

Industry Canada  
Research Publications Program

# **CANADA IN THE 21<sup>ST</sup> CENTURY**

## **I. SCENE SETTING**

### **BROAD LIBERALIZATION BASED ON FUNDAMENTALS: A FRAMEWORK FOR CANADIAN COMMERCIAL POLICY**

*Paper Number 2  
November 1998*

### ***Industry Canada Research Publications Program***

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### **BROAD LIBERALIZATION BASED ON FUNDAMENTALS: A FRAMEWORK FOR CANADIAN COMMERCIAL POLICY**

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Aussi disponible en français

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## Canadian Cataloguing in Publication Data

Wigle, Randall  
Broad Liberalization Based on Fundamentals: A Framework for Canadian  
Commercial Policy

(Canada in the 21st Century. I, Scene Setting; paper no. 2).  
Text in English and French on inverted pages.  
Title on added t.p.: Libéralisation étendue axée sur les aspects fondamentaux.  
Includes bibliographical references.  
ISBN 0-662-63777-1  
Cat. no. C21-27/1-1998-2

1. Canada – Commercial policy.
2. International economic relations.
3. Foreign trade promotion – Canada.
4. International trade – Forecasting.
- I. Canada. Industry Canada. Micro-economic Policy Analysis Branch.
- II. Title.
- III. Series: Canada in the 21st Century. I, Scene Setting.

HF1480.W53 1998

382'.3'0971

C98-980314-7E

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## PREFACE

AS A NEW MILLENNIUM APPROACHES, Canadians are going through a time of dramatic economic change. Markets are becoming global and economic activity across nations is becoming increasingly integrated. Revolutionary developments in computer and communications technology are facilitating globalization, and are also altering a great deal the workplace and the lifestyles of Canadians. At the same time, largely as a consequence of the information revolution, knowledge-based activities are becoming increasingly important within the Canadian economy and the economies of other industrialized nations.

These and related major transformations of the economic environment invite a comparison with the Industrial Revolution of the 1800s. As in the earlier time, major structural changes are giving rise to uncertainties. Firms and workers are struggling to find their place in the new economic order. Canadians collectively face the question of whether their nation's physical, human and institutional resources will provide a firm foundation for continued prosperity. Many see Canada's prospects as being much less secure than in earlier years, when the country's rich natural resources played a major role in shaping the Canadian economy.

To examine fully the medium to longer-term opportunities and challenges of these developments, the Micro-Economic Policy Analysis Branch of Industry Canada asked a group of experts to provide their "vision" for Canada in the 21st Century on a number of important issues. Each author was required to undertake two formidable tasks: first, to identify major historical trends and develop scenarios to illustrate how developments in his/her respective area might unfold over the next ten to fifteen years; and second, to examine the medium-term consequences of these developments for the Canadian economy.

The papers coming out of this exercise are now being published under the general heading of "Canada in the 21st Century". This series consists of eleven papers on different aspects of Canada's medium-term outlook. The papers are divided into three major sections. The first section, *Scene Setting*, focuses on important developments that are going to shape the medium-term economic environment in Canada. The second section, *Resources and Technology*, looks at trends among some important components of Canada's wealth creation and considers the actions needed to ensure that these factors provide a firm foundation for continued prosperity. The last section, *Responding to the Challenges*, explores individual, corporate and government responses to the medium-term challenges and offers some options for an appropriate course of action.

As part of the *Scene Setting* section, this paper by Professor Randy Wigle, of Wilfrid Laurier University, considers how Canada's commercial policy can best address the policy challenges posed by the dramatic changes under way in the world economy. Professor Wigle argues that as a result of policy liberalization and the introduction of new information technologies, world commerce is

becoming increasingly global and there is a corresponding need for global solutions in many policy areas. Canada has a strong interest in removing impediments to international commerce because of its small domestic market and its need of foreign investment and foreign technology. The author argues that the further liberalization now required, involving the extension of national treatment into new areas of international commerce, should be pursued by Canada through both multilateral discussions at the World Trade Organization (WTO) and OECD and through regional initiatives involving the Asia Pacific Economic Cooperation forum (APEC), the North American Free Trade Agreement (NAFTA) and the proposed Free Trade Area of the Americas (FTAA).

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## SUMMARY – THE CHALLENGE

**T**HE NEXT 10 TO 15 YEARS WILL SEE DRAMATIC CHANGES in the world economy. As it becomes increasingly driven by information and as border trade measures continue to fall, we will observe further globalization of international commerce.

The shift toward an information society means many things to many people, but the most fundamental consequences of new technologies are:

- the enhanced ability to integrate productive activities separated by distance;
- dramatic enhancement of the technological capacity to trade some services internationally;
- an increasing share of new business effectively driven by innovation; and
- increasing complementarity between international trade, direct investment and technology flows in business.

One result of these developments is the emergence of enterprises with operations and ownership that are hard to describe in terms of nationality. A related development is the increasing interdependence of a number of domestic and international policy fields. Competition policy and innovation policy were once regarded as overwhelmingly domestic in orientation, but that assessment is less and less accurate. In short, world commerce is increasingly global in outlook and orientation.

As commerce takes on this global perspective, regulatory reforms in many areas need a more global orientation. Governments will be able to achieve domestic policy goals only by giving due regard to the global context. In the long run, as globalization truly includes parts of the world where integration has not yet progressed very far, the multilateral forum will be ideal for resolving international trade issues. For a host of practical reasons, however, the first steps toward solutions will often be taken in the context of regional agreements or negotiations.

### CANADA'S COMMERCE

EVEN WITH THE PROLIFERATION OF INFORMATION TECHNOLOGIES and the lowering of trade barriers, geography still matters for significant parts of commerce. This is particularly true for Canada, where geography, combined with shared elements of history and culture, have led the Canadian and U.S. economies to be highly integrated. The integration is the result not merely of recent policy but also of inherent cost advantages from proximity and the existence of widespread networks linking the two nations.

Faster growth rates in other areas of the globe, along with more fundamental structural and policy reforms, are likely to mean that the fastest-growing



markets (in percentage terms) in the next 10 to 15 years will be outside North America. For example, overall trade by South and East Asia is predicted to grow by almost 10 percent per year over the next 10 years. The technological changes mentioned have reduced the importance of geography in many, but by no means all, sectors. As a result, the volume of trade and investment between Canada and the United States is still likely to dominate Canadian international commerce for the near future.

### **BROAD DIRECTIONS**

THIS PAPER ARGUES THAT CANADIAN COMMERCIAL POLICY over the next 10 years should support liberalization on the broadest regional and substantive basis possible. The focus should be on identifying and devising solutions to fundamental problems rather than managing troublesome symptoms such as trade balances or market shares.

### **LIBERALIZATION OR RETREAT?**

CANADA HAS LITTLE REAL CHOICE BUT TO PURSUE OPEN ACCESS to foreign markets through multilateral as well as bilateral negotiations. Some of the reasons are very simple:

- Canada's domestic market is small.
- Access to technology is crucial to Canadian economic growth.
- Access to foreign investment is crucial to Canada.

Accordingly, Canada must continue to push for progressive liberalization in the foreseeable future. This course must be interpreted in light of new realities of international commerce, specifically since liberalization now means more than simply reducing tariffs.

Improving firms' market access or market presence will often amount to extending national treatment to all firms, products and services in more and more areas of international commerce. Just as Canada was in the forefront of liberalization of border measures, it must take the lead in the effort to draft new international accords in areas such as investment, competition policy and product standards, and also in the reconsideration of existing remedies (such as anti-dumping and countervailing duties) in light of these reformulated international disciplines.

### **WHAT FOCUS?**

FOR MANY REASONS, NEGOTIATIONS ON NEW CODES OF CONDUCT in areas such as competition policy, investment and domestic regulation are likely to take place in several forums. These include multilateral discussions at the WTO and

OECD, discussions in regional forums such as APEC and the NAFTA, and broader discussions about more liberal trade in the Americas.

With the emergence of the United States as the sole political superpower, its dominant position is probably as great a challenge to Canadian policy makers as at any time in our country's history, and it is likely to remain so. For this reason, Canada should continue to give adequate priority to negotiations in the multilateral sphere as a natural counterbalance to the United States' pre-eminent economic power vis-à-vis Canada.

Further, the returns from further negotiations in the Americas have waned in comparison with those in the multilateral forum, partly because of the breadth of achievements in the NAFTA along with Uruguay Round disappointments.

While regional and multilateral discussions on new and traditional dimensions of market access are important, special priority should be given to discussions at the WTO, preferably in the context of a new round of multilateral negotiations. A pressing agenda already exists for a new multilateral round, which should be launched at the earliest opportunity. Canada's overall negotiating strategy should concentrate on the multilateral disciplines that could result as a long-term goal.

## **BACK TO BASICS**

IN GENERAL, WHEN PURSUING SOLUTIONS TO THE NEW CHALLENGES or reducing traditional border measures, wherever possible Canada should start by identifying the fundamental cause (in terms of an uninternalized externality or distortion) of an apparent problem and should proceed from there to a solution. In the area of competition policy, for example, Canada should seek elimination of anti-dumping as it is now used. It should also oppose proposals that target symptoms (such as trade balances or market shares) chosen in isolation from any underlying economic analysis. Canada should oppose any proposals involving such targeting except as transitional measures.

## **ENVIRONMENTAL AND HUMAN RIGHTS ISSUES**

OVER THE NEXT 10 TO 15 YEARS, the international community will determine how or whether international trade should be linked to environmental and human rights. Canada should clearly promote international efforts to improve the global environment and human rights in their respective primary forums.<sup>1</sup> At the same time, Canada should be committed to making trade aspects of any international accords as consistent as possible with core principles of the trading system, and it should also support solutions that truly address the fundamental challenges of protecting the environment and human rights.

## CONCLUSION

CANADA'S COMMERCIAL POLICY OVER THE NEXT 10 TO 15 YEARS should stress two key commitments:

1. Commitment to liberalization on the broadest range of international commerce. This should include a renewed commitment to development of the multilateral system, even in our discussions in other forums.
2. Commitment to achieving the fundamental goals of trade policy in the least trade-distorting manner possible.

The greatest challenges for Canadian policy makers in the next 10 to 15 years are likely to be reining in the public debt and improving the ability of the labour market to supply jobs and needed skills. While prudent commercial policy is an important ally in this task, it cannot replace sound domestic policy making. At the same time, it is quite clear that bad commercial policies (in particular, those that attempt to scapegoat trade) would certainly thwart the achievement of domestic policy goals.

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## INTRODUCTION

THIS PAPER ANALYSES THE COMMERCIAL POLICY CHALLENGES and opportunities for Canada over the next 10 to 15 years. This period will see dramatic change, some aspects of which are easier to anticipate than others. While many of the biggest challenges facing Canadian negotiators will be in the new areas of deeper integration,<sup>2</sup> there is a continuing challenge to pursue the process of shallow integration.

Canada's commitment to liberalization on the broadest basis is longstanding and well justified, perhaps especially so in the increasingly integrated global economy. But globalization appears to apply not only to the world economy but the world of international commercial diplomacy. For the foreseeable future, Canada must remain committed to discussions in a host of different forums including the World Trade Organization (WTO) and the Organization for Economic Co-operation and Development (OECD), as well as the American trade sphere and the Asia Pacific Economic Cooperation forum (APEC). The paper addresses the issue of the fit and balance between the various forums. The most obvious recommendation is that Canada undertake the groundwork for launching a new multilateral round at the earliest opportunity.

The essential motivation for most international commercial agreements arises from the observation that certain actions by government or private actors in one country ignore externalities that lead to reduced global welfare. Examples range from classic problems such as tariffs to less obvious problems such as national regulation of safety standards for automobiles. In the first case, the externality posed by a national government is obvious and the correction is equally obvious. In the other, the externality lies not merely in the setting of standards but rather in doing so with an eye to benefiting domestic firms.<sup>3</sup> In that case, the key uninternalized externality is a possible lack of consideration by the national government for the compliance costs of foreign producers. The solution here would be to set a standard in light of other existing standards<sup>4</sup> and without special regard for domestic producer interests. Clearly the latter result is less straightforward but it follows from a careful identification of the underlying problem.

This paper argues that, wherever possible, international disciplines should focus on identifying and dealing with the underlying causation rather than symptoms that may seem to need redress. One might think here of large trade or current account deficits or imbalances in trade. The heart of the argument is that focussing on elimination of the observed disparities often means working to eliminate the very trade gains that most multilateral and bilateral negotiations seek to preserve and enhance.

Following the Introduction, the first section discusses the nature of the emerging global economy, highlighting its importance to Canada. The next section discusses the evolution of Canadian commercial policy and lays some of the groundwork for the following section, which discusses future policy issues, followed, in the last section, with our conclusions.



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## THE GLOBAL ECONOMY

### GLOBALIZATION AND THE INFORMATION ECONOMY

THE NEXT 10 TO 15 YEARS WILL SEE DRAMATIC CHANGES in the world economy. As it becomes increasingly driven by information and as border trade barriers continue to fall, we should observe continued integration of most national economies.

The shift toward an information society means many things to many people, but the most fundamental consequences of new technologies are the following:

- enhanced ability to integrate productive activities separated by distance;
- dramatic enhancement of the technological capacity to trade some services internationally;
- an increasing share of new business effectively driven by innovation; and
- increasing complementarity between international trade, direct investment and technology flows in business.

One consequence of these developments is the emergence of enterprises whose operations and ownership are hard to describe in terms of nationality. A related development is the increasing interdependence of a number of domestic and international policy fields. Competition policy and innovation policy were once regarded as overwhelmingly domestic in orientation, but that assessment is becoming less and less accurate. Further, the linkages between investment, competition and innovation policy are becoming tighter.<sup>5</sup> In summary, world commerce will be progressively more global in outlook and orientation.

### TRENDS IN WORLD TRADE

BECAUSE OF DIFFERING GROWTH RATES AND POLICY REFORMS, in the next 10 to 15 years the fastest-growing markets (in percentage terms) are likely to be outside North America. In particular, for East Asia as a whole, trade is projected to grow by an average of over 10 percent per year, fuelled by both East Asian export-oriented market economies and China. For South Asian countries trade is projected to grow by nearly 8 percent. In the case of both China and India, increased trade results from extensive policy reform and excellent regional growth prospects. The situation for the newly independent states and former communist countries is somewhat less favourable, partly because of fears of uneven policy reforms and growth prospects. For Latin American countries, trade is expected to grow at a speed similar to that for high-income countries generally.

In many cases, increasing liberalization of trade policies in developing countries is expected to raise these trade growth figures. Developing countries have undergone a remarkable sea change in terms of opening their economies, and the trend is expected to continue (Dean, 1995). Unfortunately there are some important exceptions; hence the projection of mixed trade growth for some low-income nations (World Bank, 1996a).

### THE INCREASING AND CHANGING ROLE OF FDI

THE RECENT DRAMATIC EXPANSION of international foreign direct investment (FDI) has some new characteristics. While FDI stocks are still predominantly in industrialized nations,<sup>6</sup> FDI flows to other countries (most notably China and Singapore) have been growing much faster.

If FDI in China stabilizes near the levels of the last few years, that country will become as important a host to foreign investment as the United States within 10 to 15 years.<sup>7</sup>

In addition, policy concerns in developing countries by and large have turned from protecting against foreign investment to actively attracting it. This shift is in part due to the technology transfer that is now part and parcel of much FDI. Most developing countries now realize that they need technology transfer to improve their growth performance. In general, they have also found that fears of domination by multinational corporations have been overblown.

**TABLE 1.1**

**FORECAST GROWTH RATES, 1996–2005**  
PERCENTAGE

Region	Imports	Exports	GDP
World	6.3	6.3	3.5
High-Income Countries	5.8	6.0	2.8
<b>Low- and Middle-Income Countries</b>			
East Asia and Pacific	10.7	10.2	7.9
South Asia	8.1	7.2	5.4
Latin America and Caribbean	5.8	6.1	3.8
Europe and Central Asia	5.9	5.1	4.3
Middle East and North Africa	5.9	4.1	2.9
Sub-Saharan Africa	5.5	4.8	3.8

Source: World Bank, 1996b.

**TABLE 1.2****GROWTH OF FDI FLOWS, 1985–93**  
ANNUAL PERCENTAGE CHANGE

Region	Outward FDI	Inward FDI
North America	9.9	10.1
Western Europe	15.3	16.2
South and East Asia	22.2	16.0
Rest of World	14.5	10.0
World Total	14.3	13.1

Source: Graham, 1996, p. 16.

Globalization has also meant that investment, once viewed as a substitute for trade, is increasingly a complement to trade as firms offer a package of goods (or services) plus local support and service for them.

**CANADA AND THE GLOBAL ECONOMY**

MERCHANDISE TRADE PLAYS AN IMPORTANT PART in the Canadian economy, amounting to roughly 30 percent of GNP (see Table 1.3). This ratio is expected to grow over the next 10 to 15 years. Over the last 20 years, trade in services has grown at about the same rate as the Canadian economy (see Table 1.4). Its volume is currently much smaller than that of merchandise trade but is expected to grow much faster given the technological innovations discussed earlier.

**TABLE 1.3****MERCHANDISE TRADE IN CANADA'S GNP**

	1935	1975	1995
Exports (\$ millions)	732	33,347	253,821
Share of GNP (%)	17	20	33
Imports (\$ millions)	526	33,986	225,431
Share of GNP (%)	12	20	29

Sources: Leacy, 1983; and Statistics Canada, 1996.



<b>TABLE 1.4</b>			
<b>TRADE IN SERVICES</b>			
	<b>1935</b>	<b>1975</b>	<b>1995</b>
Service Exports (\$ millions)	397	6,686	36,504
Share of GNP (%)	9	4	4
Service Imports (\$ millions)	474	11,418	45,860
Share of GNP (%)	11	6	6
Sources: Leacy, 1983; and Statistics Canada, 1996. Excludes factor services (investment income).			

While Canada still relies on important primary exports (notably forest products, grains, minerals and energy products), manufactures now account for more than 65 percent of its merchandise exports. The share of primary goods in Canada's total exports (including non-factor service exports) is less than 30 percent and has been falling over the last 20 years.

### **The Geographical Pattern of Trade**

Canada's trading relations with the United States are very important. In the first quarter of 1996, exports to the United States accounted for over 80 percent of Canadian exports. By contrast, about 25 percent of U.S. exports come to Canada. Even though each is the other's most important trading partner, Canada's reliance on the U.S. market is dramatically greater than U.S. reliance on the Canadian market.

The increasing importance and participation of low- and middle-income countries in international commerce has been widely noted. Nevertheless, it is possible to overstate the future importance to Canada of their trade. Even though Canada's trade with Asian nations is likely to grow much more quickly than with the United States, the volume of trade and investment between Canada and the United States is still likely to dominate Canadian international commerce for the foreseeable future.

## Foreign Direct Investment

When Canadians speak of foreign investment, they usually think of foreign countries acquiring Canadian firms or opening Canadian subsidiaries. The term “foreign investment” has tended to be used for inward foreign investment in Canada. As Table 1.5 notes, this view was appropriate even as recently as 1975. Now, however, Canadian direct investment flows abroad are almost as large as foreign investment flows into Canada.<sup>8</sup> When Canada considers international rules on investment, it ought to examine them from the viewpoints of both host country and potential investor.

TABLE 1.5		
FOREIGN DIRECT INVESTMENT		
	1975	1995
Foreign Direct Investment in Canada (\$ millions)	39,000	168,077
Canadian Direct Investment Abroad (\$ millions)	8,200	142,347
Ratio of Inward to Outward FDI	4.7:1	1.2:1
Source: Hummels and Stern, 1994, and CANSIM 1996.		

## SUMMARY

WHAT WILL ALL THIS MEAN FOR CANADIAN CONSUMERS and businesses over the next 10 to 15 years?

- Trade and investment opportunities should grow faster than Canada’s GNP. Growth will be especially strong in East and South Asia.
- Even given the higher rates of growth in trade with other regions, the United States will continue to dominate Canada’s international commerce.
- An increasing array of products and services will be available to Canadian consumers at attractive prices. Some of this change will be driven by technology but an important part will be the result of our international commercial linkages.
- We can expect ongoing pressures in labour markets in two main directions:

- turnover and frictional unemployment; and
- increasing skilled-unskilled wage differentials.

Once again, these pressures will come partly from technological change and partly from increased trade competition.

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## THE EVOLUTION OF CANADA'S POST-WAR COMMERCIAL RELATIONS

THIS SECTION SURVEYS DEVELOPMENTS IN CANADIAN COMMERCIAL POLICY and the multilateral trading system, presenting the background to a future policy approach. Some specific dimensions of Canada's trade policy are related to its particular place in the world economy.

Over the last half-century, Canada has played a prominent role in the world trading system. As a founding member of the General Agreement on Tariffs and Trade (GATT), Canada signalled the importance of stable export markets. The restrictions on Canadian protection imposed by adherence to the GATT system has seemed more than a fair exchange for more predictable and rules-based access to export markets.<sup>9</sup>

Canada's place in international commerce has also influenced its commercial policy choices. As noted earlier, Canada sends roughly 80 percent of its exports to the United States; accordingly, access to this market is key to successful commercial policy. At the same time, Canada's dependence on the U.S. market for exports has been a cause of concern. With an obvious disparity in economic and political clout between Canada and the United States, GATT's commitment to rules has offered a natural counterbalance to U.S. power. On another track, virtually since Confederation Canada has approached and backed away from preferential bilateral trading arrangements with the United States.

The conflict between Canada's commitment to the multilateral trading system's non-discrimination principle and the desire to secure access to its most important market has long been a topic for debate. Until 1965, Canada had eschewed the bilateral path in favour of unequivocal support for the multilateral system.<sup>10</sup>

Canada's indecision about special trading relations with the United States is understandable at a number of levels. On the one hand, there is the opportunity to maximize the returns on trade negotiation efforts, given both the volume of initial trade and the like-mindedness of Canada and the United States. On the other hand, the multilateral approach offers broad-based gains with the widest range of countries. There is, however, an additional issue at stake: the question of how to manage the relative power balance between Canada and the United States. The advantage of the bilateral option is that we signal how seriously we treat the bilateral trade relationship. This is both benefit and cost in the sense that it tends to draw us into negotiations where the United States has more power over agenda setting. A subsidiary issue is the conflict between preferential treatment of the United States and the principle of more favourable treatment for poor nations.

## THE AUTO PACT

THE 1965 AUTO PACT BETWEEN THE UNITED STATES AND CANADA could be considered a watershed for Canadian commercial policy, a one-of-a-kind opportunity. The logic of the Auto Pact came from two salient facts (noted in English, 1964; and Eastman and Stykolt, 1967):

- Short production runs made Canadian-produced autos significantly more costly to manufacture than their U.S. counterparts. Vehicles were produced primarily for the small Canadian market. On the export side, border measures made it harder for Canadian firms to increase their production runs by selling cars in the United States.
- U.S. auto firms dominated the Canadian auto industry, and they would benefit from improved access to the Canadian market and cost reductions through rationalizing their operations between Canada and the United States.

Because the Big Three auto firms spanned the Canada-U.S. border, the major resistance to free trade in autos arose from fears that it would lead to the dismantling of the Canadian auto assembly industry. These fears were addressed by safeguards built into the Auto Pact, specifying formulas to assure Canada a fair share of the auto market. The Big Three went along because they did not expect the safeguards to restrict them significantly.

The Auto Pact may be the instance in which the relative returns on the bilateral approach to trade policy were most advantageous. There were potentially large gains on both sides of the border; at the same time, worldwide negotiations on free trade in autos would have been extremely cumbersome and unlikely to succeed. While trade in autos and parts was once small, it now accounts for over 40 percent of Canada's exports to the United States, and over 30 percent of the country's total exports.<sup>11</sup>

## THE TOKYO ROUND

BY 1970, THE GATT SYSTEM HAD CONDUCTED SEVEN ROUNDS of multilateral trade negotiations. As well as significantly reducing industrial tariffs, the Tokyo Round (1973–79) went a long way toward codifying some of the key principles of the multilateral trading system. The principle of special and differential status (S&D) for developing countries was embodied in Part IV of the GATT. The Tokyo Codes (which amounted to rule books for anti-dumping, safeguards and countervailing duties, among others) also became part of the GATT and marked a major step forward in making the system more transparent.

The Tokyo Round thus achieved significant results, but problems remained. Trade in agriculture as well as textiles and clothing continued to vio-

late core GATT principles. By the 1980s, the dispute settlement mechanism was being criticized for its delays and the refusal of parties to comply with GATT rulings. The application of most of the Tokyo Codes on an unconditional Most Favoured Nation (MFN) basis had led to divisions between contracting parties. On the one hand, a core group of parties had acceded to all the codes, thereby committing themselves to apply the codes on an unconditional basis to all countries. On the other hand, many low- and middle-income countries acceded to few or none of the codes; accordingly, they came to be known as free riders. Since many of these same countries did not participate in tariff reductions, the view was fostered of a GATT consisting of a core of wealthy nations and a wider group of non-participating countries.

In this split Canada was clearly in the GATT core, and in a sense our experience with the post-Tokyo GATT was not unrepresentative. We had suffered from a lack of compliance with GATT rulings in our favour and had also delayed compliance with GATT rulings against us. Canada has also been equivocal on agriculture: it has sought open markets for its major export products (grains and red meat) while advocating quota protection for the supply-managed sectors.

## THE FTA AND NAFTA

CANADA'S INTEREST IN NEGOTIATING FREE TRADE with the United States finally led to the signing of the bilateral Canada - U.S. Free Trade Agreement (FTA) in January 1988. Fuelling the long-standing interest in a special trade deal with the United States were dispute settlement problems and the expected difficulty of addressing new and increasingly important areas (notably services and investment) in the multilateral context.

In the negotiations, Canada's main concern was security of access, including more effective discipline on U.S. contingent protection. For its part, the United States seemed interested chiefly in providing a model for the Uruguay Round of negotiations and constraining some aspects of Canadian policy that were particularly offensive to the Americans. In addition, there may well have been a U.S. willingness to reward a like-minded government for pursuing desirable economic policies. Among the policies that the United States may have wanted to restrict were export controls under the National Energy Program, and Canadian review of foreign takeovers under the Foreign Investment Review Act (FIRA).

The FTA eventually established free trade in most goods, and it extended broad national treatment provisions for trade in services and for investment. Most notably, the FTA introduced a dispute settlement mechanism designed to address the key weaknesses of the GATT process: delays and non-compliance.

The most trade-distorted aspects of agricultural trade were exempted from free trade in goods (notably Canada's supply-managed sectors and U.S. sugar).

Many circles in Canada were highly sceptical of the extension of the FTA to include Mexico under the North American Free Trade Agreement

(NAFTA), but the real impact of that extension on Canadian trade is likely to have been modest indeed.<sup>12</sup> Certainly, trade volumes with Mexico have not increased as rapidly as some had expected. This is not to say that the FTA extension was not a good idea but rather that its effects were less dramatic for Canada than for the other parties.

In many respects the NAFTA resembles the FTA, with obvious changes required to integrate Mexico. The crucial changes included the following:

**Side agreements** – The agreements on environmental and labour issues are notable in that they are parallel rather than integral to NAFTA. Accordingly, they tend to address the underlying issues directly rather than focussing on trade remedies, as some had argued they should do.

**Rules of origin** – The NAFTA's rules of origin are considered by many to be less open than those of the FTA. In particular, the rules of origin for autos, textiles and clothing have higher content requirements. Although they are less subject to bureaucratic manipulation, it appears that in some respects these rules were designed to favour the Big Three auto makers at the expense of offshore producers.<sup>13</sup>

**Enhancement of new areas** – A number of subtle changes broaden the applicability of already strong disciplines on investment, standards and services.

### Free Trade in the Americas

Future extension of the NAFTA to eventually include all of the Americas has been spoken of in terms of Western Hemispheric Economic Integration,<sup>14</sup> the Enterprise for the Americas initiative or, more recently, a Free Trade Area of the Americas (FTAA). This is now seen as emerging either from a country-by-country expansion of the NAFTA or perhaps from integration of an expanded Mercosur into the NAFTA. The 1994 Miami Summit of the Americas ended with a commitment by leaders to negotiate a free trade agreement by the year 2005. Canada has also shown its willingness to negotiate bilateral trade agreements with individual Latin American countries, most notably Chile.

### THE URUGUAY ROUND

WHILE THERE IS INSUFFICIENT TIME TO PRESENT AND ANALYSE the full significance of the Uruguay Round to Canada, some important characteristics of the agreement are worth emphasizing. Some of the ongoing discussions under way in the WTO sphere are examined later.<sup>15</sup>

The Uruguay Round broke new ground in several respects:

- coverage of new areas;
- liberalization in problem areas;
- increased participation of non-core countries; and
- broad-based attempts to strengthen the support for rules and to encourage compliance with panel findings.

### **Expanded Coverage**

The Uruguay Round attempted to extend GATT discipline to new areas of international commerce, specifically international trade in services, international investment and intellectual property. The extension was important because part of the perceived weakness of the General Agreement on Tariffs and Trade was that it did not deal at all with what were becoming key elements of the global economy.

Although the service sector in most industrialized countries constitute close to 50 percent of GNP, it had not been covered by GATT disciplines. This was partly because trade in services is largely restricted by domestic regulations or restrictions on foreign firms' right to do business, rather than by the usual GATT border measures; hence the obvious linkages to investment discussions.

The framework created for future negotiations is very valuable since it provides for further liberalization of trade in services within the multilateral setting. Somewhat disappointing, however, was the extent to which nations committed to applying the national treatment obligations.

Investment measures were discussed in the specific context of the Trade-Related Aspects of Investment Measures (TRIMS). These discussions were very disappointing, for several reasons. First, much time was devoted to identifying which investment measures were or were not trade-related, even though most authorities on the topic argue that any such distinction is artificial. All measures that affect investment can be seen as trade-related, particularly when one realizes the fact that an increasing volume of investment is complementary to trade.

In contrast, the progress made on protecting intellectual property was quite remarkable. A broad range of countries agreed to significantly improve protection of intellectual property. In a sense this amounts to a huge concession on the part of developing nations, the overwhelming majority of which are significant net importers of intellectual property. At the same time, improved protection of intellectual property may well have been in these nations' own interest, helping them to attract investors.



### **Problem Areas**

Virtually since the establishment of the GATT, trade in agricultural products and in textiles and clothing has remained outside of normal GATT disciplines. Before the Uruguay Round, trade in these problem areas violated the principles of progressive liberalization, MFN, transparency and special and differential treatment (S&D). More generally, the violations threatened to undermine respect for the multilateral trading system.

Quotas, export subsidies and production subsidies for agriculture were quite common in wealthy countries. One could have called this a cold war of one wealthy nation against another, fought with the weapon of budgets. Poor agricultural exporting countries were often unable to compete.

The Uruguay Round Agreement on Agriculture specifies very modest levels of initial liberalization but it commits nations to return to GATT disciplines, most notably through tariffication and restriction of export subsidies. If future rounds further reduce trade barriers, we should see better access for Canada's major agricultural exports (grains and red meat) and the relaxation of the country's extremely restrictive border measures on supply-managed products.

Trade in textiles was governed by a complex system of bilateral quotas under the Multi-Fibre Arrangement (MFA). This amounted to a detailed trade management arrangement featuring restricted access to wealthy markets for low- and middle-income producers. The Uruguay Round commitments, if realized, should eventually mean the end of the MFA. The main threat to this result is the possibility that producers in wealthy nations would resort to anti-dumping duties to limit penetration of imports. Such a move would probably be a major disappointment for many exporters, particularly given the inadequacies of anti-dumping (see the section entitled *Anti-Dumping and Competition Policy* below).

### **Increased Participation**

The Uruguay Round went a long way toward integrating poorer nations into the world trading system. To a large extent, this success was the result of many countries' amazing policy direction shift toward more liberal trading regimes.<sup>16</sup> More directly, the Uruguay Round's single undertaking meant that each country signing the Round agreed to abide by essentially the same wide range of commitments as any other. This uniformity will effectively eliminate the two-tier system of GATT, with the wealthy countries adhering to one set of codes and low- and middle-income countries adhering to weaker ones.

### **Rules versus Power**

The Uruguay Round also provided a number of features that serve to bolster the role of rules in the trading system. Most important, because of the adoption of a more automatic (and thus more rules-based) dispute settlement mechanism,<sup>17</sup>

parties to disputes have a reduced ability to interfere with the investigative panels established under the WTO agreements.

### CONCLUSION

SINCE THE INCEPTION OF THE GATT, Canada has been a major supporter of the multilateral trading system and (as many argue) one of its most prominent beneficiaries. Nevertheless, in recent years Canada has devoted special interest to the Pan-American avenue of negotiations. An ongoing question is how these recent efforts mesh with efforts to extend and support the multilateral system.



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## FUTURE POLICY ISSUES

**I**N WHAT FOLLOWS, WE DISCUSS SEVERAL ISSUES on the trade policy agenda for the near future. The next section briefly endorses liberalization on the broadest basis as the first priority. Subsequent sections look at a broad range of other issues.

### LIBERALIZATION OR RETREAT?

CANADA HAS LITTLE REAL CHOICE BUT TO PURSUE OPEN ACCESS to foreign markets through multilateral as well as bilateral negotiations. Some of the reasons are very simple:

- Canada's domestic market is small.
- Access to technology is crucial to Canada's economic growth.
- Access to foreign investment is crucial to Canada.

Accordingly, Canada must continue to push for progressive liberalization in the foreseeable future. This course must be interpreted in light of the new realities of international commerce, specifically since liberalization now means more than simply reducing tariffs.

Perhaps more important than reasons supporting liberalization is a recognition of the danger of the opposite course: policies that attempt to solve domestic problems by scapegoating trade are likely to be both costly and very ineffective.<sup>18</sup> Because trade policy works so indirectly on any number of domestic policy problems, solutions based on protection are likely to interfere with better-targeted responses. For example, if we react to technologically-driven unemployment by becoming more inward looking, we might make the adjustment to new technologies that much more difficult by increasing the cost of learning, acquiring and using new technologies.

### TRADE IN SERVICES

DISCUSSIONS OVER TRADE IN SERVICES WERE NEW to the Uruguay Round and led to the General Agreement on Trade in Services (GATS). Once again, the number of specific commitments was modest but a framework was created for future negotiations. Because trade in services often does not involve the movement of goods from one country to another, something different was needed from the customary GATT approach of restricting the application of border measures on goods. Liberalization in services will often mean changing domestic regulations that discriminate against foreign service providers. The linkages to discussions on investment are particularly obvious here, since trade in services is often made possible by direct investment.

Perhaps the main challenge on the multilateral agenda is to broaden the applicability of national treatment to more sectors, with fewer exemptions. This long-term goal could be addressed in a new trade round. To a significant degree, extending national treatment will require governments to identify the precise goals of policies violating national treatment, with the aim of addressing the fundamental concern more directly than by discriminatory restrictions on service providers. NAFTA provisions on services apply national treatment more broadly and with fewer exceptions, but even here excepted sectors remain.

Canada offers an example of the justifications used for exempting particular service sectors from national treatment obligations. It has long maintained that Canadian culture is threatened by the domination of U.S. media and culture, necessitating special treatment for cultural industries. Many aspects of the "cultural" industries (e.g., publishing, broadcasting and the arts) fall within the category of trade in services.

In several cases in recent years, Canada has moved to protect "cultural" industries when the United States has considered them to be essentially commercial activities. In one case, Borders Books (a United States-based bookseller) was prevented from opening outlets in Canada. At the heart of the dispute is the question of whether book selling is a cultural industry. While it seems clear that the publication of Canadian writers or other artists is cultural, it is far less evident that retailing falls under this rubric.

There is no consensus in Canada about which aspects of culture deserve protection and what amounts to protection of essentially commercial interests. It would seem that restricting retailing is an extremely indirect way of supporting Canadian culture. This could be done most directly and transparently by supporting Canadian authors or the publication of their work. Such an approach would not require any rules restricting what retailers sell, nor would it require that book retailers from other countries be excluded from the market. Further, the intervention would be applied as directly as possible to the identified problem.

Extension of GATS provisions could be discussed at a new multilateral round, although it is unclear how much success would be achieved. There is less scope for extending services disciplines in the NAFTA context. The general consequences of the process are likely to contribute to increased growth in trade in services; but as noted earlier, given the small base for imports or exports of services, volumes may not increase dramatically. Nonetheless, improved market presence is of interest to a wide variety of global firms.

## COMPETITION POLICY

WHILE THE EXACT AGENDA FOR FUTURE DISCUSSIONS on international competition policy is far from clear, the need for such discussions is obvious.<sup>19</sup> As argued earlier, the increasingly integrated world economy has led to inextricable linkages between national competition policies and the abilities of offshore firms to

do business abroad effectively. This applies to firms wanting to sell goods abroad as well as those wishing to undertake direct investments or establish a market presence.

A core concern of competition policy should be to promote economic efficiency, for example, by ensuring that markets are as competitive (contestable) as possible. Doing this will normally entail granting foreign firms and products national treatment for the purposes of establishment and investment. The application of conditional national treatment<sup>20</sup> will not normally be consistent with promoting efficiency.

Broad areas of concern in discussions of international competition policy include the following:

**International cartels** – The operations of international cartels often lie outside the jurisdiction of any one country, making international rules necessary.<sup>21</sup>

**Restrictive business practices** – Often, business practices have the effect of excluding foreign suppliers.

**Corporate governance** – Differing forms of corporate governance affect the ease or difficulty encountered by new entrants to a market. In some cases foreign firms may be at a particularly disadvantage. Also, firms used to easy entry in their domestic markets may expect similar openness in foreign markets.

**Government regulation** – Some aspects of government regulations treat foreign firms differently from domestic firms. Further, some regulations not explicitly discriminating against foreign firms may still put them at a disadvantage.

**Product standards** – Standards can effectively bar entry of foreign products even without explicitly discriminating against them. Differing safety standards in different countries can result from different national approaches for achieving often comparable ends. The problem for firms is that adapting products to different standards may be costly, particularly where larger-scale production offers greater returns.

The difficulties of negotiating a comprehensive international accord are profound. First, it must be acknowledged that different nations enforce their competition policies with different levels of energy. This in itself has led to significant friction, notably between the United States and Japan. Further, some developing countries do not have a competition policy.

Even beyond these practical difficulties, there are fundamental problems with the economic foundations of some policies, both at the theoretical and empirical level. For example, the theoretical ground for opposing some types of horizontal takeovers has shifted since widespread acceptance that market con-

centration is a problem only when the market concerned is not contestable. Even where the theoretical ground is reasonably clear (as in the case of resale price maintenance), the appropriate policy may depend on case-by-case (including nation- and sector-specific) considerations of empirical magnitudes such as elasticities. The efficiency basis for challenging certain forms of vertical integration (such as the Japanese vertical *keiretsu*) is also very shaky. Further, the appropriate competition policy may depend on the link between rivalry and innovation. Increased rivalry can improve innovation in some circumstances; in others, it may reduce the ability to innovate.

In summary, it is not clear what the “best” competition policy is; and even if we fully understood the economics underlying this question, the “best” competition policy would probably differ from country to country. As a result, negotiating a binding international accord on all aspects of competition policy is very unlikely in the foreseeable future.

The leading options for eventually concluding a multilateral agreement are as follows:

1. To monitor experience with existing arrangements (under the NAFTA and between other governments) and simultaneously to pursue discussions, probably through the OECD. This approach would see a broader multilateral agreement emerging at a later stage. For the discussions to contribute to a broader multilateral agreement, wide participation of non-OECD nations would be essential.
2. To begin negotiations very soon, preferably as part of a new round of multilateral discussions, on a (probably narrower) agreement to be integrated with the WTO dispute settlement process. Discussions can then continue in other forums to aid in future elaboration of the multilateral agreement. The narrower agreement would probably include provisions on cartels and restrictive business practices.

The second option offers the greatest advantage if it can take place in the context of a new multilateral round, partly because there would be the broadest scope for cross-agenda trading.

### **Anti-Dumping and Competition Policy**

Some aspects of existing GATT rules run counter to the goal of assuring contestability of markets. This is the case most notably with current anti-dumping practices. The fundamental argument in favour of anti-dumping duties (ADDs) is that they prevent predatory behaviour through imports. That is, domestic firms should be protected from foreign firms attempting to eliminate competition by predatory pricing.

Most economists argue that, in actual application, anti-dumping duties do little to achieve this goal.<sup>22</sup> Most notably, the calculation of price and cost esti-

mates is heavily biased in favour of finding positive dumping margins. More generally, many aspects of the application of anti-dumping duties err on the side of finding that dumping has occurred even when predatory intent is very unlikely.<sup>23</sup>

The motivation for a large proportion of current anti-dumping cases seems to be the protection of declining industries from import competition. Safeguards protection in the GATT should normally be temporary and should facilitate adjustment (reduction in size) of the industry requesting protection; in contrast, anti-dumping duties need not be limited by any sunset clause.

A current ADD case illustrates the conflict between the intent of anti-dumping and its application, and also shows the resulting difficulties: Canadian bicycle manufacturers are asking for ADDs against a wide range of foreign bicycle manufacturers. They are doing so even though the Canadian producers dominate the Canadian bicycle market to such an extent that no foreign supplier could attempt to eliminate all domestic competition.<sup>24</sup> In this case, ADDs granted earlier have helped some domestic manufacturers but hurt others (those who use frames covered by the ADDs). At the same time, the Canadian manufacturers have suffered from ADDs imposed on their exports to Europe.

One possible element of an international accord on competition policy would be restrictions on “predation” based on national treatment. If the real aim of anti-dumping duties is to prevent predatory behaviour, competition policy is clearly a more appropriate instrument for this purpose. Nations should seriously consider abandoning anti-dumping altogether in favour of international disciplines on predation as a restrictive business practice.

At the very least, if anti-dumping is really about predation, GATT disciplines should be refined to reflect that concern.<sup>25</sup>

Implementation of the Multi-Fibre Arrangement reforms could be held hostage to the current state of anti-dumping duty rules. Many fear widespread adoption of such duties, which could deal exporting countries a serious blow.<sup>26</sup>

### **Summary: Competition**

Given the case for launching a new round of multilateral trade talks, it would seem that future discussions relating to competition should occur there.

### **INVESTMENT**

INTERNATIONAL DISCIPLINE ON INVESTMENT encompasses transparency plus the extension of broad-based national treatment<sup>27</sup> to firms wishing to enter a foreign market.<sup>28</sup>

The current situation is that APEC has endorsed a set of non-binding principles to be applied (including transparency, national treatment and non-discrimination), but these are rather ambiguously written. The OECD is in the process of negotiating a Multilateral Agreement on Investment (MAI) and has



already negotiated related codes of conduct for its members.<sup>29</sup> Because of its narrower membership, the OECD has been able to go further in terms of substance than APEC or the TRIMS negotiations under the Uruguay Round. Accordingly, one proposal is that future discussions of international disciplines on investment take place at the OECD, with continuing experience and elaborations occurring in the context of the NAFTA and other regional groupings.

The drawback to this course of action is that some of the obvious issues for negotiation involve non-OECD countries. Many non-OECD countries identify investment incentives provided by wealthy nations as a prime topic for discussion, whereas wealthy countries wish to discuss performance requirements maintained by many poorer nations. While the OECD might be able to reach a consensus more quickly, it is not clear that the coverage of substantive issues would be significantly greater.<sup>30</sup> Further, the greatest possible geographical coverage would be achieved in the context of WTO negotiations.<sup>31</sup> Once again, the type of cross-agenda trading possible in a new round of multilateral talks might facilitate negotiations at the WTO.

One issue deserving special attention is the extent to which investment disciplines under regional and multilateral agreements should apply.<sup>32</sup> The main option is to apply the (usually more stringent) disciplines of regional agreements only to signatory nations. This is indeed the current application of NAFTA investment provisions. The other alternative is to extend the benefits of the regional agreement on a non-discriminatory basis. (In the case of the NAFTA, this would amount to national treatment for many purposes.)

There are usually two arguments against extending such disciplines to non-signatories: First, by doing so the member nations lose some leverage for convincing others to offer similar benefits in return; this is the free-rider problem. Second, member nations are less willing to agree to substantive rules because of the free riders; this is the foot-dragger problem. There must be significant returns for free riding to support the argument for conditional treatment of investors.

In the case of normal border measures, in many cases unilateral liberalization is judged to generate much of the welfare gains associated with multilateral liberalization. The assumption is that the benefits come from eliminating a domestic tariff distortion and are thus more direct, whereas the benefits from foreign liberalization (and the free-riding returns for non-member nations) depend on favourable terms of trade effects.<sup>33</sup> In the context of multilateral liberalization, these effects are likely to be positive for some nations.

In the case of investment disciplines, it is possible that the benefits come even more overwhelmingly from adopting the disciplines rather than the reciprocal access. In the context of regional trading arrangements, granting national treatment to investors from all home countries would offer limited benefits to free-riding nations. It would also eliminate the need to determine the home nation of a given investor – something very difficult for thoroughly global corporations to do.

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## TRADE AND THE ENVIRONMENT

ONE OF THE MORE CONTENTIOUS ISSUES TO BE ADDRESSED over the next few decades is the relation between international trading rules and some dimensions of concern for the environment. The connections and feedbacks between trade, economic growth and the environment are numerous and the nature of some of these linkages is not well known.<sup>34</sup>

There are three main avenues of effect. First, economic growth appears to lead to two impacts: With existing environmental standards it tends to cause environmental quality to worsen, since emissions rise with economic activity. As income per capita rises, however, nations tend to raise their environmental standards.<sup>35</sup>

International trade may contribute to economic growth and thereby add the third linkage between growth, trade and environmental quality. The direct influence of trade liberalization on overall environmental quality is likely to be very small.<sup>36</sup> This is partly because most trade is motivated by other forces than an attempt to avoid environmental regulations.

There is an indirect link between environmental quality and trade: tighter environmental regulations can spur trade in abatement equipment, services and environmental technology. Finally, environmental quality contributes to economic growth by improving the health of workers and directly improving productivity in primary sectors.

More or less independent of this statement of the problem, some questions are raised by the linkages mentioned. First, can the rules of the international trading system somehow be made compatible with international environmental accords such as the Montreal Protocol on ozone-depleting substances or proposed agreements to control releases of greenhouse gases? Second, to what extent should international commercial agreements and international environmental accords be made consistent with one another?

Application of national treatment requires that imported goods be accorded the same treatment as domestically produced goods once negotiated border measures are applied. In the context of goods, national treatment in no way restricts measures (such as taxes) to control the consumption of goods that damage the environment. It also does not restrict measures to regulate domestic production.

Perhaps the most difficult question to be addressed is whether one country should be able to base border measures on another country's lax environmental rules. For example, trade restrictions based on the application of different environmental standards might discriminate unfairly against low-income countries even when they have demonstrably higher environmental quality than the country imposing the restrictions.<sup>37</sup> Further, they violate Canada's usual aversion to extraterritorial application of legislation. Most economists believe that environmental rules are unlikely to be compromised by an open trading system.

International commerce might well be less affected by such measures than by actions to deal with some of the world's pressing environmental concerns. For example, the global response to climate change could involve severe limits on fossil fuel use. Various models for reducing carbon dioxide emissions indicate that the impacts on the world's economy would be sufficiently dramatic to have their own independent effect on international trade, regardless of how international commercial rules are changed.<sup>38</sup> In light of this fact, Canada's major concern almost certainly should be the nature of commitments made to reduce greenhouse gas emissions rather than modifications to trading rules.

One potential aspect of emissions reduction is an attempt to allocate abatement costs more fairly, particularly between wealthy and poor nations. Joint Implementation is one such proposal, and it would imply the following:

- Rich nations commit to a certain amount of abatement.
- Rich nations can undertake abatement projects in poor nations (which initially are not committed to any abatement). In this case the country financing the project gets credit for the abatement achieved.<sup>39</sup>

Such a scheme would allow a higher share of costs to be borne by wealthy nations.<sup>40</sup> Since the citizens of wealthy countries are usually assumed to value environmental quality more than citizens of poor ones, such trading may be acceptable to rich nations and poor alike. As mentioned before, abatement costs have been estimated to be very high, and broad-based action may lag until the evidence for global warming is more conclusive.<sup>41</sup>

## **HUMAN RIGHTS, WORKER RIGHTS AND TRADE**

THE GOAL OF THE DISCUSSIONS RELATING HUMAN RIGHTS, worker rights and trade is to ensure that international commerce does not undermine international support for worker and human rights. The challenge is to design rules that safeguard workers without hampering the exports of poor nations. In particular, it is feared that rules designed to block imports of goods produced in nations with inferior protection of worker rights could be used to reduce imports from any low-wage country. Another question is whether international trade sanctions are likely to enhance the protection of human and worker rights significantly.

A possible outcome of these discussions is the kind of parallel accord that was signed with the NAFTA. It could include provisions to monitor human rights protections and permit other nations to request consultations, conduct investigations and publicize the conduct of offending nations. The use of trade sanctions would seem to be inappropriate. As a practical matter, trade measures brought against the exports of specific sectors are extremely unlikely to convince national governments to alter their human rights policies, and economy-wide trade measures are likely to hurt the workers they are intended to protect. If

discussions of labour and human rights lead to an accord that does not include specific trade responses, the agreement will probably result from adherence to this line of argument.

### **Environmental and Human Rights Issues**

Canada's posture in crucial negotiations on global environmental concerns seems clear. First, we should energetically pursue international accords to deal with global environmental issues. At the same time, we should lobby within those negotiations for application and enforcement systems that do not needlessly conflict with key principles such as national treatment and non-discrimination. Finally, we should encourage the adoption everywhere of environmental policies focussed on the environmental problems themselves rather than on largely irrelevant imports.

As in the case of environmental issues, Canada should pursue primary negotiations on worker and human rights, for example, at the International Labour Organization. At the same time, we should support a system of trade measures only when it is clear that those measures will truly be aimed at improving worker or human rights, and will not conveniently be used by domestic firms wanting protection against imports from lower-wage countries. Otherwise, Canada could run the risk of hurting the workers these measures are intended to help.

### **GOODS TRADE**

WHILE THE URUGUAY ROUND WAS WIDELY HAILED AS A WATERSHED in the international trade of agricultural goods, it remains to be seen whether the agreement on agriculture will be followed by continued adherence to GATT principles and progressive liberalization. Canada's supply-managed producers are well protected under the current high tariffs. As the tariffs fall, the commitment of many countries to the multilateral trading system may be tested. However, Canadian consumers and exporters of grains and red meat stand to gain significantly if future reductions of agricultural barriers are locked in.<sup>42</sup> The bold step of tariffication will be a very hollow victory if the current high tariffs on some goods are not reduced.

The Uruguay Round also liberalized trade in clothing and textiles. The Multi-Fibre Arrangement restricted trade from lower- and middle-income countries to industrialized country markets; it should effectively cease to function within the next 15 years. This change will benefit the lower-income nations with exports currently constrained by the MFA. But the benefits will come only if industrialized countries do not (as some fear) respond to increasing import penetration with broad-based campaigns of anti-dumping actions.

In agriculture as well as textiles and clothing, there is a clear special and differential treatment component. Major exporters of primary agricultural products and clothing have been constrained by policy regimes that favoured producers in high-income countries at the expense of those in lower-income regions of the world.

In a new round of negotiations, it may be possible to think in terms of eventual elimination of all border measures. Even short of this lofty goal, important issues in goods trade could be addressed.<sup>43</sup>

### AMERICAN PREFERENTIAL TRADING ARRANGEMENTS

SOME SPECIFIC ISSUES RELATING TO EXTENDING NAFTA COVERAGE have been discussed above under the topics of investment and competition policy. However, there are also general issues to be addressed by Canada.

Two important criteria for evaluating Canada's participation in other trade forums (most notably APEC and the Free Trade Area of the Americas discussions) are their impact on Canada's commercial interests (improved access, increased trade, higher investment flows) and their impact on progress in the multilateral system.

Many, though not all, commentators argue that Canada's involvement in NAFTA discussions laid the groundwork for the multilateral discussions, or in several cases offered models for subsequent multilateral accords. (The TRIPS accord – or Trade-Related Aspects of Intellectual Property Rights – is probably the best example; in this case the NAFTA and Uruguay Round agreements are very similar.) At the same time, the view from abroad is not always so generous, and many countries in Asia worry about potential trade and investment diversion as a result of a NAFTA extension.

The returns to Canada from extending NAFTA to encompass all of the Americas are unlikely to approach those of the original Canada-U.S. agreement or its extension to Mexico. Even extension of the FTA probably offered only modest benefits to Canada.<sup>44</sup> Part of Canada's gains from Pan-American economic integration may already be accruing as Latin American countries such as Chile and (more recently) Argentina unilaterally adopt more liberal trading regimes.

It is often said that geography and cultural matters are less important to trade than ever before; nevertheless, distances still matter for a wide range of commerce. The information revolution has made it dramatically easier to produce components in Chile, but the cost of transporting them back to Canada has not fallen by nearly as much. The technological improvements in transportation are significant but they are not on the same scale as those in information technologies.<sup>45</sup>

From Canada's viewpoint, the main dollars-and-cents gains from Pan-American trade discussions are likely to arise from extending the substantive rather than the regional coverage of NAFTA. The fact that NAFTA's coverage

of services, investment, goods trade and intellectual property is already extensive suggests that these returns are likely to be modest.

As a result, Canada should place the discussions at a lower priority than multilateral discussions. Further, our FTAA discussions should be designed to support and lead progress at the multilateral level, especially in the context of a new multilateral round.

### APEC AND PACIFIC RIM LIBERALIZATION

CANADA AND THE UNITED STATES ARE BOTH MEMBERS of the Asia Pacific Economic Cooperation forum. APEC includes a wide range of nations with interest in economic cooperation on the Pacific Rim. Most of its members are from East Asia, and among them are many of the world's most dynamic economies. This group has been engaged in wide-ranging discussions concerning possible future deeper integration between Pacific Rim nations. Among other things, it has endorsed a set of investment principles (see the section entitled *Investment* above).

While leaders have committed themselves to a broad-ranging agenda contributing to global integration, the discussions on areas of deeper integration (e.g., investment and competition policy) tend to take place with a view to generating consensus and informal application rather than developing a rules-based system. To some extent this approach reflects cultural differences as well as the relative importance attached by Asian nations to deeper integration.

Many prominent Southeast Asian nations attribute their past and future economic success largely to the liberalization of border measures (so-called shallow integration). They feel that greater attention should be given to ensuring continued progress on access rather than deepening integration. To some extent this attitude has been a stumbling-block and may remain so.

APEC's advantage and drawback is its membership. It is broad enough to include China, the United States and Chile, but not broad enough to meaningfully include all the Americas. While the APEC nations constitute a large and fast-growing market,<sup>46</sup> the question remains whether APEC should be seen as home to a new regional trading agreement, a talking shop to support discussions in multilateral forums or an interesting curiosity in function as well as name.

If a new multilateral round is launched, it would seem that APEC could provide a crucial forum for resolving the conflict between the rules-based approach, supported by the United States and (in varying degrees) Canada and the European Union (EU), and the consensus-based informal approach supported by many Asian nations.<sup>47</sup> Beyond matters that can fit into this mould, APEC does not seem well placed to complement a new multilateral round.

The breadth of membership means that agreement within APEC will be difficult. A narrow membership means that there is significantly less scope for cross-agenda trading than in the context of a new multilateral round.

## TRADE WITH FORMERLY COMMUNIST COUNTRIES

THE LAST FIVE YEARS HAVE SEEN REVOLUTIONARY CHANGES in economic policy in the former Soviet Union, Central Europe and China. At the same time, there have been dramatic changes in trade and investment flows, as noted earlier. A major task of the international community over the next 10 to 15 years will be the integration of these economies into the world economy. The task is immense. Further, the commitment to adopting more open economic policies varies from nation to nation within this group.

In the case of several of the former Soviet states, integration with the European Union is already proceeding as a natural outcome of their geographic location and their higher level of pre-reform integration. Plans are already under consideration to continue the integration by granting EU membership to former East-bloc countries such as the Czech Republic. European-based integration discussions take place in a number of forums (the Council of Europe and the Central European Initiative, *inter alia*). Several of the former Soviet states have clearly signalled their desire to integrate with the global economy.

Over the next 10 to 15 years, most of the Newly Independent States will want to join China as new contracting parties of the WTO. A major question is when or whether these new traders will be able to assume the full range of WTO commitments. Given the recent elimination of the two-tier GATT through extension of most WTO disciplines to developing countries, the idea of a transitional set of commitments may be unattractive but may still be necessary. If accession becomes gradual, it would be far better to specify time-limited exemptions for particular parties rather than introduce a new layer of exemptions that could give the wrong signals. Significant parts of the pre-Uruguay Round GATT allowed differential and more favourable treatment for developing countries, but this approach may have been harmful, permitting developing countries to follow policies that were almost certainly not in their own interest. Countries had access to these measures (and, in the past, exemption from full participation in tariff reductions) as long as they remained classified as "developing."

Most important, however, it would be unrealistic to assume that political realities in all the states will continue to favour binding commitment to multi-lateral reform. The best insurance of such a commitment will be ongoing good performance by the more serious reforming states.

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## THE WTO AGENDA

EVEN BEFORE THE SIGNING OF THE URUGUAY ROUND'S FINAL ACT, there was much discussion of the next round of multilateral trade talks. This proposed round was initially referred to as the "Green" round, reflecting the expressed need for multilateral discipline in efforts to protect human rights or environmental policy. It seems clear now that there exists an extremely ambitious and promising agenda for a new trade round, with at least the following key elements:

**Services** – Extend national treatment more generally.

**Investment** – Extend coverage to all investment issues, not only those that are (nominally) trade-related.

**Competition policy** – Address key elements of anti-competitive behaviour, and begin the broader task of developing consensus for wider coverage.<sup>48</sup>

**Environment** – Improve the interface between multilateral trading rules and trade aspects of environmental agreements, thereby strengthening them.

**Rights** – Establish clear restrictions on trade sanctions ostensibly responding to inadequate protection of worker or human rights.

**Subsidies** – Link subsidization definitions and remedies to new discussions on investment and services.

**Goods trade** – Follow up on the Uruguay Round progress in agriculture, textiles and clothing, and look ahead to the eventual goal of removing MFN border measures on all products.<sup>49</sup>

There are many important issues to be negotiated, and the diversity of issues is sufficient to allow for cross-issue trading, facilitating the process.

The ground for multilateral progress seems fertile, particularly since most developing countries are pursuing more liberal trading regimes. On the other hand, the poorer nations' continued support for rules to protect intellectual property will bear fruit only if the wealthy nations remain committed to the multilateral system.





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## CONCLUSION

THIS PAPER HAS PROPOSED A VISION for Canadian commercial policy over the next 10 to 15 years, based on two broad themes.

First, Canada should support liberalization in the broadest sense. In other words, it should pursue negotiations in a number of forums but should make its highest priority a new multilateral round. A broad enough (and clearly full enough) agenda exists to make launching a new multilateral round worthwhile. Canada's negotiating strategy in other forums should always take into account the multilateral forum.

Second, under certain policy approaches, the identification of the fundamental cause associated with an apparent problem suggests an appropriate response. Wherever possible, Canada's analysis should start from this perspective. There are specific examples where identifying the key externality implies a solution; but more important than these are proposals that target symptoms (e.g., trade balances or trade shares) chosen in isolation from any underlying economic analysis. Canada should oppose any such approach.

The greatest challenges for Canadian policy makers in the next 10 to 15 years are likely to be reining in the public debt and improving the ability of the labour market to supply jobs and needed skills. While prudent commercial policy is an important ally in these tasks, it cannot replace sound domestic policy making. At the same time, it is quite clear that bad commercial policies (in particular, those that attempt to scapegoat trade) would certainly thwart the achievement of domestic policy goals.



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## NOTES

- 1 For example, the International Labour Organization for labour rights issues, and the Intergovernmental Panel on Climate Change for climate change issues.
- 2 In other words, economic integration dealing with topics beyond border measures against goods and associated disciplines (customarily referred to as shallow integration).
- 3 In this example, there are potentially many externalities since the standard-setting national government does not have to pay any of the cost of compliance with the standard.
- 4 This might mean having a standard that accepts any of a number of alternative standards — an approach referred to as mutual recognition.
- 5 Kaell *et al.*, 1995.
- 6 Roughly 70 percent of FDI stocks are in North America, Western Europe and Japan.
- 7 FDI in China fell markedly in 1995 but has since recovered.
- 8 Note that the stock of foreign investment in Canada still dramatically exceeds the stock of Canadian investment abroad.
- 9 Many economists would argue that, for a small open economy, the discipline on domestic protection in itself is a main benefit of adherence to the GATT system, independent of any balancing concessions from other countries.
- 10 This is not to say that there was no significant support for closer economic ties with the United States. Instead, possible preferential trading arrangements were ultimately passed over until the Auto Pact.
- 11 See *Statistics Canada Daily*, July 18, 1996.
- 12 Watson, 1992.
- 13 Lipsey *et al.*, 1994.
- 14 Hufbauer *et al.*, 1994.
- 15 For an overview see Schott and Buurman, 1994; and World Bank, 1995. Nguyen *et al.*, 1995 and 1996, give a numerical evaluation.
- 16 Dean, 1995.
- 17 The mechanism adopted draws heavily on the FTA/NAFTA model in the specific respect of time limits and deadlines.
- 18 This theme is taken up in Bhagwati, 1990.
- 19 This section draws heavily on Graham, 1995 and 1996.
- 20 Firms from country *A* receive the same treatment in country *B* as firms from country *B* receive in country *A*.
- 21 Export cartels are implicitly condoned under GATT. See Dam, 1970, pp. 244 ff.
- 22 See the chapter by Messerlin in Schott, 1990; and Finger's chapter in Finger and Olechowski, 1987.
- 23 Among other things, this includes practices such as "cumulation" for determining injury, and flexible definitions of like products. See Finger, 1992.
- 24 "Bike makers face uphill climb," *Globe and Mail*, August 6, 1996.
- 25 Chapter by Lipstein in Graham and Richardson, 1996.
- 26 Under the MFA, exporters received valuable quota rights. If the MFA is phased out only to be replaced by more widespread use of ADDs, exporters would face barriers but would have no quota rights.
- 27 Including national treatment in terms of regulation, transfer of funds and for right of establishment.
- 28 This section draws heavily on Graham and Richardson, 1996.

- 29 The Code of Liberalization of Capital Movements, the Code of Liberalization in Invisible Operations, and the National Treatment Instrument.
- 30 For example, wealthy countries might agree to dramatic extension of their restrictions on performance requirements, but OECD-agreed restrictions on investment incentives might be looser than would be the case if poorer nations participated in the negotiations.
- 31 This is essentially the argument presented in Graham and Richardson, 1996.
- 32 This is the so-called carve-out issue.
- 33 The term analogous to the terms-of-trade effect of a trade liberalization calculation relates to the reduced returns to domestic investors attributable to the failure of free-riding nations to apply comparable disciplines. Because of the increasing fluidity of asset markets, this term may tend to be quite small.
- 34 See Anderson and Blackhurst, 1992; Uimonen, 1995; and Low, 1992.
- 35 Grossman and Krueger, 1992; and Radetzki, 1992.
- 36 Perroni and Wigle, 1994.
- 37 For example, some would argue that nations mandating very clean technologies could levy duties on goods coming from nations using less clean technologies. This approach could lead to the situation where goods produced in Ghana (an area with excellent air quality but using a slightly less “clean” technology) are banned from sale in Los Angeles (an area with notoriously bad air quality) because of environmental concerns.
- 38 Dean, 1993; and Cline, 1992.
- 39 Australian Bureau for Agricultural and Resource Economics, 1995; Hinchy *et al.*, 1993.
- 40 Since a ton of carbon has the same impact regardless of where it is emitted, any scheme that sets rich nations’ abatement responsibilities will be significantly more cost-effective if some of the abatement can be undertaken in poorer nations, where the marginal abatement cost is lower.
- 41 *The Economist*, 1995.
- 42 This is not without challenges since the supply management system also has an important interprovincial dimension that favours Quebec.
- 43 The complete elimination of tariffs may be opposed by those developing countries that use tariffs as a revenue source, but overwhelming arguments favour other methods of revenue raising.
- 44 Properly conceived estimates of the welfare gains to Canada from signing the NAFTA are very small. The major issue is whether the basis for comparison is a post- or pre-FTA world. François and Shiells, 1994; Hufbauer *et al.*, 1994.
- 45 For the same reasons, Canada’s bilateral trade accord with Chile is unlikely to generate significant returns or contribute meaningfully to the multilateral discussions.
- 46 In spite of the fact that APEC includes high-growth economies, numerical estimates of the gains to Canada from APEC-based trade liberalization are negative or very small (less than 0.1 percent of GNP). Young and Huff, 1996; Adams *et al.*, 1996.
- 47 This theme is central to a recent Brookings volume; Lawrence *et al.*, 1996.
- 48 An important test of confidence for the multilateral system will be at least to focus anti-dumping on predation or, at best, to agree on an international competition policy that could replace anti-dumping.
- 49 This would not mean the end of safeguard-type measures, but it would eliminate all barriers to most trade in goods.

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**APPENDIX:  
CORE PRINCIPLES OF THE MULTILATERAL  
TRADING SYSTEM**

**T**HIS SECTION PROVIDES A BRIEF DISCUSSION of some of the core principles of the multilateral trading system.

**PROGRESSIVE LIBERALIZATION**

THIS PRINCIPLE IS THE MOST STRAIGHTFORWARD. Participants in the trading system typically wish to cooperate to the reduction of trade barriers in the belief that it is in the general interest of nations to do so on a reciprocal basis.<sup>1</sup>

**NON-DISCRIMINATION**

THIS PRINCIPLE IS OFTEN REFERRED TO AS THE MOST FAVOURED NATION (MFN) principle. According to it, no country should be accorded less favourable treatment than the “most favoured” trading partner. In practice, this means that no country’s imports should be treated differently (either better or worse) from those of any other country.

**NATIONAL TREATMENT**

THE PRINCIPLE OF NATIONAL TREATMENT is also relatively straightforward. According to it, once the appropriate border measures have been applied, imported goods should be treated at least as favourably as domestically produced goods. This principle largely concerns discouraging hidden protection (as in the case of imports subject to added taxes or extensive testing not required of domestically produced goods).

**POORER NATIONS**

THE PRINCIPLE OF MORE FAVOURABLE TREATMENT of poorer nations is usually referred to as the principle of special and differential treatment (S&D). This reflects two concerns: First, there is the widespread belief that poorer nations will improve their state of economic and social development only if they are afforded good access to foreign markets for their exports. Second, poorer nations may not be able to afford the expertise needed to implement some parts of their international obligations. In each case, international trading rules have featured preferential treatment, particularly for the poorest nations.

## FAIR COMPETITION AND SAFEGUARDS

ACCORDING TO THE PRINCIPLE OF FAIR COMPETITION, firms should not have to compete with unfair imports. There are two primary aspects to this principle: First, unfair imports include those that are subsidized by foreign governments as well as those that are “dumped” on foreign markets.<sup>2</sup> In each case, domestic industries injured by such unfair imports can apply for protection from them.

Further, under the (distinct) safeguards aspect of the principle, industries should be afforded temporary protection when import surges from abroad claim radically higher shares of the domestic market. Note that safeguards measures apply to fairly traded imports. In this case, the idea is that as comparative advantages change, some sectors grow and others decline but firms deserve a reasonable amount of time to respond to increased import competition.<sup>3</sup>

## TRANSPARENCY

THE PRINCIPLE OF TRANSPARENCY TOUCHES ON A NUMBER of the other principles in that transparency means that the effect of a given trade barrier should be as well understood and clearly explained as possible. Potential suppliers of a foreign market must be able to gauge the effect of a given trade barrier, and domestic consumers must be able to understand the amount of protection offered to domestic producers. The principle touches on the principle of national treatment, since the impacts of measures violating that principle are unlikely to be transparent to exporters or consumers.

## NOTES

- 1 Among the founding principles of the GATT is that of “binding” of barriers. This amounts to commitment to a specific schedule of tariffs. For our purposes this will be treated as a means of dealing with an important potential loophole for trade discussions: unilateral alteration of the tariff schedule before negotiations begin.
- 2 It is not always clear what is unfair about goods that are allegedly dumped.
- 3 The nature of the adjustment may merely be retooling or retraining, but in many cases it may mean that a given industry will decline in the face of import competition.

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