

A New Era in Canada-US Economic Relations or Just a Family Spat?

Grace Skogstad

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Grace Skogstad is the Chair of the Department of Political Science at the University of Toronto, and she served as President of the Canadian Political Science Association in 2002-03. Among her many publications are *The Global Promise of Federalism* (2013), co-edited with David Cameron, Martin Papillon, and Keith Banting, and most recently, "Policy Feedback and Self-Reinforcing and Self-Undermining Processes in EU Biofuels Policy," in the *Journal of European Public Policy* (2017).

Canadian-American economic relations are currently in an unprecedented period. Not since the signing of the 1987 Canada-US Trade Agreement (CUSTA) and the implementation of its 1994 successor, NAFTA, has there been so much uncertainty regarding the future of a trade regime that Canadian governments, the business and financial communities, and a majority of Canadians believe has benefitted Canada. NAFTA established what has proven to be a stable and comparatively open trading regime among Canada, the US, and Mexico. The 2015 Presidential campaign promise of Donald Trump to tear up NAFTA, and the subsequent entry of the three NAFTA countries into renegotiation of NAFTA, has put in question the very existence of NAFTA.

The NAFTA renegotiations themselves, over the past year, have been marked by the American President taking rhetorical jabs at the unfairness of Canadian policies and making derogatory comments about the Canadian Prime Minister. More consequentially, they have also been attended by an unprecedented number of trade remedy actions and threats by the Trump administration.[i] The most significant of the latter are the US imposition of tariffs on Canadian aluminium and steel in June 2018, and its initiation of an investigation to determine whether to levy tariffs on auto vehicles and auto parts: the number one export to and from NAFTA countries.[ii] Both actions were justified as necessary to protect US national security: a rationale Canada's Prime Minister described as "insulting" and Canada's Foreign Affairs Minister labelled "absurd", and "hurtful".[iii] In response to these deliberate efforts to put pressure on Canada to make NAFTA concessions, and in what the Canadian Minister of Foreign Affairs described as Canada's "strongest trade action since the Second World War," Canada implemented dollar-for-dollar retaliatory tariffs.[iv]

Just how bad are current relations between the Canadian and US administrations? From the perspective of a member of the Trump administration, all we are witnessing is "a mere family quarrel" that has nothing to do the long-standing alliance and friendship between Canada and the US.[v] From the perspective of a former Canadian diplomat, "neighbourly relations" between

Canada and the U.S. are now over, and Canada is engaged in “a long, bitter and painful battle with the Americans” for the first time in more than 150 years of shared history.[vi] Which view is correct?

In defence of the first perspective, Canadian-American relations *are* deep and broad, and, for the most part, friendly. The United States is Canada’s largest trade and investment partner. In 2016, 76% of the value of Canadian merchandise exports and 55% of the value of Canadian services exports went to the US, while 52% of the value of Canada’s merchandise imports and 56% of the value of Canadian services imports came from the US.[vii] In 2016, the US was also the largest destination of Canadian direct investment abroad and the largest source of foreign direct investment in Canada.[viii] Value chains, especially in the agriculture and auto sectors, have become integrated. Auto parts and materials, for example, may cross NAFTA borders six or seven times as they are built into components, ready for final assembly into vehicles.[ix] Canadian live cattle and pigs are shipped to the US where they are fed and processed into meat before being exported back to Canada or non-NAFTA markets.[x]

Further in defence of the ‘family quarrel’ perspective is that Canada-US trade disputes are not new. Indeed, they should be expected as politicians and domestic trade remedy bodies respond to the pressures of well-organized domestic lobbies to ward off competition in their domestic market. The recurrent dispute over Canadian softwood lumber exports to the US is one example. When the US levied countervailing duties on Canadian softwood lumber in 2017, it did so for the fifth time since the early 1980s. These disputes, precipitated by pressure from the US domestic timber industry, have usually been settled by binational panels in Canada’s favour but they have also resulted in Canada agreeing to curtail its exports to the US. The protracted 2008-2015 Canada-US dispute over the US country-of-origin labelling (COOL) is another example of a dispute triggered in response to pressures from a group of American farmers to keep Canadian products out of the US market. Canada’s WTO challenge of COOL, which required retailers to indicate the country of origin of fresh beef, pork, and lamb, was ultimately successful. The WTO agreed COOL’s effects were discriminatory insofar as they effectively locked Canadian meat products out of a US market estimated to be worth \$1 billion in annual sales for them.

However, there are nonetheless reasons to take the second perspective seriously. The current tariff war means that Canada-American trade relations are likely to remain fraught for the duration of the NAFTA renegotiations and/or until the tariffs are removed. There is also the very real question of whether a compromise can be found on items on the list of the Trump Administration’s renegotiation priorities that simultaneously constitute ‘red lines’ or deal breakers for Canada.

One deal breaker for Canada is the US proposal to eliminate the existing dispute settlement mechanism (DSM) in Chapter 19 of NAFTA and make the DSM in Chapter 20 voluntary. Chapter 19 provides for an independent binational panel to review countervailing (in response to unfair subsidy charges) and antidumping (in response to dumping charges) decisions made by a trade regulatory body of a NAFTA partner. Chapter 20 provides a state-to-state mechanism through which a NAFTA country can dispute the interpretation or application of NAFTA obligations. Canada sought independent dispute settlement mechanisms in CUSTA in order to end domestic administrative tribunals and courts having the final say in cross-national trade

disputes. It walked out of the CUSTA talks until the US agreed to them. It maintains this position in NAFTA, believing binational panels are necessary to ensure market access and mitigate the bias of national (US) trade agencies towards domestic interests.[xi]

Another defined red line for Canada is its opposition to the American proposal to include a sunset clause in any new NAFTA agreement. Canada argues that a provision whereby NAFTA automatically expires after five years unless renewed by all parties would, by inducing uncertainty about the continuity of NAFTA, deter investment in the NAFTA bloc. The US refusal to abandon its sunset clause proposal prompted Prime Minister Trudeau to cancel a May 2017 meeting with President Trump on the NAFTA talks.

Canada has also defined protection of its supply managed dairy, poultry, and egg sectors as “essential.” It is resisting the US demand to eliminate existing border protection for these industries. Under the 1994 WTO Agreement on Agriculture, Canada secured tariff rate quotas for supply managed products; imports above these quotas face very high tariffs. The US unsuccessfully challenged the tariffs as inconsistent with NAFTA. Since then, dairy tariffs in particular have been a chronic bone of contention for American dairy farmers and processors who seek an export market for their surplus milk products.

Canada also finds itself seeking to salvage the NAFTA status quo on other proposals of the US administration.[xii] A major one is the US proposal to redefine rules of origin in the automotive sector. Canada’s auto and auto parts sector argues raising the current rules of origin for qualified duty-free automotive trade within North America above the current 62.5% NAFTA content, already the highest of any US agreement, would undermine the competitiveness of the NAFTA auto sector.[xiii] The US proposal to include a new US content requirement for autos and auto parts would, it is argued, shift automotive sector jobs from Canada to the US.

Although the NAFTA partners have reportedly agreed over the past year on a number of other items to modernize the 24-year old agreement, there has been little public evidence of progress in bridging the gap between Canada’s bottom lines and the priorities of the US administration. Getting a NAFTA agreement and getting back to neighbourly relations will depend upon the incentives of the NAFTA governments to bridge these gaps. For its part, the Canadian government enjoys broad public and cross-party support for what the Prime Minister has described as its ‘refusal to be bullied’ approach to the Trump administration, including by levying retaliatory tariffs against US goods.[xiv] Broad domestic support for its negotiation approach means Canadians are unlikely to support concessions that would be detrimental to Canada’s economy—just to secure an agreement. At the same time, however, Canadians, regardless of partisan affiliation, overwhelmingly support membership in NAFTA.[xv]

If domestic politics give the Canadian government strong incentives to push for a negotiated settlement, the same is not necessarily the case for the Trump administration. Polling data show Americans are not only less supportive of NAFTA than are Canadians or Mexicans, but also divided on partisan grounds. A majority of self-described Democrats support NAFTA while only a minority of self-described Republicans do.[xvi] Notwithstanding the partisan incentives provided the Trump administration to tear up NAFTA, there is nonetheless ample evidence of domestic opposition in the US to doing so, as there is to its punitive tariffs on Canada.[xvii]

Indeed, it is pressures on the US administration from the US manufacturing, agricultural and service sectors that have benefitted from NAFTA that represent the best chance for a NAFTA compromise acceptable to Canada.

We are, in the words of Pete Sessions, Chair of the US House of Representatives Rules Committee, at “a critically unique time between our two countries.”^[xviii] Compromise may yet prove elusive. An end to NAFTA would have implications for the economies and broader political relationships among the three NAFTA countries. However, an end to NAFTA would not terminate trading relations between Canada and the US. They would continue—albeit now under the rules of the WTO regime, and possibly, as well, CUSTA. Whether these relations are cooperative or conflictual would depend, as it does now, upon the reasonableness of the neighbours.

[i] Colin Robertson, NAFTA: A Primer for the Montreal Round. Canadian Global Affairs Institute, January 2018, reports that the US Commerce department initiated 82 anti-dumping and countervail investigations against Canada in 2017, a 46% increase over the previous year and a 16-year peak in the number of initiated investigations.

[ii] M. Angeles Villarreal and Ian F. Fergusson. Congressional Research Service Report on NAFTA Renegotiation and Modernization. 7-5700. www.crs.gov. Jul 26, 2018, Figure 5 CRS, p. 11.

[iii] See Chrystia Freeland’s remarks to the Canadian House of Commons Committee on International Trade, June 19, 2018. On Trudeau’s comments, see his interview with NBC Meet the Press, on June 1, 2018.

[iv] See Freeland, *Ibid*.

[v] The description is that of Larry Kudlow, Director of the National Economic Council, as reported by Daniel Dale in “Trudeau ‘over-reacting’ to U.S. tariffs, top Trump advisor says,” The Star.com, June 2, 2018. <https://www.thestar.com/news/world/2018/06/03/us-imposing-tariffs-on-national-security-grounds-is-insulting-justin-trudeau-tells-nbc.html>.

[vi] Lawrence Herman, “Neighbourly relations with the U.S. are over”, *The Globe and Mail*, May 31, 2018.

[vii] House of Commons. Standing Committee on International Trade. Priorities of Canadian Stakeholders Having an Interest in Bilateral and Trilateral Trade in North America, Between Canada, the United States, and Mexico. Report. December 12, 2017. 42nd parliament, 1st Session, p. 20. This report is hereafter referred to as CIT Report.

[viii] CIT Report, p.20.

[ix] David Paterson, VP Ford Canada, as reported in CIT Report.

[x] Testimony of Brian Innes, President of the Canadian Agri-Food Trade Alliance, and Dan Darley, President of the Canadian Cattlemen's Association to the Standing Committee on International trade, as reported CI, Report.

[xi] See comment of Canada's Chief NAFTA Trade Negotiator, Steve Verheul, to the Committee on International Trade on December 4, 2017: 'Canada will not accept an outcome that does not respect this fundamental concept of effective enforcement of legal obligations.'

[xii] Other demands of the US would require Canada to eliminate foreign investment restrictions in banking, telecommunications, and a number of cultural industries; to adopt US intellectual property protections that strengthen legal protections enjoyed by foreign manufacturers of branded pharmaceuticals; to allow unrestricted cross-border flows of digital information that would threaten Canadian broadcasting regulations that currently promote the production and distribution of Canadian entertainment programming. See Steven Globerman and Christopher Sands. 2017. *The Fate of NAFTA: Possible Scenarios and their Implications for Canada*. Fraser Institute. <https://www.fraserinstitute.org>

[xiii] See testimony of Caroline Hughes, VP, Ford Motor Company, and David Paterson, VP General Motors to the House of Commons Standing Committee on International Trade, May 9, 2017.

[xiv] An IPSOS June 2018 poll showed a majority (72%) of Canadians approve of Trudeau's handling of Trump Situation, while 79% agreed Canada should retaliate against US-imposed tariffs with tariffs of our own against the US. See: <https://www.ipsos.com/en-ca/news-polls/Global-News-NAFTA-June-16-2018>.

[xv] As reported in Robert Wolfe and Giancarlo Acquaviva, "Where Does the Public Sit on NAFTA?", Policy Options, April 19, 2018, p.2. Available at:
<http://policyoptions.irpp.org/magazines/april-2018/public-sit-nafta>.

[xvi] Ibid.

[xvii] M. Angeles Villarreal and Ian F. Fergusson. Congressional Research Service Report on NAFTA Renegotiation and Modernization. 7-5700. www.crs.gov. Jul 26, 2018, p.2.

[xviii] "Canada has a partner in the US Congress," Speech to the Macdonald-Laurier Institute, Ottawa, April 5, 2018. Available at: <https://www.macdonaldlaurier.ca/canada-partner-us-congress-pete-sessions-inside-policy/>