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The North American political economy in the global context: an analytical framework

The North American political economy (with apologies to Mexico) is a shorthand reference to the political economy of Canada-United States relations. This term does not presume a single economic (or political) system encompassing the two countries. It merely recognizes the extensive interdependence between the two economies, and the reality that many of the economic problems encountered by one or other of the two countries are in fact the product of the same global developments.[1] The fundamental purpose of this essay is to identify the reasons for and nature of the responses by the Canadian and United States governments to global economic developments, and to explore alternative responses.

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1 The definition of political economy may itself raise questions, because of the variety of approaches which subscribe to that label in the current academic literature. Different schools of thought ranging from marxism to neo-classical economics hold different values, adopt different modes of analysis, and pose different questions concerning different variables. All bring together politics and economics, and in different ways see politics as the expression of economic interests and interactions. The approach here will be one which recognizes the interdependence of the Canadian and United States economies and the interdependence of those two economies with the rest of the world economy.

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Many of the recurrent bilateral economic problems between Canada and the United States can best be understood as stemming from differing national responses to common problems in the changing international economic environment. There is a tendency to attribute the cause of such bilateral disputes to the deliberate or inconsiderate action of one country or the other, to its succumbing to domestic political pressure or abdicating international responsibility. This charge is not entirely without foundation. But it fails to appreciate the underlying international origin of the pressures and responsibilities and the global context which both gives rise to national and bilateral policy problems and in turn constrains policy options. A survey of this global context, over which neither government has control, can provide a better understanding of the underlying dynamics of the North American political economy and can raise the question of possible common Canadian and United States interests in responding jointly rather than competitively to common problems.

The modern economic world is an interdependent one. That interdependence is marked by the inability of governments to attain their domestic policy objectives solely by unilateral actions, and by the fact that policy actions aimed at domestic objectives have international consequences. However, the interdependent world is also becoming increasingly competitive. And although the demand for government action is high, the capacity of governments to respond satisfactorily is low. This 'control gap' is large and growing and ultimately constitutes the fundamental source of many, if not most, international economic disputes.[2]

The dynamic dimension of interdependence is evident when two interdependent countries with different philosophies and values respond in dissimilar ways to common and related problems and thereby encounter bilateral disagreements. Canada

2 Robert O. Keohane and Joseph S. Nye Jr, eds, *Transnational Relations and World Politics* (Cambridge MA: Harvard University Press 1972), xxii-xxiii.

and the United States share many fundamental political values, but have differing philosophical approaches to such questions as the relationship between the state and the private sector or the role of the government in encouraging regional development and equalization.[3] Even if there were consensus on philosophical objectives, dissimilar policy responses are only to be expected from time to time from Canada and the United States as well as from the other countries of the Organization for Economic Co-operation and Development, given the existence of independent centres of decision together with the variety of domestic interests and pressures at play. Policy co-ordination or compatibility is all the more difficult when there is disagreement about major issues like the wisdom of prevailing macro-economic policy.

Since the dawn of the industrial age, there have always been problems of adjustment to changing comparative advantage and competitive conditions. However, the problems of adjustment faced by Canada and the United States, and by the other advanced industrialized countries, may be greater at present than ever before. Structural changes in the pattern of international competitiveness are being compounded by actions of governments, by the volatility of exchange rates, by the uncertainty of the international economic environment, and by the growing segment of the international trading system that does not operate according to the non-discrimination principles of the General Agreement on Tariffs and Trade (GATT).

This paper will first outline the fundamental trends in the evolving context of the global environment which affect the North American political economy. Second, it will provide a framework for assessing the state of domestic industry in Canada and the United States in individual sectors of the economy which might be specifically affected by these international trends. Third, it will examine national policies in Canada and the United

3 David Leyton-Brown, *Weathering the Storm: Canadian-U.S. Relations, 1980-83* (Toronto and Washington: Canadian-American Committee 1985), 13-15.

States which have been developed to respond to the problems arising from these trends and assess their impact on bilateral trade and other bilateral issues. Finally, the paper will present a range of possible unilateral, multilateral, and bilateral policy responses to these problems.

I TRENDS IN THE INTERNATIONAL ENVIRONMENT

The trends to be discussed are the changing economic and political position of the United States in the international system, structural changes in comparative advantage associated with the changing international division of labour, actions by governments which divert patterns of trade away from those which would result from economic factors alone, the trade effects of volatile exchange rates, the uncertainty of the international economic environment associated with the present post-recession recovery, and the significance for the commitment to multilateral trade liberalization of the large volumes of trade beyond the jurisdiction of GATT.

The decline of United States hegemony

A recent preoccupation in the academic literature has been the decline of United States hegemony and the emergence of a more pluralist international order.[4] The concept of hegemony is best understood as embodying two aspects: the possession by a nation of a preponderance of economic, military, and other capabilities, and the perception by others of the legitimacy of the exercise of leadership by the preponderant power. Whatever one's view of the absolute power of the United States, it cannot be denied that its relative standing has declined on many dimensions, typically because of the increase in power of competitors. Its share of world gross national product and world

4 The range of arguments on the question is summarized in John J. Kirton, 'America's hegemonic decline and the Reagan revival,' in D.H. Flaherty and W.R. McKercher, eds, *Southern Exposure: Canadian Perspectives on the United States* (Toronto: McGraw-Hill Ryerson 1986), and Bruce Russett, 'The mysterious case of vanishing hegemony; or, is Mark Twain really dead?' *International Organization* 39 (spring 1985).

trade has diminished. It has shifted from being a net exporter of capital to being the world's greatest debtor country. Its nuclear superiority has given way to parity, and its conventional military posture is considered by some to be inferior to that of the Soviet Union despite recent and costly modernization.

The role of the United States as security guarantor of the Western alliance provides the glue for the political and economic relationship among the Western countries. Nevertheless the United States demonstrates increasing unwillingness, and in the long run inability, to continue to bear a disproportionately large share of the alliance defence burden, although it has recently increased its own defence spending in a strategic modernization programme.

The other measure of hegemony is the acceptance by other countries of the leadership role of the hegemonic power. The United States has become both less able and less willing to bear the costs of underwriting the system at the same time as divergences on such matters as macro-economic and industrial policy have made it more difficult to achieve international policy co-ordination. It will be important not only how other governments respond to this change, but also whether the United States itself responds by pursuing its own short-term competitive interests or by attempting to exercise leadership in a multilateral context.

The international division of labour

The internationalization of production reflects a global rationalization and redeployment of productive investment and capacity. Vertically integrated production, international joint ventures, and the assembly of final products from internationally produced components indicate a corporate readiness to subcontract or invest wherever factor prices or other inducements suggest the greatest profitability. This shift stems from a structural change in international competitiveness which represents a new international division of labour.

Canadian and United States export markets and even domestic markets are threatened by the emergence of new competitors. Growing numbers of developing countries are increasingly competitive in labour-intensive light manufacturing industries with standardized production techniques, such as textiles, clothing, and footwear. The newly industrializing countries are moving successfully from labour-intensive manufacturing to capital-intensive manufacturing of industrial materials (eg, copper, steel) and manufactured goods with standardized end-products and large economies of scale (eg, automotive parts). The advanced industrialized countries all are seeking to expand production in technology-intensive industries, and their competitive capabilities are becoming more uniform in this area. In each case, these are not simply aspiring competitors of the United States and Canada, but countries whose underlying structural conditions give them comparative advantages in these areas.[5]

In keeping with the internationalization of production and the changing international division of labour, there is a change in the extent, form, and location of direct foreign investment. For example, such investment is now much more frequently concentrated in manufacturing rather than in extractive industries, and Canada's share of global incoming direct foreign investment has fallen from 25 per cent in the 1960s to 3 per cent in the 1980s. This changing international investment pattern does not entirely reflect economic calculations regarding factor costs and market opportunities. The desire of governments for the economic benefits thought to accompany foreign investment frequently leads to the provision of a variety of investment incentives. In 1977, 26 per cent of all United States affiliates abroad were receiving one or more kinds of incentive.[6]

5 Peter Morici, *The Global Competitive Struggle: Challenges to the United States and Canada* (Washington DC: Canadian-American Committee 1984), chap 2, and Michael C. Webb and Mark W. Zacher, 'Canadian export trade in a changing international environment,' in Denis Stairs and Gilbert R. Winham, eds, *Canada and the International Political/Economic Environment* (Toronto: University of Toronto Press in co-operation with the Royal Commission on the Economic Union and Development Prospects for Canada and Supply and Services Canada 1985), 92-9.

6 Morici, *The Global Competitive Struggle*, 29.

Government-business negotiations of investment location decisions are sensitive to political as well as economic calculations.

Investment patterns affect trade competitiveness in two ways. First, an increasing amount of world trade is accounted for by inter-affiliate transfers within the structure of multinational enterprises. Fifty-six per cent of Canada's exports to the United States in recent years have been inter-affiliate transfers.[7] Second, some countries impose performance requirements upon foreign investors in exchange for investment approval. These performance requirements can include export requirements and labour content requirements which affect trade.[8]

The change in the international division of labour accompanies a shift in the composition of world trade. The relative importance of trade in manufactured goods, services, and information-related goods is increasing, while trade in primary products is of declining importance. In keeping with that trend, the United States economy is becoming more service-based. In 1983-4, the United States lost 2 million manufacturing jobs. These were offset by the creation of jobs in the service sector and therefore did not cause a net increase in unemployment in the United States. This does suggest, however, the possibility of a permanent net loss in the manufacturing capability of the United States economy.

The problems of adjustment to the changing international division of labour are complicated by the rapidity of technological change. While change is occurring most quickly in the high-technology industries, it is present throughout the economy. It can either exacerbate problems of unemployment and overcapacity, or it can provide opportunities to compete in mature industries through new production processes and modernization.

A consequence of the changing international division of labour is the problem of surplus capacity in a variety of industrial sectors. Surplus capacity normally results from the contin-

7 Webb and Zacher, 'Canadian export trade,' 129.
8 Morici, *The Global Competitive Struggle*, 31.

ued existence of older plants faced with competition from lower cost, more efficient new producers at home and abroad, from overestimation of demand, or from political decisions to create or maintain an industry in contradiction of market signals. Prolonged surplus capacity leads inevitably to a need for industrial restructuring. Some governments (eg, those in Europe) have been less willing than others to accept or encourage such restructuring and have sought to shield domestic industries from international pressures, a policy which merely passes on the cost of adjustment to others. Of course, much excess capacity would never have been built in the first place if market forces were the only determinant. The substitution of political priorities for economic criteria increases the competitive challenges of the international environment.

Government action

On top of the competitive challenges resulting from the structural changes in the international division of labour, governments are intervening heavily in trade patterns, altering them from what they would be on the basis of comparative advantage alone. Many policy programmes aimed at domestic development or fulfilment of social objectives have intended or unintended trade consequences. In some countries the political decision has been made that it is important to create or maintain a particular industry despite the economic realities of comparative advantage. In such cases the industry is operated ultimately not for profit but for social benefit. Moreover, some governments deliberately alter the pattern of competition through export subsidization or other programmes targeted to secure an immediate trade advantage.

Governments are implementing policies designed to lessen or delay adjustment to international competitive changes and to increase competitiveness in new industries. Especially in democratic societies, governments are driven by domestic pressures to maintain and increase employment. Traditional mercantilism involved reducing imports, stimulating home production, and promoting exports in order to achieve a trade surplus with a resulting increase in the stock of wealth. Current policies involve government intervention in trade and the economy to reduce imports, stimulate home production, and promote exports, largely in order to achieve an increase in the stock of jobs.[9] Many governments are intervening to maintain employment in sectors unfavourably affected by trade and in particular geographical areas of high unemployment. This leads inevitably to an increase of protectionist sentiment, especially in circumstances of an uncertain or declining international economic environment.

For some developing countries, their international debt is an even greater driving force than their search for employment and development. The need for revenue to service their debt drives them to reduce imports from the advanced industrialized countries and to seek by whatever means possible to penetrate the markets of those advanced countries.

Even more disruptive of international trade patterns is the deliberate attempt by some governments to achieve trade advantages through intervention, thereby creating 'artificial' comparative advantages. Exports can be subsidized by export financing and by domestic production grants which on occasion appear almost predatory in character. Imports can be deliberately blocked in favour of domestic production by a host of non-tariff barriers or regulatory mechanisms. For example, in one of our project workshops, an official of a company observed that its access to certain foreign markets was impeded by an oscillating set of regulatory investigations – no sooner did it escape the costly and time-consuming defence against the charge that its prices were too low in the anti-dumping or countervailing duty process than it was faced with an antitrust investigation on the charge that its prices were too high. Measures

9 The general thrust of this policy drive is not new; cf John Gerard Ruggie, 'International regimes, transactions, and change: embedded liberalism in the postwar economic order,' in Stephen D. Krasner, ed, *International Regimes* (Ithaca NY: Cornell University Press 1983). What is new is the growing disjuncture of policy paths leading to domestic versus international stability.

of these kinds indicate that not all governments are playing by the same rules.

The major distinction within international trade may no longer be among manufactured goods, resources, and services, but between fair and unfair trade. However, to raise that issue begs the question of what constitutes unfair trade. In the last round of the multilateral trade negotiations, an initial attempt was made to develop a code dealing with subsidies, but the problem remains of disagreement on what constitutes an unfair subsidy. The United States has gone farther than any other country in enshrining in its domestic law what it considers unfair trade practices, but its legal measures to protect United States producers against unfair advantages enjoyed by foreign competitors can themselves be viewed as unfair impediments to trade by foreign governments which do not consider their own policies to have been unfair. The present system of unilateral determination by the United States of what constitutes unfair trade runs the risk of effectively equating the fairness of any policy on such diverse domestic issues as resource management or manpower retraining with prevailing United States practices. That danger should not obscure the fact, however, that a government's policies are sometimes deliberately designed to bestow unfair competitive advantages on its industries and thus run counter to the philosophical objectives of trade liberalization in a world of comparative advantage.

Volatile exchange rates

Fluctuations in the exchange rates of major currencies have been greater in the 1980s than in any previous five-year period. Much of this volatility is due to reasons other than adjustments to changing international competitiveness. Exchange-rate changes have occurred not only because of relative rates of inflation, productivity, or production costs, but also because of fiscal and monetary policy or political considerations. As well currencies have become commodities. World currency markets now trade

US$75 to US$100 billion worth of currencies per day, and exchange rates themselves have become a matter of speculation rather than a corrective for trade imbalances.

Within this volatile international monetary environment, misalignment of currencies has also been a factor. The United States and Canadian dollars have experienced particular difficulty. The Canadian dollar has depreciated against the United States dollar while appreciating against every other major currency. The United States dollar until recently has experienced a massive rise in value relative to every other major currency, with serious trade effects. From 1979 to 1984, the trade-weighted value of the United States dollar increased by 55 per cent. A large and growing budget deficit combined with a tight money policy resulted in high interest rates and a rising value for the dollar which have led to a large and growing trade deficit.

More recently the value of the United States dollar has fallen, because of the concerted action of United States and other banking authorities. In the six months from late 1985 to early 1986 the trade-weighted exchange rate fell over 30 per cent. However the impact on the United States trade deficit has thus far been marginal.

The trade effects of exchange-rate changes can be more abrupt and more consequential than the removal of tariffs. Because of exchange-rate changes, real unit labour costs in the United States are now approximately equal to those in Europe, instead of about 20 per cent lower as they were in the late 1970s, which has contributed substantially to the United States trade deficit. Because of exchange-rate changes, Canadian steel has become the second most expensive in the world market, even though Canadian steel prices, in Canadian dollars, have risen less than competitors' steel prices in their currencies. Because of exchange-rate changes, some multinational companies have been driven to close more efficient plants in the United States and Canada and shift production to less efficient but more profitable plants abroad. Because of exchange-rate changes, United States and Canadian companies have suddenly been shut out of traditional foreign markets and are even being undersold by foreign competitors in their domestic markets.

If these changes were simply the reflection of underlying changes in international economic conditions and comparative advantage, it could be argued that they merely prompt painful but needed adjustments. However, exchange-rate changes which reflect divergent macro-economic policies or political considerations do not represent changes in international competitiveness. What is more, some governments have deliberately fixed exchange rates to achieve trade advantages. Where the increased cost of imports after devaluation can be spread evenly over the entire population, a government may choose devaluation as a way to attempt to increase exports. However, the benefits of such competitive devaluations can be squandered quickly through such subsequent developments as rising wage rates or production inefficiency.

However much the long-run benefit to manipulators of exchange rates may be, the competitive position of the United States and Canada is complicated by the volatile exchange-rate system. Canada's trade advantages in the United States market resulting from the declining relative value of the Canadian dollar cannot be separated from the global monetary environment and the forces driving up the value of the United States dollar.

The uncertain economic environment

In contrast to the widespread economic growth in the 1950s and 1960s which eased structural adjustment and encouraged trade liberalization, the 1970s and 1980s have been characterized by slow growth, high unemployment, and uncertainty surrounding recurrent recession and recovery.[10] This situation has fuelled protectionism by increasing pressures on governments to help those in difficulty. Competitive problems created by the shift in the international division of labour and the emergence

10 Webb and Zacher, 'Canadian export trade,' 99-101.

of new competitors have been complicated by the limited market opportunities associated with slow growth, shifting consumption patterns, and the challenge of new substitutes. Recovery from recession can still release pent-up demand in some sectors, however, such as occurred in housing.

Further contributing to uncertainties in the international economic environment are developments in what might be called the biophysical resource base. This has to do with the changing economics of resources, such as energy, water, and the environment. Pricing of resources and trade in them (not to mention ownership) can be a source of strain in itself, but can also connect to broader issues of economic competitiveness through the impact on factor costs. Among the long-run consequences of the oil shocks of 1973 and 1979 have been changes in consumption patterns for consumer durables and industrial materials.

The spread of interdependence has led to a global economy different from the traditional international economy which comprised separate national economies managing their own affairs. The present situation of interpenetrated national economies requires a different set of approaches than the world of Bretton Woods. Yet the multilateral response remains uncertain.

Reduced commitment to multilateral trade liberalization

Apart from the spectre of protectionism in the early 1980s, which threatened to reverse the momentum toward trade liberalization which had developed since the Second World War, it is striking that there is a proliferation of trading arrangements which do not subscribe to the non-discrimination principles of the GATT and a significant portion of international trade which takes place outside GATT jurisdiction altogether. We have witnessed the emergence of regional trading blocs which discriminate in favour of members and against non-members. These include the European Community, the Andean common market, the Caribbean Common Market, various schemes for generalized systems of preferences, and the United States-Israel

Free Trade Agreement. Other regional and bilateral trade agreements are being considered more or less seriously.

Entirely apart from such formal preferential agreements, a large proportion of international trade takes place outside GATT jurisdiction. The GATT has never dealt with trade in services, much of agricultural trade, and many of the trade effects of investment and exchange-rate policies. Trade in services and manufactured goods under restrictions of offsets and counter-trade agreements is conducted on non-GATT terms. The Multi-Fibre Arrangement governing much of the trade in textiles and clothing between advanced industrialized and developing countries is not a part of the GATT structure. Orderly marketing arrangements and voluntary export restraints are negotiated separately to deal with large sectors of international trade such as steel and automobiles.

It remains an open question whether the upcoming round of the multilateral trade negotiations will succeed in reinvigorating the GATT system, or whether it will give way to a patchwork of bilateral and regional arrangements, resulting in a less predictable and principled trading system.

II THE STATE OF DOMESTIC INDUSTRIAL SECTORS

These international trends will have different impacts on different sectors of the domestic North American economy. The experience may be different in ascending and declining industries, and in resource, secondary, and high-technology manufacturing, and in services. To assess that impact, together with the bilateral Canada-United States problems which arise in any given sector, it is necessary to review the state of the domestic industry in that sector in each country.

Of initial importance is the supply and demand structure of the domestic industry – such considerations as the number and size of major firms in the industry, and their national and international ownership patterns. The major domestic and foreign markets served by the domestic industries should be identified along with any excess capacity, as should the major domestic and foreign suppliers to the local market.

Next, it is important to assess the level of productivity and the rate of growth and technological change in the sector. Productivity and growth relate to the international competitiveness of the sector, which can be adversely affected by high wages, low productivity, high domestic safety and pollution standards, and the like. Technological change relates not only to the efficiency and modernization of industry, but also to possible negative effects of automation on employment.

High unemployment in both Canada and the United States creates pressures on governments to maintain and create jobs. In individual sectors, the level of employment can be adversely affected both by global circumstances like recession or the changing international division of labour and by sector-specific conditions, like automation, excess capacity, and unfair trade competition. Their impact leads to demands for adjustment assistance and for protection. Within each country there can be shifts of employment concentration among regions (eg, in the United States, from the 'rust bowl' of the northeast and midwest to the 'sun belt' of the south and west). There can also be pressure on unionized labour, as firms may seek the lower labour costs associated with non-unionized production. In some sectors, firms have closed union plants and then re-opened them as non-union plants.

The most important issue with respect to the state of the domestic industry is the pace and extent of industrial rationalization and restructuring. This is the fundamental issue of competitiveness and adjustment. Economic theory would lead us to expect that as industry adjusts to new competitive challenges, the least productive, less efficient, and less profitable companies will go out of business, and that throughout the sector workers will be laid off, plants will be closed, and old unproductive plants will be replaced with newer, more modern, and more efficient plants. However, there may be political opposition to such developments in particular locations, and governments may seek to cushion or assist the adjustment process. Accordingly, it is important to examine why and how fast industrial restructuring occurs, how it is financed (ie, from internal capital, borrowing, or government assistance), and what its long-term consequences are. An exaggerated pace of plant closures and disinvestment in the face of unfair competition can lead to a disintegration of capital stock or lay the base for less productivity and efficiency in the future in individual sectors.

III NATIONAL POLICIES AND BILATERAL TRADE PROBLEMS

Existing national policies indicate the ways in which the Canadian and United States governments have responded thus far to the international trends discussed above. They also establish the setting within which bilateral trade occurs and bilateral economic problems arise. Differences between Canadian and United States policies are indicative of underlying philosophical differences between the two countries about such matters as the role of the state in the economy, the relationship between federal and regional governments, ethnic-multicultural relations, regional development and equalization policies, and the degree of government regulation. Many of the policies of one government which the other sees as irritants derive from these fundamentally different premises about the nature of appropriate policy action.

Both governments offer a variety of forms of support to domestic industry. Some are of general applicability, and others vary from sector to sector. Policies related to industrial development include but are not limited to: concessional export financing; domestic production and employment subsidies; performance requirements for foreign investors; administrative guidance for domestic companies in procurement and investment; reservation of a segment of the domestic market for an emerging industry; competition, merger, and antitrust policies; discriminatory government procurement; countertrade; and government-to-government participation in trade.[11] In addition, policies that affect economic activity, and therefore

11 Morici, *The Global Competitive Struggle*, 22.

indirectly affect bilateral trade, may be developed for other purposes, such as social welfare or environmental protection.

Trade restrictions that directly respond to the challenges of international competition fall into three broad categories: general protection through tariffs and non-tariff barriers; selective protection through trade management arrangements; and contingent protection under trade laws in conformity with GATT commitments.

Canada's tariffs are generally higher than those in the United States. By 1987, when the tariff reductions agreed to in the Tokyo Round are all implemented, Canada's average tariff will range from 9 to 10 per cent while United States tariffs will average 5.5 per cent. By contrast, non-tariff barriers are more prevalent in the United States. However, neither of these is as important to the Canadian and United States economies as the other two types of trade restriction.

Selective protection has resulted in a variety of managed trade agreements in both Canada and the United States. Orderly marketing agreements, voluntary export restraints, and voluntary restraints agreements have been concluded with a variety of countries in sectors ranging from footwear to automotive products. These measures, which have increased in number in recent years, erode the GATT principle of equal treatment. They also pose the problem of guaranteeing through negotiation a market share achieved initially by unfair trading practices such as dumping or subsidization.

The contingent protection provisions of the United States Trade Act (of 1974 and 1979) are the major legal response by the United States government to the pressures of the international environment. In keeping with GATT agreements, various sections of the law allow for the imposition of countervailing duties, anti-dumping duties, and safeguard duties or quotas in appropriate circumstances, upon petition by private parties through a quasi-judicial process. Canadian law has similar provisions, but they have been used much less vigorously than in the United States.

Countervailing duties may be imposed upon foreign imports which are found to have materially injured United States producers and to be subsidized within the terms of United States law. The injury test is internationally accepted, but the United States government has taken it upon itself to define what constitutes a subsidy. Indeed the omnibus trade bill passed by the House of Representatives but not the Senate in 1986, and expected to be reintroduced in the 100th Congress, would broaden that definition. The Canadian and other governments are concerned that foreign government policies which differ from those in the United States on such matters as resource management or administered pricing will automatically be considered subsidies, thereby subjecting exports from those countries to the United States to the possibility of countervailing duties if injury can be proved. Even if consensus could be reached on an internationally accepted definition of a subsidy, there would remain a problem inherent in reliance upon the countervailing duty process to withstand unfair competition: it raises the price of future shipments, but does not relieve past injury.

Even broader is the effect of safeguard actions (section 201 of the Trade Act) which allow for the temporary imposition of quotas or duties if injury to United States producers is proved. Safeguard actions do not distinguish between fairly and unfairly traded imports and may through quotas perpetuate market shares achieved by unfair trade, or even grant new entrants in the market shares which they have never enjoyed.

Certain common characteristics may be found among the specific bilateral economic problems which have arisen in this context. The United States is concerned with the rising Canadian share of the United States market in certain sectors at a time of a growing United States trade deficit and a perception of spreading unfair trade competition. There are frequent charges of Canadian export subsidization, and contingent protection cases are common. Canada is concerned about protectionist threats to its access to United States markets and fears that the already costly and time-consuming burden represented by United States contingent protection measures could become even more of a barrier to trade if United States law defines as unfair a wide variety of policies which differ from those in the United States.

IV POSSIBLE POLICY RESPONSES

These bilateral problems, and the global economic challenges in which they are embedded, must be responded to by the Canadian and United States governments. It is clear that there are genuine structural changes under way in the international economy to which the economies of Canada and the United States must adjust. Furthermore, it is clear that governments must intervene in the economy in some way to provide assistance to national industries and labour to adjust to these changes and also to protect them from unfair competition. The failure of government to provide adjustment assistance would leave the national economy at the mercy not of the market but of foreign competition, both fair and unfair. Details vary from sector to sector, and it is unwise to generalize about the economy as a whole. Nevertheless, protectionist national policies aimed simply at insulating a national industry from international competition will provide no more than temporary relief, will be costly, and, by delaying the necessary adjustments, will make the eventual problem of adjustment even greater. The challenge lies in designing adjustment assistance policies which are politically compatible with existing government and public beliefs, administratively feasible, economically attractive, and which do not reward, even if only by acquiescence, any unfair competition by other governments.

Suitable policies must also meet the separate and joint needs of Canada and the United States. Canada's primary need is security of access to the United States market. The prime United States need is reduction of its trade deficit. Both countries need enhanced employment opportunities and adjustment. These needs can be pursued through unilateral, multilateral, and bilateral policy responses.

Unilateral responses

Given the character of the democratic system, it is only natural that companies, groups, and communities threatened by developments in the international environment will press their governments for relief. It is ironic that business leaders who are extraordinarily sensitive to global pressures on their companies lobby governments for purely national responses to developments which are beyond national government control. In any event, governments can and will provide adjustment assistance and design regulatory and other policies to enhance competitiveness.

Protectionism is one possible unilateral response. Legislation can be passed to create permanent trade barriers. Temporary protection can be provided through contingent protection provisions or through transitional adjustment assistance. Immediate trade challenges can be responded to through trade management agreements, voluntary export restraints, and the like. These protectionist measures are prey to the disadvantages mentioned above, but also to the fundamental problem that they are economically beneficial only if no other country responds in the same way. If protectionism invites retaliation and a wall of trade barriers arises, the welfare of all concerned is diminished.

Local content requirements have been suggested for certain sectors (eg, automobiles) in both Canada and the United States, primarily to ensure the preservation of jobs. Advocates argue that by requiring companies to produce a certain proportion locally of what they sell in that market, content requirements simply ensure a fair share of investment and employment. Opponents argue that content requirements remove the incentive for business to become efficient and competitive and impede adjustment because price becomes secondary to content.

The Canadian and United States governments can and will act unilaterally in response to problems of global origin. But if the two countries do not respond in similar ways to problems, and instead compete with one another, they will open the way for foreign companies and governments to play them off against each other.

Multilateral responses

There is a logical attractiveness to addressing problems that originate in the global environment on the level on which they occur. The upcoming round of multilateral trade negotiations offers an opportunity to reverse the danger of protectionism, revitalize the international trading system, and extend trade liberalization into areas not previously encompassed by the GATT. To the extent that agreement can be achieved, the negotiations could increase predictability in the international economic environment and achieve commitment against unfair trade practices. However, progress is bound to be slow, and dramatic new agreements are most unlikely to result from the process in the near future.[12]

Bilateral responses

Because many of the economic problems experienced by Canada and the United States are the product of the same global developments, and because their economies are so closely intertwined, it is quite possible that the two governments will consider joint solutions to mutual issues.

The first such joint response is the prospect of bilateral free trade. This is not the place to examine all the arguments for or against sectoral or comprehensive free trade. However, in terms of Canada's identified needs there would be a clear benefit to Canada if it were able to negotiate with the United States a definition of what constitutes unfair trade, instead of allowing the United States to determine it unilaterally.

Continental industrial rationalization has been suggested as a means of increasing the efficiency, and hence the competitiveness, of industry in Canada and the United States. The evidence indicates that the rationalization provided by the

12 C. Michael Aho and Jonathan David Aronson, *Trade Talks* (New York: 1985).

Automotive Agreement of 1965 did enhance the efficiency of the automotive industry in both countries. However, it is instructive that despite the existence of the auto pact and the similarity of the threat to the industry in both countries from Japanese automobile exports, Canada and the United States did not negotiate a common continental voluntary export restraint agreement with Japan, but instead negotiated separately.

A dispute settlement mechanism to resolve bilateral economic problems, whether in the context of a free trade agreement or not, might be of value. Given the unequalled level and complexity of interdependence between the two countries, and the external origins of many of their bilateral problems, such a mechanism might depoliticize tensions and aid in the search for mutually acceptable solutions.

The unilateral, multilateral, and bilateral responses are of course not mutually exclusive and may indeed be pursued simultaneously. There is a danger, however, that multilateral solutions may seem frustratingly slow to materialize and that bilateral responses could fall prey to competition rather than mutual interest in the face of externally generated problems. If so, the natural tendency to look to one's own government to solve one's own problems would be intensified. In such circumstances, the danger of politically satisfying but economically non-productive protectionist measures, rather than the more painful but more useful adjustment assistance, would be greater. The two governments are more likely to respond appropriately to these problems if they remain conscious of the global context of the challenges facing the North American political economy.