

**CANADIAN TRADE WITH
THE UNITED STATES –
AN UNHEALTHY DEPENDENCY**

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INTRODUCTION

From fur trade with France in the 1500s to automotive trade with the United States in the present day, the Canadian economy has always relied heavily on international trade. Currently, exports account for more than 40% of Canada's GDP – a larger percentage than any other G7 nation [1]. However, the majority of Canada's trade is with the U.S. in the largest bilateral trade agreement in the world. The two countries have been each others' largest trading partners since 1946 [2], [3]; in 2003, over 87% of Canada's exports were destined for the U.S. while nearly 24% of all U.S. exports arrived in Canada [4]. Unfortunately, with such a high dependence on trade with the U.S., Canada is prone to undue U.S. influence. In this paper, the primary components of trade between Canada and the U.S. are first discussed before reviewing the history that led to Canada's dependence on America. Examples of economic and ideological disputes between the two nations that threaten their trading relationship are discussed next. The paper then summarizes Canadian efforts to expand its trade base beyond the U.S. into a larger global market and finally presents a concluding recommendation for future Canadian trade policy.

MAJOR CANADIAN EXPORTS TO THE UNITED STATES

Canadian trade with the U.S. is concentrated in two sectors: automobiles / automobile parts and energy (oil and natural gas). In 2003, these two industries represented nine of the top ten Canadian exports to the U.S. (the other top-ten export, softwood lumber, is discussed later). Together, these products account for 19.3% and 15.5% of all exports, respectively, totaling nearly 35% of all Canadian exports to the U.S. [5]

Automobiles and Automobile Parts

In the early 1900s, a limited number of Canadian car companies were in the automobile market. However, despite 35% tariffs on imports, American cars outsold Canadian cars, pushing most Canadian companies out of business [6]. After WWI, American automaker GM opened a branch plant in Canada and within the first twenty years, Canada had produced one million GM cars [7]. By 1928, car production was an integral part of the Canadian economy, as the Big Three U.S. automakers established branch plants to access the large Commonwealth market via Canada [6].

Unfortunately, the depression of the 1930s shrunk the car market, stalling the Canadian economy. After WWII and through the 1960s, Western Europe became a prominent car producer and in 1961, Canada was running an automobile trade deficit [6]. To resolve this problem, the Canadian government pushed for an integrated continental auto market [6]. The U.S. and Canada agreed to rationalize production of car industries in both countries and to expand auto trade by removing trade barriers and tariffs in the automotive field [6]. This agreement was formalized in the Canada-U.S. Automotive Products Agreement, or the auto pact, signed in 1965 [8].

Under the auto pact, greater automotive products trade between the two countries was facilitated by elimination of relevant tariffs and other trade barriers. Furthermore, if any American car company agreed to produce at least one car in Canada for every car it sold in the country (referred to as the 1:1 ratio requirement), that company was allowed to import vehicles and vehicle parts into Canada from anywhere in the world duty-free [8]. The auto pact was highly controversial in Canada during its first five years as many Canadian autoworkers found themselves unemployed and American car companies moved their operations back to the U.S. However, the Canadian government continued to focus on the automobile industry, especially developing expertise in car parts; by the 1980s, Canada's auto industry began to rebound with increased production and car parts exports to the U.S. as well as Japan and Germany [6]. American and other foreign car companies, such as Suzuki and Honda, opened facilities in Canada because of the specialized parts industry, an available and skilled workforce, and the low, stable-valued Canadian dollar [6].

The auto pact was clearly a success for Canada: in 1965, Canada controlled only five percent of the North American auto industry but by 1987 Canada's share had increased to eighteen percent. Furthermore, the substantial Canadian car industry provided jobs for tens of thousands of Canadians [6].

However, the American auto industry viewed the auto pact less favorably. Under the agreement, foreign carmakers were able to import their Canadian-produced vehicles duty-free into the U.S.;

Americans claimed the pact was never intended to allow duty free import of foreign cars [6]. As a result of this discontent, the auto pact was a controversial subject in the 1980s free trade negotiations between Canada and the U.S. Because the 1:1 ratio requirement of the pact originally only applied to American companies, the U.S. argued other foreign carmakers had unfair access to the North American auto market via Canada. Therefore, in the final Canada-U.S. Free Trade Agreement (FTA), Japan and other foreign companies lost the right to import parts and vehicles duty free into Canada unless they abided by the 1:1 ratio; these companies were subject to a 6.1% duty on their imports [6]. The Canada-U.S. automobile trade relationship under auto pact was unchanged in the later North American Free Trade Agreement (NAFTA).

In 2001, the auto pact was struck down by the World Trade Organization (WTO) on a challenge brought by Japanese and European automakers; the complainants argued the 1:1 requirement provided American automakers an unfair advantage. Despite dissolution of the trade agreement, Canada's mature auto industry continues to prosper, ranked as the eighth largest automotive industry in the world [5], [6]. Canada maintains the second and third most productive plants in North America and has won 13 of 39 JD Power Plant quality awards for North America despite producing only one-fifth the number of cars produced in the U.S. Car companies incur 31% less labor costs and 11% lower total costs in Canada compared to the U.S., while enjoying 7.3% higher productivity [9]. The industry employs over half a million people in Canada and in 2003, the automotive industry comprised nearly one-quarter of all Canadian export value; 95% of the automotive exports were destined for the United States [5]. The Canadian economy relies heavily on its automotive industry.

Energy Resources

In addition to cars and car parts, Canada also trades extensively with the U.S. in energy sources, especially oil products and natural gas; in fact, Canada is the number one supplier of oil products to the U.S. [10]. North America has proven crude oil reserves of 50 billion barrels (Bb) and natural gas resources of 290 trillion cubic feet, representing 5% of world oil and 6% of world gas. Canada controls 8.8% and 32% of North America's traditional oil and natural gas reserves, respectively [11]. In addition, Canada has vast oil sands with 308Bb of economically recoverable oil [11], more than the total traditional oil reserves in Saudi Arabia [10].

In 1952, the U.S. recognized Canada as a strategic source of oil and in 1961, the Canadian government enacted the National Oil Policy to protect the Canadian oil industry and decrease Canada's reliance on foreign oil by investing in domestic oil projects [12], [13]. During this time, U.S. restrictions on overseas oil imports drove U.S. oil prices higher than Canadian prices; Canadian oil companies profited by selling their domestic oil to the U.S. [12] In 1973, world oil prices jumped and the Canadian government responded by fixing the price of oil and taxing exports to prevent foreign countries from depleting Canadian supplies [12]. In 1980, as world oil prices continued to rise, Canada adopted a self-sufficiency policy, the National Energy Policy (NEP) [13].

The NEP sought to attain energy self-sufficiency in Canada by fixing oil prices and providing Canadians the opportunity to participate in the Canadian oil industry by limiting foreign ownership [12], [14]. Businesses received government funding to explore and develop new oil sources; the level of funding was proportional to the degree of Canadian ownership of the business. In addition, federal rules favored Canadian companies applying for licenses to develop public lands [12]. Americans were angered by the NEP, claiming it involved too much government control of a free market good. The U.S. feared such a policy would threaten their energy security [15].

In 1984, after world oil prices receded from their record highs, the Canadian government scrapped the NEP, eliminating price control, lowering taxes on production, and increasing Canadian oil exports [12]. In the Canada-U.S. FTA, the U.S. sought to create a single energy market and to ensure the NEP or a similar policy would never again be adopted [12]. To that end, tariffs on all energy products were eliminated in the FTA and both nations agreed not to erect new restrictions on energy trade [16]. Canada removed electricity fees that discriminated against export and the U.S. eliminated discriminatory pricing against B.C. hydro destined for California [16]. To guarantee energy security for both countries, the FTA mandates that neither country can limit exports of energy resources unless the other country reduces its exports proportionally [17]. Energy trade rules regarding the U.S. and Canada were not significantly

changed in the later NAFTA; under that agreement, the U.S. and Canada gain free market access to the Mexican market over time, eventually creating a truly continental single energy market.

Given its vast natural resources, Canada is the largest single supplier of petroleum products to the U.S., providing 17% of all U.S. imports in 2002 (9% of U.S. total use). The next largest suppliers to the U.S. are Venezuela and Saudi Arabia, each providing 13.9% of the U.S. imports. Furthermore, 94% of all Canadian natural gas exports are destined for the U.S. (providing 15% of U.S. total use) [10]. Canadian energy trade with the U.S. is another large component of Canada's economy and as the tar sands and new oil projects such as the Hibernia and White Rose offshore oil projects come into full production, energy resources will continue to be a major Canadian export.

The two major components of Canadian trade are efficient, internationally competitive, and strong industries yet these industries trade almost exclusively with the United States. A better understanding of the reasons for the close economic ties between the two countries requires an exploration of their trading history.

HISTORY OF CANADIAN TRADE WITH THE UNITED STATES

Canada and the United States have always been close trading partners. Because of close ties to the British Empire and geographical proximity to the U. S., early Canadian trade focused on those two countries and concentrated on goods such as furs, fish, wheat, lumber, and other natural resources. However, in 1846, Britain adopted a unilateral trade policy, ending Canada's preferred trading status [18]; Canada's immediately redirected its trade efforts to the U.S.

In 1854, Canada and the U.S. implemented the Elgin-Marcy Reciprocity Agreement (EMRA). This agreement guaranteed Canada free entry for its exports in return for allowing Americans navigation rights on the Great Lakes and fishing rights in the rich Grand banks [18].

Unfortunately, under this agreement the U.S. did not obtain significant trade rights and Canada was able to increase duties on American goods [18]. Furthermore, the agreement had few American proponents after Southerners were removed from Congress following the U.S. Civil War. Therefore, in 1866, the U.S. cancelled the reciprocity agreement.

Under the EMRA, Canadians, especially farmers and loggers, enjoyed economic growth due to export commerce and thus Canada fought to renegotiate another reciprocity agreement with the U.S. However, in 1867, negotiation efforts ceased when the U.S. mandated that Canada had to join the Union to obtain free trade with the U.S. [18]

Approximately five to seven years after the 1867 Confederation of Canada, Canadian trade with the U.S. stagnated and efforts to revive trade with England continued to flounder [18]. During this time of slow economic growth, Canadian officials repeatedly attempted to draft a new reciprocity agreement with the U.S. but Republican politicians rejected proposals and steadily raised tariffs on products entering the country [18]. Canada's response to these U.S. actions was the adoption of the National Policy by the federal government.

The National Policy was a nationalistic policy intended to strengthen Canada's economy and increase national confidence in Canada's self-sufficiency. Tariffs on most manufactured goods were increased while those on raw materials supplied to Canadian producers were reduced [19]. This protectionist policy initiated a production and transportation revolution in Canada, leading to many innovations and a general strengthening of domestic industries [18]. Successive Canadian governments retained the National Policy and reciprocity negotiations with the U.S. were altogether abandoned in 1896 [18].

In the early 1900s, the world economy improved and international trade increased; owing to its improved industries, Canada was able to benefit greatly from this internationalization [18]. Canada's economy enjoyed a boom driven by exports of wheat, lumber, newsprint, mining, and other manufacturing goods [18]. With this new confidence, Canada again proposed a reciprocity agreement with the U.S. but Canadian businesses, accustomed to the protectionist National Policy, rejected the new deal even after the U.S. accepted the proposed agreement [18]. In 1911, Canada and the U.S. government under President Taft agreed to free entry of natural resources and equalization of tariffs on manufactured goods between the two countries but complete reciprocity was not achieved [18].

Later in 1911, a new Canadian federal government adopted stronger protectionist policies and cancelled the agreement with the U.S. As a result, trade between the two countries was minimal despite U.S. adoption of the Underwood Tariff in 1913, which set U.S. tariffs at their lowest levels in over fifty years [20]. U.S. entrepreneurs could only establish branch plants in Canada and Canadian agriculture and resource exports found the U.S. market unreliable; therefore both countries assigned the other “least favored nation” status and sought other international trade partners [18].

In 1932, Canada and other Commonwealth members convinced Britain to adopt an imperial trade preference system at the Imperial Economic Conference in Ottawa [21]. However, the preferred status obtained under this agreement failed to generate an appreciable increase in trade. Coupled with the rising economic power of the U.S., Canada again began to look south for trade relations [18].

In the early 1900s, trade policy in the U.S. was the responsibility of Congress; because different members of Congress had different priorities, U.S. tariffs became increasingly complex and protectionist. Tariffs in the U.S. rose throughout the 1900s and peaked in 1930 with the Smoot-Hawley Tariff Act (SHTA) [18]. SHTA was originally designed to protect American farmers from world agriculture overproduction but eventually tariff revisions spread to all sectors of the American economy [22]. In the end, the SHTA represented the most protectionist tariffs in U.S. history, with tariffs on goods averaging 60% [23]. These large tariffs greatly damaged U.S. trade relations with other countries: trade with Europe fell from \$3.6B to \$1.2B from 1929 to 1932 and many other foreign countries implemented retaliatory trade measures [22].

In 1934, the U.S. changed its trade policy to embrace trade liberalization rather than protectionism [22]. The president was given power to negotiate trade agreements with any country offering reciprocity, potentially lowering tariffs by half [18]. Fresh from the 1932 Imperial Conference, Canada immediately began negotiations with the U.S. and in 1935, the two countries entered into a trade agreement under which both attained “favored-nation” trading status and tariffs were reduced [18]. Three years later, Canada reached an improved agreement with the U.K., entrenching the U.S. and the U.K. as Canada’s primary global partners [18].

In 1947, the General Agreement on Tariffs and Trade (GATT) provided Canada with rules and procedures to liberalize trade and resolve multinational trade conflicts: Canada was allowed to negotiate agreements with other countries in addition to the U.S. and U.K. without choosing between any single trade partner [18].

In the post-WWII era, improvements in communication and transportation enabled companies to compete internationally, leading to huge growth in global production and trade. Canada's main exports remained resources though trade in goods at different stages of development grew. Canada was able to benefit from the post-war global economy; between 1948 and 1973, Canadian trade grew by seven times while the GNP increased by a factor of five. Canada and the U.S. considered a bilateral trade agreement during this period but instead continued the multilateral agreement under GATT [18].

Protectionist attitudes persisted in Canada, especially in the dairy, poultry, and horticulture markets. Canada enacted some protectionist measurements in these markets against the U.S. and the U.S. responded with protectionist measures of its own [18]. However, the two countries remained close trade partners and in 1965 their economies were further intertwined by the auto pact and a defense products sharing agreement whereby Canadian branch plants of U.S. defense firms received preferred trade status [6], [18].

The trade peace was shattered in 1971 when U.S. president Nixon, facing the costs of the Vietnam War, enacted several dramatic trade policy revisions. Most importantly, a 10% import surcharge was applied to all products from all foreign countries. Canada appealed for an exemption from the new fee but was told that trade with Canada was a major source of U.S. economic woes; Nixon told Canada they were on their own [18].

Unfortunately, at this time, the U.K. abandoned its commonwealth trade in favor of greater ties with Europe. And in the Tokyo GATT negotiations of 1973-1979, the U.S., European Community (E.C.), and Japan dominated talks, excluding Canada from many discussions [18]. In 1976, Canada negotiated with Japan and the E.C. but only achieved political commitments

rather than real trade policy agreements [18]. As a result of these failed efforts to expand trade with other countries, Canada continued trading primarily with the U.S.

In the late 1970s, Canadian trade with the U.S. was inhibited when the responsibilities for trade relations changed. Since 1934, U.S. trade policy had been under the governance of the President and the State Department. However, in the late 1970s, Congress relegated trade authority to separate agencies better able to respond to individual lobby groups, especially those of agriculture and industry [18]. This delegation of control to lobby-influenced agencies reversed U.S. trade liberalization, shifting U.S. trade towards more protectionist policies. The decentralization of trade authority also greatly complicated trade relations with foreign countries, especially Canada, accustomed to dealing with one central U.S. trade authority.

After failing to enter new multilateral agreements with other countries during 1982 GATT talks, Canada found that although its economy was very reliant on U.S. trade, Canada was not confident enough in the reliability of the relationship to invest heavily [18]. Furthermore, U.S. trade relations were soured by Canadian protectionist actions including the NEP and the Foreign Investment Review Act which restricted foreign investment in Canada [24]. A new Canadian government in 1984 believed that the only way to cement a reliable relationship with the U.S. was to negotiate a free trade agreement with mechanisms for binding resolution of trade disputes [18]. Both countries desired a return to the old “favored-nation” relationship but under a more contractual relationship.

From 1984 through 1987, free trade with the U.S. was the most important political topic in Canada. Although American interest in the trade talks was much less than in Canada and despite protests from American special interest groups [18], political leaders were able to hammer out an agreement: the Canada-U.S. FTA was accepted and implemented on January 1, 1989.

The objectives of the FTA are to eliminate trade barriers in goods and services, encourage fair competition, relax foreign investment rules between the two countries, establish a means of dispute resolution, and lay the foundation for further bilateral or multilateral trade agreements [25]. The agreement called for the elimination of almost all tariffs by January 1, 1998 [26]. As

with all free trade agreements, the Canada-U.S. FTA (and later NAFTA) allowed companies in both countries to conduct long-term planning and investment without fear that trade rules would change [16].

In 1991, the U.S. entered into talks with Mexico regarding bilateral trade; Canada seized this opportunity and participated in the negotiations to obtain access to Mexican markets [18]; the resulting North American Free Trade Agreement was enacted in 1994. Although NAFTA built on the FTA, trade relations between Canada and the U.S. were not significantly altered. Rather, NAFTA strengthened dispute resolution rules and expanded the list of zero-tariff products [27].

The history of Canadian trade with the United States illustrates the evolution of the relationship and explains why the economies of the two countries are tightly intertwined. However, trade relations between the two have encountered significant difficulties.

PROBLEMS WITH THE CANADA-U.S. TRADE RELATIONSHIP

Throughout their relationship, ideological disagreements and various trade disputes have threatened the free flow of trade between Canada and the United States.

The Iraq War

In 2003, the Canadian government chose not to support the U.S.-led war in Iraq because the action was not backed by the U.N. [28]. On March 25, 2003, Paul Cellucci, the American ambassador to Canada spoke at the Economic Club in Ottawa. He criticized the Canadian government for not joining the war and warned that Canada's decision could, in the long run, "affect diplomatic and economic relations" between the two countries [29]. Furthermore, after the war began, Bush cancelled a May 2003 trade talks visit to Canada [31]. The National Post and C.D. Howe institute noted that such signals indicated the U.S. was upset with Canada [29], [32];

Canadian businesses feared Canada's absence from the Iraq war would sour trade relations with their largest trading partner. In response, many Canadian businesses and the Alberta government (a primary source of Canadian energy resources) broke ranks with the federal government to

establish their own lines of communication with Washington [30], hoping to avoid trade retribution. In the fall of 2003, Cellucci stated that one way for Canada to smooth over trade relations with the U.S. would be to allow greater U.S. access to Canadian energy resources, especially oil products [33]. And in late 2003, Canada and other countries that opposed the war were barred from bidding on reconstruction contracts in Iraq [34] (though Canada was later allowed to bid, for reasons discussed in the next section).

Personal Relations Between the Prime Minister and the President

Canadian trade relations with the U.S. also suffered during the George W. Bush administration while Jean Chretien was prime minister of Canada because of the poor personal relationship between the two leaders [35]. Chretien was a close friend of the Clinton administration and personally supported Gore in the 2000 U.S. presidential election [34]. Chretien was also known to be critical of the Bush administration: Chretien's communications director resigned in November 2002 after referring to the U.S. president as a "moron" [36] and the Natural Resources Minister stated the Iraq war reflected Bush's failure as a statesman [30]. The Bush administration, in turn, was critical of the Canadian Prime Minister, referring to Chretien as "dino", short for dinosaur [37].

However, in December 2003, Chretien retired and was replaced by Paul Martin. Months before assuming control of the government, Martin stressed that improving relations with the U.S. was his first priority; his first action as Prime Minister was the creation of a cabinet committee on Canada-U.S. relations and he quickly appointed a new minister of defense who supported the Iraq war [34]. Two days after Martin became Prime Minister, Canada was invited to bid on Iraq reconstruction contracts and in January, 2004, Martin and Bush met to discuss improving relations between the two countries. Immediately after these meetings, Bush stated that the U.S. relationship with Canada was important because he and Martin "share the same values of family" [39]. Given this improved relationship between Martin and Bush and Martin's apparent efforts to appease the Bush Administration, experts believe trade relations will improve between the two countries [40].

Conflicting Social Policies

In addition to personal differences between leaders, liberal policies in Canada have become unpopular in the U.S., especially with the politically powerful [38] religious right [40], [41]. In July 2003, Canada introduced draft legislation to change the legal definition of marriage to include same-sex marriages [42], a move that is equally supported and opposed by the Canadian public [43]. Christian groups in the U.S. including those lead by James Dobson and Pat Robertson attacked the Canadian position, noting that Canada is becoming morally wrecked and warning that the U.S. could soon follow Canada's example [44]. Christian groups in the U.S., especially Dobson's, wield considerable power in U.S. politics, especially under the present Bush administration [38].

Canada's recent changes in drug policy have similarly upset the U.S. administration. In 2002, a Canadian Special Committee to the government recommended that marijuana be subject to the same laws and regulations as alcohol [45]. Based on that report, the Canadian government is currently investigating legislation to decriminalize marijuana; Chretien supported the decision noting "Perhaps I will try it when it will no longer be criminal, I will have my money for my fine and a joint in the other hand" [46]. And in 2003, Vancouver opened a safe-injection site for heroin users sponsored by the Canadian Institute of Health Research; researchers believe the site will allow experts to work with addicts and will improve the safety of heroin while reducing petty crime associated with drugs by moving trade off the streets [47]. The U.S. response to the decriminalization of marijuana and the introduction of safe injection sites has included threats to Canadian trade relations. An assistant to the U.S. drug czar and a policy advisor to the Bush Administration stated that the U.S. is prepared to sacrifice the free flow of trade with Canada in response to decriminalization [48], [50]; safe injection sites have elicited similar warnings [49].

The Softwood Lumber Dispute

In 2003, Canadian softwood lumber represented the fifth largest export category to the U.S. [5] Softwood lumber is easy-to-saw wood such as pine and spruce used in building and it has been a key component of U.S.-Canada trade talks since the reciprocity agreement of 1854 [51]; unfortunately, softwood lumber trade has also been a key source of trade disputes. In Canada,

much of the exported lumber originates from public land and logging companies pay a stumpage fee for every tree they harvest. Conversely, in the U.S. most lumber is harvested from private land with higher, market-set stumpage fees. Many U.S. lumber companies claim lower stumpage fees in Canada constitute a subsidy [51].

On October 7, 1982, the U.S. Coalition of Fair Lumber Imports complained to the U.S. Department of Commerce (DoC) that the U.S. lumber industry was being injured by Canadian subsidies on softwood lumber. The coalition requested that the DoC impose a countervailing duty to offset the alleged Canadian subsidy; however, both the independent U.S. Trade Commission and the DoC concluded no duty was justified [52].

Four years later, the U.S. coalition complained again about the low stumpage fees and in 1986, the DoC concluded the Canadian stumpage fee system was equivalent to a 15% subsidy thus a 15% tariff was imposed on Canadian lumber imports [51]. Interestingly, Canadian logging practices had not changed since 1982; rather, the U.S. administration had changed to the more protectionist Reagan era [51]. In 1987, Canada responded to the DoC request by offering to collect a 15% tax on lumber exports to keep the money in Canada. Many Canadians were outraged at this settlement, fearing the U.S. had too much power over a domestic issue such as tax [51].

Over the next four years, Canada increased its stumpage fees and altered its forest industry to better align with the U.S. demands; as a result of these changes, Canada repealed the 15% tax in 1991 [52]. Immediately, the U.S. lumber industry complained to the DoC and U.S. International Trade Commission (ITC), claiming Canadian subsidies were again hurting the U.S. industry. In 1992, the U.S. ITC sided with the coalition and levied a 6.5% duty on Canadian lumber. Canada appealed the ruling under the FTA; the trade body eventually ruled the duty illegal [52]. The U.S. appealed this FTA decision and claimed conflict of interest on the arbitration panel; however, no conflict was found and the U.S. was ordered to repay nearly \$1B in collected duty [52].

To avoid further conflict, in 1996 Canada volunteered to limit its lumber exports for five years under the Softwood Lumber Agreement (SLA). Under this agreement, the U.S. imported a quota of Canadian lumber duty-free; any imports over the quota were subject to duty. This quota system resulted in Canadian companies and provinces competing with each other for a share of the exports, resulting in Canadian job and company losses [51].

Upon expiration of the SLA, the lumber wars re-ignited. The U.S. imposed a 27% duty on Canadian lumber again because of Canada's stumpage fees. In retaliation, Canadian lumber producers and transporters attempted to dump as much wood across the border as possible before the SLA expired [51]. The U.S. coalition then filed two petitions with the DoC: a petition for a countervailing duty claiming Canada subsidized its lumber by 40% and an anti-dumping petition alleging that Canadian producers were selling their lumber below cost [51]. In 2001, The DoC agreed with the coalition and instated 19% countervailing duties plus 8% anti-dumping fees. However, the independent U.S. ITC disagreed and revoked the duties only to have the DoC reinstate them again [52]. Canada appealed both penalties under the WTO and NAFTA [52]. In 2002 the WTO ruled against the U.S. on eight of nine technical arguments, deciding the U.S. was wrong to impose duties on Canadian wood; but U.S. industry ignored the non-binding WTO decision [51]. Twice in 2003, the WTO ruled again in Canada's favor regarding the lumber issue; that year, the U.S. offered to drop all penalties if Canada imposed a 33% tax on lumber exports, a deal Canada rejected [51]. And in August 2003, NAFTA ruled that although Canadian lumber does receive a financial contribution from the government, the U.S. imposed tariffs are much too high [51].

Currently, the NAFTA ruling is being appealed and any recommendations will require time by both countries to implement. The Canadian government is investigating voluntary quota allocations and export controls to avoid further lumber wars [52].

Mad Cow Disease

Similar U.S. protectionist policies are evident in other industries such as cattle trade. Although cattle exports to the U.S. comprise less than 1% of all Canadian exports, in 2002, they constituted \$1.2B in trade, of which nearly all was destined for the U.S market [5]. On May 20,

2003, a cow in Alberta was found to be infected with bovine spongiform encephalopathy, or mad cow disease [2]. Before the discovery, the U.S. typically exported to Canada at least half the amount of beef it would import from Canada [54]; therefore, the cattle in both countries moved freely across the border and many Canadian officials and farmers argued the cattle market between the two countries was essentially identical [2], [55]. Because mad cow disease has an incubation period of up to eight years [53], the Canadian beef industry argued that the U.S. was as susceptible to the disease as Canada; furthermore, testing for mad cow disease in Canada is more stringent than in the U.S. [2]. However, once the diseased cow was found, the U.S. halted all Canadian beef imports in an attempt to keep open its own export market with Japan [37]; the U.S. trade block crippled the Canadian beef market [2].

In December 2003, mad cow disease was detected in the U.S.; however, Canada did not impose a similar import block on American beef. Currently, although the largest U.S. beef export market, Japan, views the U.S. and Canadian beef industries as completely integrated [56], the U.S. still forbids the import of most Canadian cattle products, further damaging the Canadian beef industry. Despite the current political differences in dealing with mad cow disease, the two countries are working together to make their beef suitable for global trade [39]. Cattle exports in Canada fell from \$1.2B in 2002 to \$425M in 2003 though after May 2003, exports fell below 1% of their normal values [5].

Prescription Drugs

Prescription drug imports to the U.S. from Canada continue to be a thorny trade issue between the two countries. The U.S. is the only industrialized nation without government regulation of drug prices [57]. Prices in the U.S. are also high because pharmaceutical companies are allowed to market directly to consumers and the \$3B spent per year on this marketing is passed on in costs to the consumer [58]. In Canada, no direct marketing is allowed and the Patented Medicine Prices Review Board, a government agency created in 1987, regularly reviews drug prices and imposes caps on medicine prices [58]. Additionally, after patents expire, patent laws in Canada allow competitors to produce generic drugs sooner than in the U.S., further lowering Canadian drug prices [59]. As a result, Canadian pharmacies sell the same prescription drugs at prices far below those in the U.S. [58]. Because of the lower prices, many Americans,

especially seniors, have turned to Canada for their drugs; in fact, in 2003, the U.S. Senate voted in favor of allowing American pharmacies to import drugs from Canada [60], a reversal of a 1987 law banning the import of prescription drugs [63].

The prescription drug trade in Canada is growing quickly, especially with the advent of internet pharmacies [58]: exports to the U.S. were \$593M in 2000, \$970M in 2002, and over \$1.5B in 2003 [5]. However, despite support by the U.S. senate, the U.S. administration and major U.S. drug companies are fighting the import of Canadian drugs. The Bush administration and the U.S. Food and Drug Administration have blocked the importation of Canadian drugs by American companies, stating that Canadian drugs are unsafe although many of the imported drugs are originally shipped from U.S. companies to Canada [61]. Furthermore, U.S. policy researchers and Canada's health minister maintain Canadian drugs are safe and that Canada has one of the most rigorous drug approval procedures in the world [63], [62]. At least three major drug companies – Eli Lilly and Co., Pfizer Inc., and GlaxoSmithKline PLC – have cut or reduced supplies to Canada because of the reimportation of those drugs to the U.S. market [58]. Interestingly, many U.S. states and cities are ignoring federal law in an attempt to obtain affordable medical care: California and six other states as well as many U.S. cities are considering buying drugs from Canada while two U.S. cities already have such programs in place. These state and local governments believe they can obtain savings of better than 60% buying from Canada [57], [64].

The Byrd Amendment

In 2000, the United States enacted the Continued Dumping and Subsidy Offset Act, also known as the Byrd Amendment. U.S. companies benefit from a reduction in competition when their foreign competitors are assessed anti-dumping and countervailing duties on imports to the U.S. Under the Byrd Amendment, U.S. companies that support petitions for countervailing and anti-dumping duties receive an additional benefit: the fees collected from foreign imports are distributed to those companies by the U.S. Treasury [65]. Importantly for Canada, although NAFTA has ruled to reduce U.S. charges on Canadian lumber [51], substantial duties collected during the Canada-U.S. softwood lumber dispute stand to be distributed to U.S. lumber companies under the Byrd Amendment.

Immediately after the Act passed, Canada and ten other members of the WTO complained that the Byrd Amendment amounted to double benefits for U.S. companies [66]. In 2002, the WTO ruled the Byrd Amendment illegal; in 2003, the WTO rejected a U.S. appeal of the ruling and gave the U.S. until the end of 2003 to comply [65]. Although the office of the U.S. Trade Representative stated that the U.S. would comply [67], the U.S. has not yet revoked or altered the amendment. Because of the lack of U.S. action, the original complainants are currently seeking permission from the WTO to invoke trade sanctions against the U.S. including tariffs or suspensions of obligations concerning Byrd Amendment issues [65].

Helms-Burton Law

In 1996, the Cuban Air Force shot down two planes flown by an anti-Castro organization based in the United States; in response, the U.S. enacted the Helms-Burton Law. This law allows U.S. citizens and businesses to sue foreign businesses that use or benefit from confiscated Cuban property [68]. International reaction to the law was swift: Canada, Mexico, and the EU charged the U.S. was attempting to control the behavior of foreign companies outside U.S. jurisdiction. Both Canada and the EU filed complaints with the WTO [69] arguing that the Helms-Burton law impedes free trade. However, despite these complaints and condemnation by other countries, the U.S. has not yet revoked the law although it has been suspended continuously since 1996 by the U.S. Administration [70].

Trade with Cuba is worth approximately \$500M per year for Canada and in 1997, the Canadian foreign minister, Lloyd Axworthy traveled to Cuba for trade talks; the U.S. administration was vocal in its disapproval of the visit and in Canada's continued trade with Cuba. However, Axworthy maintained the visit was necessary to reinforce the independence of Canada's foreign policy [71].

These examples illustrate that various disputes have threatened free trade between the United States and Canada. Given its strong reliance on U.S. trade, such disputes have thus greatly threatened the Canadian economy and have driven some Canadians to seek other international trade partners.

CANADIAN TRADE RELATIONS WITH OTHER COUNTRIES

Under NAFTA, Mexican markets were opened to Canada, especially the automobile and energy sectors [6]. In addition to this trade with Mexico, since 1997 Canada has entered into or initiated negotiations for free trade agreements with many different nations besides the United States; Canada has also maintained mutual arrangements for economic cooperation with several nations since 1995. A detailed review of Canada's trade relations with other nations is beyond the scope of this paper; instead, this section provides a brief overview of Canada's relations with other nations.

Canada's free trade agreements with other countries or other groups of countries aim to provide a stable, predictable base upon which Canadian businesses can expand beyond domestic markets. These agreements also eliminate tariffs on most goods traded between the nations while providing a forum in which trade disputes can be settled. Canada began free trade with Chile and Israel in 1997 and Costa Rica in 2001 [72]. Results of these free trade agreements are mixed: Canadian exports to Chile have decreased from \$283M to \$227M while imports rose from \$237M to \$628M from 1997 to 2003; Canadian exports to Israel have decreased from \$182M to \$170M while imports rose from \$227M to \$439M from 1997 to 2003; and Canadian exports and imports to Costa Rica rose from \$122M to \$210M and from \$41M to \$49M from 2001 to 2003, respectively [5].

Currently, Canada is negotiating free trade agreements with the Americas (under the FTAA), Singapore, the Central America Four (El Salvador, Guatemala, Honduras, and Nicaragua), and the European Free Trade Association (Iceland, Norway, Switzerland, and Liechtenstein). In addition, Canada may soon begin free trade negotiations with the Andean Community (Bolivia, Colombia, Ecuador, Peru and Venezuela), the Caribbean Community, the Dominican Republic, and the European Union [72].

Besides free trade agreements, Canada also has economic cooperative arrangements with several countries. Cooperative arrangements are much less formal than free trade agreements and seek to improve economic relations between two countries by identifying mutually beneficial areas of

trade and investment [72]. Canada currently has such arrangements with MERCOSUR (Argentina, Brazil, Paraguay, and Uruguay) since 1998, South Africa since 1998, Andean Community since 1999, Norway since 1997, Australia since 1995, Switzerland since 1997, and Iceland since 1998 [72]. Finally, the Canadian government also has trade action plans or informal arrangements for trade improvement with Japan, South Asia, and a group consisting of Central America, El Salvador, Guatemala, Honduras, and Nicaragua [72].

Canada is accelerating its efforts to engage in bilateral and multilateral trade agreements with countries other than the United States. Various disputes and dispute settlements under these agreements and agreements under the WTO continue to refine Canada's economy into one suited for large-scale, global free trade.

CONCLUSIONS

Although the United States and Canada have a long and close trading relationship that has been beneficial to both countries, the U.S. has abused its position of dominance in Canada's trade-dependent economy, using the threat of trade sanctions to influence Canadian policy and to reprimand Canada for taking actions with which the U.S. disagrees. Recently, the U.S. used the threat of trade sanctions to punish Canada for not joining the Iraq war and to stop Canada from implementing domestic policies including marijuana decriminalization and heroin safe injection sites. As noted, many trade experts believe the new Canadian prime minister will help improve trade relations between the two countries since George Bush enjoys a much better personal relationship with Paul Martin than he did with Jean Chretien. However, a trade relation dependent on ideological agreement between the two countries is extremely unreliable and threatens Canada's national independence.

Furthermore, the U.S. has engaged in numerous unfair trade practices with Canada seeking to improve its own economy to the detriment of Canada's; though the WTO and NAFTA predominantly side with Canada in these disputes, the U.S. continues implementing protectionist trade policies. The softwood lumber dispute is an especially distressing example of continued unfair U.S. trade action despite repeated condemnations by international trade bodies. Canada is loath to enact trade sanctions against its dominant trade partner; indeed, trade experts were

surprised when Canada joined WTO complainants in calling for the right to impose sanctions against the U.S. regarding the Byrd Amendment dispute [66]. U.S. – Canada trade is a one-sided relationship in which the United States is clearly in control.

Unfortunately, Canada has done little to rectify the relationship imbalance; whenever the U.S. has complained about Canadian policy or enacted unfair trade policies, Canada has deferred to U.S. demands. This deference is evident in Canada instating voluntary trade quotas on softwood lumber to avoid further unfair trade sanctions despite trade rulings against the U.S. This deference is evident in the new Canadian administration promising to improve U.S. relations although the U.S. continues its unfair trade practices. And this deference was especially evident when Alberta and many Canadian businesses spoke out against their federal government during the Iraq War to gain favor with the U.S. and avoid trade sanctions. Canada needs to assume a more assertive role in its trade relation with the U.S. to prevent continued U.S. domination of Canada-U.S. trade.

Trade with the U.S. has helped develop Canada's industries, yielding an efficient and internationally competitive Canadian economy. Given this strong production capability, Canada is well positioned to benefit from increased global trade liberalization. Decreasing Canada's reliance on the U.S. through increased international trade and by assuming a more assertive role in Canada-U.S. trade relations is crucial to prevent undue U.S. influence on the Canadian economy and on Canada's sovereignty. That Canada is pursuing such actions is evident in recent efforts by Canada to negotiate new free trade agreements as well as Canadian complaints to the WTO and NAFTA regarding unfair U.S. practices and Canada's continued trade with Cuba despite U.S. disapproval. Future Canadian trade policy that continues and expands on such actions is necessary to secure the independence and continued success of the Canadian economy.

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