.S. recovery in 1983 and 1984 relative to other industrialized countries has also been a major factor.

194. Wilkinson, *Canada in the Changing World Economy*, pp. 108-109, 156-57.

195. General Agreement on Tariffs and Trade, *International Trade 1979/80* (Geneva: GATT, 1980), p. 46.

196. Clarkson, *Canada and the Reagan Challenge*, pp. 95, 98.

197. Government of Canada, *Foreign Direct Investment in Canada*, (Ottawa: Information Canada, 1972), p. 172.

198. Laux, "Global Interdependence and State Intervention," p. 118; Maureen Appel Molot, "The Domestic Determinants of Canadian Foreign Economic Policy: Beavers Build Dams" (paper delivered at the 1977 Annual Meeting of the American Political Science Association, Washington, D.C., September 1977), p. 5. This is not to discount entirely the importance of economic factors in determining intra-corporate trade flows, since TNCs do have to be responsive to commercial and competitive considerations in the longer run if they are to maintain profitability. Department of External Affairs, *Review of Canadian Trade Policy*, pp. 30-31.

199. Williams, *Not For Export*, p. 156.

200. The technological backwardness, lack of innovative capacity, and inefficient scale of operations of many foreign-owned manufacturing subsidiaries also strongly inhibit export development; Department of External Affairs, *Review of Canadian Trade Policy*, p. 52. However, these factors will not be dealt with in detail here, as they are more appropriately considered internal constraints to Canadian export development.

201. Government of Canada, *Foreign Direct Investment in Canada*, pp. 156, 165–66.

202. Molot, "Domestic Determinants of Canadian Foreign Economic Policy," p. 14, citing *Financial Post* source.

203. Williams, *Not For Export*, pp. 114–20, gives a detailed summary of the problem as seen by the Trade Commissioner Service in the 1950s and 1960s; Government of Canada, *Foreign Direct Investment in Canada*, pp. 163–65, summarizes data from a 1969 survey conducted by the Department of Industry, Trade and Commerce.

204. Patricia Best, "Just Because of the Children," *The Financial Post 500* (Summer 1984): 24.

205. Most producers of disposable food service products were uninterested in growing market opportunities in Europe. One pointed out that "We used to export in the mid-1960s. . . . Now it's just out of Neenah" (the head office of its American corporate parent). Another "said it is precluded from exports because it is only a licensee of Keyes Fiber C., of Stamford, Conn., which has its own operations throughout Europe." *Globe and Mail*, April 2, 1984, p. IB3.

206. Department of External Affairs, Review of *Canadian Trade Policy*, pp. 53–54.

207. Best, "Just Because of the Children," pp. 25 (quote), pp. 24, 28.

208. Molot, "Domestic Determinants of Canadian Foreign Economic Policy," p. 14 (quote); Government of Canada, *Foreign Direct Investment in Canada*, p. 49.

209. Department of Energy, Mines and Resources, Mineral Policy Division, Mineral Policy Series, "Canadian Minerals and International Economic Interdependence," *Mineral Bulletin* MR 162 (Ottawa: Minister of Supply and Services Canada, March 1977): p. 6.

210. Laux, "Global Interdependence and State intervention," pp. 117–18.

211. Government of Canada, *Foreign Direct Investment in Canada*, pp. 255–59.

212. Department of External Affairs, *Review of Canadian Trade Policy*, p. 226.

213. *Globe and Mail*, May 28, 1984, p. IB8.

214. Clarkson, *Canada and the Reagan Challenge*, pp. 84, 95–99; Hufbauer and Samet, "Investment Relations between Canada and the United States," pp. 123–24, 140–42.

215. Molot, "Canada-U.S. Relations," pp. 104–105.

216. Government of Canada, *Foreign Direct Investment in Canada*, p. 169.

217. Department of External Affairs, *Review of Canadian Trade Policy*, p. 148.

218. Department of Energy, Mines and Resources, Mineral Policy Sector, Internal Report, "Industry-Government Relations, Mineral Issues and Policy Framework: A Background Paper," W.G. Jeffery, MRI81/1 (January 1981), p. 15.

219. Strange, "Protectionism and World Politics," pp. 28–29, 45.

220. Organisation for Economic Cooperation and Development, *International Investment and Multinational Enterprises: Recent International Direct Investment Trends* (Paris: OECD, 1981); *Globe and Mail*, March 7, 1983, p. B8.

221. Hufbauer and Samet, "Investment Relations between Canada and the United States," pp. 127–32, 136–40.

222. *Globe and Mail*, April 2, 1984, p. IB1; *Globe and Mail*, April 24, 1984, p. B2.

223. Survey of 52 of the world's largest TNCs conducted by the private, New York-based "Group of Thirty" consultative group. *Globe and Mail*, April 2, 1984, p. IB1.

224. GATT, *International Trade 1981/82*, pp. 15–17.

225. Department of External Affairs, *Review of Canadian Trade Policy*, pp. 169, 224.

226. *Globe and Mail*, March 23, 1984, p. B11 (quote); North-South Institute, "Into 1984," p. 8. A specific case involving Indonesia is reported in *Globe and Mail*, August 21, 1984, p. 7.

227. Department of External Affairs, *Review of Canadian Trade Policy*, p. 142.

228. Doran, "United States and Canada," p. 144; Clarkson, *Canada and the Reagan Challenge*, pp. 115, 121, 276; Lazar, "Canadian Industrial Strategy: A U.S. Impediment," p. 233; Hufbauer and Samet, "Investment Relations Between Canada and the United States," pp. 123–24.

229. Clarkson, *Canada and the Reagan Challenge*, pp. 107, 121, 140–41, 236; Hufbauer and Samet, "Investment Relations Between Canada and the United States," pp. 123–24, 141–42.

230. Hay and Sulzenko, "U.S. Trade Policy and 'Reciprocity'," pp. 472–73.

231. Ibid., p. 472.

232. Ibid., pp. 473–75.

233. Department of External Affairs, *Review of Canadian Trade Policy*, pp. 197–198; Finlayson and Zacher, "GATT and the Regulation of Trade Barriers," pp. 567–69.

234. Economic Council of Canada, *Looking Outward*, p. 55.

235. *Globe and Mail*, March 14, 1984, p. B9, *Globe and Mail*, May 23, 1984, p. B17.

236. Department of Energy, Mines and Resources, "Canadian Minerals and International Economic Interdependence," p. 7; Department of Energy, Mines and Resources, Mineral Policy Sector, Internal Report, "A Mechanism to Facilitate Canadian Mineral Industry Involvement Abroad," prepared by International Minerals Division, MRI81/9 (May 1981), pp. 2–3.

237. Department of External Affairs, *Review of Canadian Trade Policy*, p. 198.

238. Economic Council of Canada, *Looking Outward*, p. 53.

239. Department of External Affairs, *Review of Canadian Trade Policy*, p. 198.

240. Ruggie, "Embedded Liberalism," especially pp. 209, 212–14.

241. Strange, "Protectionism and World Politics," p. 49.

242. Norman Hillmer and Garth Stevenson, eds., *A Foremost Nation: Canadian Foreign Policy and a Changing World* (Toronto: McClelland and Stewart, 1977); Dewitt and Kirton, *Canada as a Principal Power*.

243. Robert O. Keohane, "Economic Dependence and the Self-Directed Small State," *Jerusalem Journal of International Relations* 6 (2) (1982): 50.

244. Peter J. Katzenstein, "Introduction: Domestic and International Forces and Strategies of Foreign Economic Policy," and other articles in *International Organization*, Special Issue: "Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States," 31 (4) (Autumn 1977).

245. Keohane, "Economic Dependence and the Self-Directed Small State," p. 56.

246. Clarkson, *Canada and the Reagan Challenge*, p. 141.

247. Keohane, "Economic Dependence and the Self-Directed Small State," p. 57.

248. Grey, *Trade Policy in the 1980s*, pp. 6–8.

249. Ibid., p. 8; Department of External Affairs, *Review of Canadian Trade Policy*, p. 203.

About the Contributors

Jock A. Finlayson is Director of Policy Analysis and Research for the Business Council on National Issues, Ottawa.

Denis Stairs is Professor in the Department of Political Science at Dalhousie University, Halifax, and one of the two Research Coordinators for the section titled "Canada and the International Political Economy," which is part of the Politics and Political Institutions Research Area, Royal Commission on the Economic Union and Development Prospects for Canada.

Michael C. Webb is a Research Associate for the Institute for International Relations, University of British Columbia, Vancouver.

Gilbert R. Winham is Professor in the Department of Political Science, Dalhousie University, Halifax, and is also one of the two Research Coordinators for the section titled "Canada and the International Political Economy," which is part of the Politics and Political Institutions Research Area, Royal Commission on the Economic Union and Development Prospects for Canada.

Mark W. Zacher is Professor of Political Science and Director of the Institute for International Relations, University of British Columbia, Vancouver.

THE COLLECTED RESEARCH STUDIES

Royal Commission on the Economic Union and Development Prospects for Canada

ECONOMICS

Income Distribution and Economic Security in Canada (Vol.1), *François Vaillancourt, Research Coordinator*

Vol. 1 Income Distribution and Economic Security in Canada, *F. Vaillancourt* (C)*

Industrial Structure (Vols. 2-8), *Donald G. McFetridge, Research Coordinator*

Vol. 2 Canadian Industry in Transition, *D.G. McFetridge* (C)
Vol. 3 Technological Change in Canadian Industry, *D.G. McFetridge* (C)
Vol. 4 Canadian Industrial Policy in Action, *D.G. McFetridge* (C)
Vol. 5 Economics of Industrial Policy and Strategy, *D.G. McFetridge* (C)
Vol. 6 The Role of Scale in Canada–US Productivity Differences, *J.R. Baldwin and P.K. Gorecki* (M)
Vol. 7 Competition Policy and Vertical Exchange, *F. Mathewson and R. Winter* (M)
Vol. 8 The Political Economy of Economic Adjustment, *M. Trebilcock* (M)

International Trade (Vols. 9-14), *John Whalley, Research Coordinator*

Vol. 9 Canadian Trade Policies and the World Economy, *J. Whalley with C. Hamilton and R. Hill* (M)
Vol. 10 Canada and the Multilateral Trading System, *J. Whalley* (M)
Vol. 11 Canada–United States Free Trade, *J. Whalley* (C)
Vol. 12 Domestic Policies and the International Economic Environment, *J. Whalley* (C)
Vol. 13 Trade, Industrial Policy and International Competition, *R. Harris* (M)
Vol. 14 Canada's Resource Industries and Water Export Policy, *J. Whalley* (C)

Labour Markets and Labour Relations (Vols. 15-18), *Craig Riddell, Research Coordinator*

Vol. 15 Labour-Management Cooperation in Canada, *C. Riddell* (C)
Vol. 16 Canadian Labour Relations, *C. Riddell* (C)
Vol. 17 Work and Pay: The Canadian Labour Market, *C. Riddell* (C)
Vol. 18 Adapting to Change: Labour Market Adjustment in Canada, *C. Riddell* (C)

Macroeconomics (Vols. 19-25), *John Sargent, Research Coordinator*

Vol. 19 Macroeconomic Performance and Policy Issues: Overviews, *J. Sargent* (M)
Vol. 20 Post-War Macroeconomic Developments, *J. Sargent* (C)
Vol. 21 Fiscal and Monetary Policy, *J. Sargent* (C)
Vol. 22 Economic Growth: Prospects and Determinants, *J. Sargent* (C)
Vol. 23 Long-Term Economic Prospects for Canada: A Symposium, *J. Sargent* (C)
Vol. 24 Foreign Macroeconomic Experience: A Symposium, *J. Sargent* (C)
Vol. 25 Dealing with Inflation and Unemployment in Canada, *C. Riddell* (M)

Economic Ideas and Social Issues (Vols. 26 and 27), *David Laidler, Research Coordinator*

Vol. 26 Approaches to Economic Well-Being, *D. Laidler* (C)
Vol. 27 Responses to Economic Change, *D. Laidler* (C)

* (C) denotes a Collection of studies by various authors coordinated by the person named.
(M) denotes a Monograph.

POLITICS AND INSTITUTIONS OF GOVERNMENT

Canada and the International Political Economy (Vols. 28-30), *Denis Stairs and Gilbert R. Winham, Research Coordinators*

Vol. 28 Canada and the International Political/Economic Environment, *D. Stairs and G.R. Winham* (C)
Vol. 29 The Politics of Canada's Economic Relationship with the United States, *D. Stairs and G.R. Winham* (C)
Vol. 30 Selected Problems in Formulating Foreign Economic Policy, *D. Stairs and G.R. Winham* (C)

State and Society in the Modern Era (Vols. 31 and 32), *Keith Banting, Research Coordinator*

Vol. 31 State and Society: Canada in Comparative Perspective, *K. Banting* (C)
Vol. 32 The State and Economic Interests, *K. Banting* (C)

Constitutionalism, Citizenship and Society (Vols. 33-35), *Alan Cairns and Cynthia Williams, Research Coordinators*

Vol. 33 Constitutionalism, Citizenship and Society in Canada, *A. Cairns and C. Williams* (C)
Vol. 34 The Politics of Gender, Ethnicity and Language in Canada, *A. Cairns and C. Williams* (C)
Vol. 35 Public Opinion and Public Policy in Canada, *R. Johnston* (M)

Representative Institutions (Vols. 36-39), *Peter Aucoin, Research Coordinator*

Vol. 36 Party Government and Regional Representation in Canada, *P. Aucoin* (C)
Vol. 37 Regional Responsiveness and the National Administrative State, *P. Aucoin* (C)
Vol. 38 Institutional Reforms for Representative Government, *P. Aucoin* (C)
Vol. 39 Intrastate Federalism in Canada, *D.V. Smiley and R.L. Watts* (M)

The Politics of Economic Policy (Vols. 40-43), *G. Bruce Doern, Research Coordinator*

Vol. 40 The Politics of Economic Policy, *G.B. Doern* (C)
Vol. 41 Federal and Provincial Budgeting, *A.M. Maslove, M.J. Prince and G.B. Doern* (M)
Vol. 42 Economic Regulation and the Federal System, *R. Schultz and A. Alexandroff* (M)
Vol. 43 Bureaucracy in Canada: Control and Reform, *S.L. Sutherland and G.B. Doern* (M)

Industrial Policy (Vols. 44 and 45), *André Blais, Research Coordinator*

Vol. 44 Canadian Industrial Policy, *A. Blais* (C)
Vol. 45 The Political Sociology of Industrial Policy, *A. Blais* (M)

LAW AND CONSTITUTIONAL ISSUES

Law, Society and the Economy (Vols. 46-51), *Ivan Bernier and Andrée Lajoie, Research Coordinators*

Vol. 46 Law, Society and the Economy, *I. Bernier and A. Lajoie* (C)
Vol. 47 The Supreme Court of Canada as an Instrument of Political Change, *I. Bernier and A. Lajoie* (C)
Vol. 48 Regulations, Crown Corporations and Administrative Tribunals, *I. Bernier and A. Lajoie* (C)
Vol. 49 Family Law and Social Welfare Legislation in Canada, *I. Bernier and A. Lajoie* (C)
Vol. 50 Consumer Protection, Environmental Law and Corporate Power, *I. Bernier and A. Lajoie* (C)
Vol. 51 Labour Law and Urban Law in Canada, *I. Bernier and A. Lajoie* (C)

The International Legal Environment (Vols. 52-54), *John Quinn, Research Coordinator*

Vol. 52 The International Legal Environment, *J. Quinn* (C)
Vol. 53 Canadian Economic Development and the International Trading System, *M.M. Hart* (M)
Vol. 54 Canada and the New International Law of the Sea, *D.M. Johnston* (M)

Harmonization of Laws in Canada (Vols. 55 and 56), *Ronald C.C. Cuming, Research Coordinator*

Vol. 55 Perspectives on the Harmonization of Law in Canada, *R. Cuming* (C)
Vol. 56 Harmonization of Business Law in Canada, *R. Cuming* (C)

Institutional and Constitutional Arrangements (Vols. 57 and 58), *Clare F. Beckton and A. Wayne MacKay, Research Coordinators*

Vol. 57 Recurring Issues in Canadian Federalism, *C.F. Beckton and A.W. MacKay* (C)
Vol. 58 The Courts and The Charter, *C.F. Beckton and A.W. MacKay* (C)

FEDERALISM AND THE ECONOMIC UNION

Federalism and The Economic Union (Vols. 58-72), *Mark Krasnick, Kenneth Norrie and Richard Simeon, Research Coordinators*

Vol. 59 Federalism and Economic Union in Canada, *K. Norrie, R. Simeon and M. Krasnick* (M)
Vol. 60 Perspectives on the Canadian Economic Union, *M. Krasnick* (C)
Vol. 61 Division of Powers and Public Policy, *R. Simeon* (C)
Vol. 62 Case Studies in the Division of Powers, *M. Krasnick* (C)
Vol. 63 Intergovernmental Relations, *R. Simeon* (C)
Vol. 64 Disparities and Interregional Adjustment, *K. Norrie* (C)
Vol. 65 Fiscal Federalism, *M. Krasnick* (C)
Vol. 66 Mobility of Capital in the Canadian Economic Union, *N. Roy* (M)
Vol. 67 Economic Management and the Division of Powers, *T.J. Courchene* (M)
Vol. 68 Regional Aspects of Confederation, *J. Whalley* (M)
Vol. 69 Interest Groups in the Canadian Federal System, *H.G. Thorburn* (M)
Vol. 70 Canada and Quebec, Past and Future: An Essay, *D. Latouche* (M)
Vol. 71 The Political Economy of Canadian Federalism: 1940–1984, *R. Simeon* (M)

THE NORTH

Vol. 72 The North, *Michael S. Whittington, Coordinator* (C)

COMMISSION ORGANIZATION

Chairman

Donald S. Macdonald

Commissioners

Clarence L. Barber
Albert Breton
M. Angela Cantwell Peters
E. Gérard Docquier
William M. Hamilton
John R. Messer
Laurent Picard
Michel Robert
Daryl K. Seaman
Thomas K. Shoyama
Jean Casselman-Wadds
Catherine T. Wallace

Senior Officers

Executive Director
J. Gerald Godsoe

Director of Policy
Alan Nymark

Secretary
Michel Rochon

Director of Administration
Sheila-Marie Cook

Senior Advisors
David Ablett
Victor Clarke
Carl Goldenberg
Harry Stewart

Director of Publishing
Ed Matheson

Directors of Research
Ivan Bernier
Alan Cairns
David C. Smith

Co-Directors of Research
Kenneth Norrie
John Sargent

Research Program Organization

Economics

Research Director
David C. Smith

Executive Assistant & Assistant Director (Research Services)
I. Lilla Connidis

Coordinators
David Laidler
Donald G. McFetridge
Kenneth Norrie*
Craig Riddell
John Sargent*
François Vaillancourt
John Whalley

Research Analysts
Caroline Digby
Mireille Ethier
Judith Gold
Douglas S. Green
Colleen Hamilton
Roderick Hill
Joyce Martin

Politics and the Institutions of Government

Research Director
Alan Cairns

Executive Assistant
Karen Jackson

Coordinators
Peter Aucoin
Keith Banting
André Blais
Bruce Doern
Richard Simeon
Denis Stairs
Cynthia Williams
Gilbert R. Winham

Research Analysts
Claude Desranleau
Ian Robinson

Office Administration
Donna Stebbing

Law and Constitutional Issues

Research Director
Ivan Bernier

Executive Assistant & Research Program Administrator
Jacques J.M. Shore

Coordinators
Clare F. Beckton
Ronald C.C. Cuming
Mark Krasnick
Andrée Lajoie
A. Wayne MacKay
John J. Quinn

Administrative and Research Assistant
Nicolas Roy

Research Analyst
Nola Silzer

*Kenneth Norrie and John Sargent co-directed the final phase of Economics Research with David Smith

POLITICS AND INSTITUTIONS OF GOVERNMENT
Canada and the International Political Economy

Canada and the International Political/Economic Environment

DENIS STAIRS and GILBERT R. WINHAM, Research Coordinators

This is the first of three volumes dealing with **Canada and the International Political Economy** (see list in back of book), included in the Collected Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada.

Since its colonial beginnings, Canada's domestic economy has been defined largely by its relationship to the global economic system. The benefits to Canada have been great, but the country has, as a result, been vulnerable to the external world. Because of the tendency of industrial nations to produce similar goods, the potential for expansion and diversification of Canadian exports is not strong. The authors of the studies in this volume contend that, for a variety of reasons, the prospects for the expansion and diversification of Canadian exports is poor and, therefore, that Canada should fight against the introduction of new measures of protectionism, which would threaten our continued access to foreign markets.

AUTHORS AND TOPICS INCLUDE:

Canada and the International Political–Economic Environment: An Introduction Denis Stairs and Gilbert R. Winham

Canadian International Economic Policy: Context, Issues and a Review of Some Recent Literature Jock A. Finlayson

Canadian Export Trade in a Changing International Environment Michael C. Webb and Mark W. Zacher

DENIS STAIRS is Professor in the Department of Political Science, Dalhousie University, Halifax.
GILBERT R. WINHAM is Professor in the Department of Political Science, Dalhousie University, Halifax.

Royal Commission on the Economic Union and Development Prospects for Canada

University of Toronto Press

ISBN 0-8020-7271-2