From Deep Integration to Reclaiming Sovereignty:

Managing Canada-U.S. Economic Relations Under NAFTA

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Introduction

Post-September 11 has changed the way the United States views the world and the way the world views the United States. In the Bush Administration's new world order, multilateralism is dead. Unilateralism trumps international law except when it serves U.S. interests. Military and economic agendas are indistinguishable. Globalization means enforcing free market rules and investor freedoms for U.S. multinationals, protecting domestic markets for national producers where required, and securing U.S. access to the world's resources.

The American government wages an unending war on an undefined "terrorism," leaving the world in a state of anxiety reminiscent of the Cold War. In its self-appointed new role, it enlists coalitions of the willing, rebukes the uncommitted, threatens the unwilling and crushes the evildoers.

It is in this climate—where not being in lockstep with the hyperpower raises the spectre of retaliation—that the discussion of deepening Canada-U.S. economic integration is playing out. Business leaders and free trade warriors are beating the drums for another big leap of faith into a new comprehensive arrangement with the United States. Once again they are warning that the status quo is not acceptable, that the costs of not taking this leap could be catastrophic for the economy and the well-being of Canadians.

"Integration" is defined by the Oxford Dictionary as a process where two or more entities come together to form a single entity. Implied in the definition is an equality of the separate entities and the creation of a new entity that combines equal elements of the pre-existing entities. In a process of coming together where one entity is dominant, the resulting combination resembles the dominant entity. This is *assimilation*—a process of becoming like the dominant entity. The distinction is important. What we are talking about is a process that more often resembles assimilation than integration.

The use of language is important in this debate. Public opinion responses vary with the choice of words. Many Canadians currently supports the idea of economic integration with the U.S., but most Canadians would also prefer to see Canada-U.S. differences maintained or widened. They don't want assimilation. As public opinion researcher Andrew Parkin told a Parliamentary committee, although Canadians favour close cooperation on economic and security matters, this, they believe, should not compromise Canadian uniqueness or sovereignty.

Integration is proceeding through the actions and decisions of corporations within the policy framework created by NAFTA. Two-way trade and investment flows, intra-company trade, and the continental integration of production have accelerated dramatically over the last 15 years. Most Canadian manufacturing output is now exported south of the border.

It is also occurring, explicitly and implicitly, at the policy level. It is happening explicitly through an array of NAFTA-established bodies engaged in everything from harmonizing labour mobility provisions to standards for pollutants. It is happening through explicit harmonization measures taking place in forums outside the NAFTA apparatus, but very much related. These notably include the post-September 11 measures to harmonize security, transportation, immigration, and refugee policies and practices. They include measures to improve the border infrastructure and expedite border procedures.

Integration is also happening implicitly (or indirectly) through, for example, the harmonization of social policy and tax policy. NAFTA does not mandate this kind of harmonization; nor is it inevitable; but NAFTA facilitates the tax-cut agendas of neoconservative governments.

Finally, the Americas free trade negotiations currently underway are proceeding very much in the NAFTA mold and could result in the deepening of the Canada-U.S. economic relationship. The way the FTAA is shaping up, as evidenced in the drafts that have been made public, it appears to be heading toward a "NAFTA-plus" deal. That is to say, it goes beyond NAFTA in its market-centred orientation, forging into new areas of domestic market deregulation and new constraints on government action. In the same way that NAFTA was not only an extension, but also a deepening of the FTA, so the FTAA will likely be not just an extension, but also a deepening of NAFTA. At least that is the agenda of the U.S., and also, it would appear, of the Canadian government at this time. This FTAA track is scheduled for completion in 2005, though how big an integration step it will be remains to be seen.

Free trade proponents from various quarters advocate a range of deep integration tracks, from small steps to quantum leaps. Some advocate big measures such as a customs union, common trade policy, common energy policy, a common security perimeter, etc. Others favour a more stealth-like or below-the-radar approach—regulatory harmonization, harmonization of tax, competition, and resource policies, etc.

The most radical integration proposal is the creation of a so-called common currency (in reality, adoption of the U.S. dollar). It is advocated by some in the business community, and in the business-funded think tanks, and by two political parties—the Bloc and the Alliance. There is no consensus on this proposal within the business and policy establishment, and it remains a possibility only in the long term.

A prominent deep integration proposal is the so-called *Big Idea* or *strategic bargain*. Spurred by September 11, it has been circulating in the public domain for a year now. The luminaries behind it include the C.D. Howe Institute led by Wendy Dobson and former trade negotiators Michael Hart and William Dymond; IRPP president and former Mulroney chief of staff Hugh Segal; free trade commissioner Donald MacDonald; former Canadian ambassador to the U.S. Alan Gotlieb; Tom d'Aquino, CEO of the newly-named Canadian Council of Chief Executives; and Perrin Beatty, head of the Canadian Manufacturers and Exporters Association. These are the same free trade warriors who brought us free trade Round One in the 1980s. Big it may be, but it is neither a new nor a good idea. And it feels like *déjà vu* all over again, coming from the same folks who promised at the time that a big comprehensive deal would put an end to American harassment of our exports.

The essence of the strategic bargain is to trade economic security (Canada's goal) for homeland security (the U.S. goal). For Canada, this means putting the remaining components of our sovereignty on the table in a mother-of-all negotiations—trade policy, culture, energy, other resources including water, agriculture, defense and security, etc.—

in return for further enhanced (and this time genuine) security of access for Canadian goods, services and "knowledge workers," and full citizenship for Canadian investors in the U.S.

Proponents stress that there is a window of opportunity to be seized, given America's heightened preoccupation with secure borders and a secure supply of resources. They also think that this can be accomplished without much in the way of new institutions; and they argue that the European Union is not the appropriate model here. The Big Idea, though stalled in the current climate of policy divergence on Iraq and reticence on the part of Prime Minister Chrétien, will likely gain serious traction in a Paul Martin-led government.

And finally, there are those like myself who do not think the Canadian government should be actively pursuing deeper levels of integration with the United States along the tracks outlined above. Further integration at the policy/regulatory level is neither inevitable nor desirable. It should be avoided or reshaped where possible, and reversed where feasible. Where it takes place, it should only do so under clear and well-defined conditions.

The impact of nearly 10 years of NAFTA (and 15 years of the bilateral FTA) has been clearly negative when measured against the only standard that counts ultimately when evaluating public policy: has it bettered the lives of those affected by it? Not only has NAFTA failed to deliver the goods it promised to the Canadian people, but it has also significantly eroded Canada's sovereignty—the capacity of government to carry out its democratic mandate.

NAFTA has embedded neoconservative structures and policies. It has radically shifted the balance between the market and government, between investor rights and citizen rights. Worse, as Stephen Clarkson has eloquently pointed out, it has frozen this imbalance in a supra-constitutional arrangement that make these neoconservative experiments difficult, perhaps even impossible, to reverse. Secondly, most Canadian governments continue to pursue neoconservative policies whose negative social effects are reinforced by the NAFTA framework.

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Thirdly, its proposed deepening and widening in an FTAA is being driven by neoconservative governments bent on further deregulating markets and further constraining the role of government. The Canadian government's initial FTAA negotiating position combines some of the worst features of NAFTA and the GATS. (*Sinclair 2003)*

Finally, the power imbalance is so great between the U.S. hyperpower (which is both imperial and neoconservative in orientation) and the two peripheral partners that, even with two progressive governments in power, the prospect of a major renegotiation of NAFTA is remote. Nor does extending it to the 34 countries of the hemisphere (minus Cuba) significantly alter this gross imbalance of power. The U.S. is three times larger economically than all the other countries combined.

Living under NAFTA: The impact

In examining NAFTA's impacts, it is important to stress that causality is complex and that not all the bad things that have happened can be attributed in whole or even in part to NAFTA. The complexity of causation and the interaction between NAFTA and other neoconservative policies; the interplay of these on a vastly uneven continental landscape of social and labour market institutions—all affect social and economic outcomes differently, between and within the NAFTA countries. Even if one were to deny that the negative effects are the result of NAFTA, one can surely ask why it failed to deliver on its own promises: secure market access, closing the productivity gap, more and better jobs, stronger social programs, generalized prosperity.

A negative social adjustment has taken place under cover of the war on the deficit; and a cut in taxes, largely for upper-income groups and corporations, has occurred under cover of competitiveness.

What have been the major NAFTA-related impacts? What problems has it helped to create or exacerbate? In what areas has it not solved the problems it was supposed to solve? The following list is not exhaustive.

First, there has been a long and painful period of economic and social restructuring marked by income loss, employment loss, and the growth of insecure and precarious employment. Although the worst is over, restructuring continues. This is not an unintended consequence. NAFTA and its policy siblings were designed—by enhancing capital mobility and hamstringing government—to transfer power from workers to management and investors, from wages to profits, from the public sector to the market.

What have been the net employment effects? Despite the much-improved job creation record of the last few years (driven mainly by demand within the domestic economy), unemployment has never fallen below its level when the FTA came into effect. A little-publicized Industry Canada study showed that, in the first eight years of "free trade," new jobs from the increase in exports were more than outweighed by jobs displaced or destroyed by the growth of imports. (*Dungan and Murphy,1999)* This is not something that "free trade" proponents like to talk about. Nor do they like to recall that Canada's performance during the 1990s (the first 10 years of "free trade") according to key economic indicators—GDP growth, per capita income, and unemployment—was the worst of any decade since the 1930s.

Second, a negative social adjustment (most visibly in the cuts to unemployment insurance) has taken place under cover of the war on the deficit; and a cut in taxes, largely for upper-income groups and corporations, has occurred under cover of competitiveness. Canadian social programs are still more generous and taxes are still higher at the top end than in the U.S. Neither tax nor social program cuts were necessary or inevitable under NAFTA. They were undertaken by neoconservative governments pursuing an agenda that is reinforced, but not mandated, by NAFTA.

Though still much less extreme than in the United States, 15 years of "free trade" have seen major increases in both income inequality and wealth inequality. *(Kerstetter, 2003)*

They have also seen a deepening of poverty, of homelessness, of hunger and the use of food banks. Again, NAFTA alone did not produce these effects. They are the product of the neoconservative policy package as a whole, of which NAFTA is a key component.

Third, labour and environmental side-agreements were negotiated under NAFTA to mitigate social and environmental dumping—the competitive bidding down of labour and environmental standards to attract investment. NAFTA's Labour and Environment Commissions have done some useful research, highlighted some problem areas, and occasionally provided a mechanism for NGO co-operation. However, the complaint process does not work and neither accord has been effective in addressing the environmental and labour problems created by NAFTA. Meanwhile, binding investor-state cases and other NAFTA provisions have put a chill on environmental and labour standards-setting throughout the region.

Fourth, NAFTA contains protections for social services such as health care and education. But these exemptions, as the Romanow Commission noted, are seriously flawed and, in tandem with the GATS, constitute a threat to domestic policy flexibility and options around health reform. As yet, foreign penetration in this sector is limited, but this is beginning to change as some neoconservative governments, after years of financially starving health care, are opening the door to more for-profit delivery and financing. The very commercialization of health care weakens the effectiveness of the exemption and increases the possibility of a challenge from foreign investors. The Chapter 11 investor-state dispute mechanism poses the most dangerous immediate threat, since it is not subject to NAFTA's social service exemptions.

Water is another resource that, despite claims to the contrary, has not been properly protected under NAFTA, and where private foreign investors are trying to make inroads, but meeting fierce resistance from Canadian citizens. As with health care and education, NAFTA poses a huge threat to these public goods, since, once a government goes down this road, the decision is irreversible.

> The Chapter 11 investor-state dispute mechanism poses the most dangerous immediate threat, since it is not subject to NAFTA's social service exemptions.

Fifth, NAFTA gutted the auto pact (a "managed" as opposed to a "free trade" economic integration accord), eliminating its ability to establish a domestic investment floor through minimum content requirements. NAFTA has greatly intensified the competitive race for auto assembly and parts plants among the many jurisdictions of North America. As the government of Ontario has recently learned, if it wants to stay in the game it has to provide huge direct and indirect subsidies and other incentives to attract and maintain these investments. This has a major fiscal impact, reducing resources available for health, education, and other social priorities.

Sixth, contrary to the promise that productivity would soar under free trade and other "free market" policies—from business tax cuts to labour market deregulation—Canada's productivity performance has been less than impressive compared to other industrialized countries. The Canada-U.S. manufacturing productivity gap, which was supposed to narrow, has in fact widened—significantly. There has also been a disconnect between productivity increases and wage increases, reflecting the intensification of low wage competition, the decline in union bargaining power, the weakening of social and labour market programs and institutions, and the still relatively high unemployment rate.

Seventh, Canada has been losing out to the other NAFTA partners, especially Mexico, as the preferred location of foreign investors that want to produce for the North American market. (It should be pointed out that, when new direct foreign investment is in the form of takeovers of Canadian companies [and most of it is], it often means the loss of high-tech and managerial jobs. How can this be good?)

Eighth, although the U.S. has grown as the destination of 85% of Canadian exports, up from 75%; and although exports now account for 43% of GDP, up from 25%, Canada's share of U.S. imports (18.5%) is about where it was at the outset of free trade. Thus, Canada has become even more vulnerable to U.S. trade sanctions, without having improved its share of the U.S. market.

Ninth, there has been no significant diversification of Canada's industrial base. The weight of resource and resource-based manufacturing is still about where it was at the outset of free trade.*(Jackson, 2003)* Although there has been some high-tech sector growth (at least until the telecommunications implosion), the trade deficit in high-tech products remains high. And Canada's poor record in private sector R&D continues.

Tenth, the large increase in north-south trade has, as anticipated, weakened east-west commercial linkages. Only P.E.I. now trades more with other provinces than outside the country. Our national transportation and communications infrastructures have also weakened. When combined with the country's weakening social bonds due to federal cutbacks and decentralization, the question needs to be asked: How much, or to what extent, has North American economic integration, which has clearly produced national economic dis-integration, weakened national social, cultural and political ties?

Alternatives to deep integration: a strategy of small steps

So, how can the current course be altered? In an ideal world the three enlightened North American governments would renegotiate NAFTA, transforming it into a trade and development accord in which citizens' rights prevail over those of corporations, where the mandate of government prevails over the imperatives of the market. A noble aspiration, but unrealistic (except perhaps in the long term, where all things are possible), given the change in the configuration of political power that would be necessary to dislodge the interests embedded in the current agreement.

Another scenario would be for a progressive Canadian government to abrogate NAFTA and conduct the bilateral economic relationship within the WTO framework, as well as through sectoral and functional bilateral mechanisms. The changes (however troublesome) in the multilateral trade architecture—the completion of the Uruguay Round and the creation of the WTO in 1995—mean that Canada, by abrogating NAFTA, would sacrifice little in terms of market access and regain important policy tools. Tariffs have largely disappeared. Anti-dumping and countervail disputes can be dealt with more effectively in the improved WTO dispute resolution system. The NAFTA social services and cultural exemptions, though far from adequate, have been reproduced in different forms in the WTO; and last but not least, the highly problematic investor-state process would be eliminated. The groundwork for invoking the abrogation clause could be laid by a government prepared to both challenge and demand renegotiation of the agreement's most harmful features.

This scenario, though desirable, would be politically costly. It would cause an uproar within the powerful business community, and among neoconservative provincial governments. It would also likely trigger retaliation from the U.S. government. The resulting disruption and instability would be extremely difficult for a national government to withstand, even if it had overwhelming public support.

Nevertheless, government should undertake a pragmatic analysis of the costs and benefits of NAFTA before deciding whether to go down the road toward deeper integration, including examining the option of abrogation. John Ralston Saul has deplored our unwillingness to honestly evaluate the FTA and NAFTA:

> "We seem unable to allow ourselves the dignity of engaging in this sort of straightforward consideration of our actions. . . Questioning is the great strength of democracy: the ability to doubt without losing face. Instead we go on chanting 'free trade = prosperity'..."

What should a progressive Canadian government do to improve the economic and social well-being of its citizens in a more environmentally sustainable manner; manage its economic relationship with the United States roughly within the existing NAFTA framework; and do it in such a way as to slow down, reshape, or reverse the integration process where feasible? I would suggest an approach that might be characterized as the deliberate pursuit of small steps—but with a coherent vision of reclaiming national policy freedom and flexibility—whose cumulative effect may over time be transformative. Specifically, as the government reclaims sovereignty it would gain the confidence to challenge NAFTA, if necessary, in key areas where national interests take precedence and be prepared to take the consequences of its actions.

I would suggest an approach that might be characterized as the deliberate pursuit of small steps—but with a coherent vision of reclaiming national policy freedom and flexibility—whose cumulative effect may over time be transformative.

First, I do not suggest reclaiming sovereignty for its own sake, but rather to enable us to flourish as a society on the North American continent with a unique social contract and cultural identity, one that values good government and a balance between individual and community. Sovereignty implies the capacity to take measures democratically that give expression to these values. Otherwise they are hollow.

Second, it cannot be emphasized too much that trade is a means, not an end. Trade is a tool, and equitable, sustainable development is the goal. Free traders always confuse the two. They automatically assume that international trade and investment are unconditionally good, and more is automatically better. This is not necessarily so. Trade may bring benefits, but it may also do great harm. It depends on the nature of the products, on the terms and conditions of the exchange. A progressive government must always keep this distinction in mind as it considers policies to enhance the well-being of its citizens.

Furthermore, it must recognize that the path to a productive and prosperous society does not lie in a vicious international competitive cycle of cutting taxes, wages, standards, and basic public services. Rather, the path lies in a strong public commitment to invest in social, environmental, transportation, communications, research, and cultural infrastructure. It lies in measures that reduce inequality and strengthen social cohesion.

> It cannot be emphasized too much that trade is a means, not an end. Trade is a tool, and equitable, sustainable development is the goal. Free traders always confuse the two.

Third, although seemingly unrelated to the issue at hand, a progressive government would be well advised to do two things: curtail the dominant influence of business over political life, and break up the big corporate-owned media conglomerates. These steps will bring back a measure of democracy to politics, ensuring that business perspectives do not dominate to the same extent as they have in recent decades. The Chrétien government is taking a significant first step in this direction by curtailing the corporate financing of political parties, but there is a long way to go.

What follows are examples of steps that a progressive government could pursue, by itself, or jointly with other nations. The list is not exhaustive.

- Reassert and rebuild the capacity of government as an active manager of the economy, rather than as a bystander to the excesses and failures of the market. Strengthen the national economy and the national demand through a variety of macroeconomic, labour market, and industrial policy tools. Though constrained, there is still substantial national policy space remaining under NAFTA. It should identify and maximize that space: and test the limits of that space where appropriate. Specific measures might include:
  - Assert forcefully that it will not allow trade agreements to constrain domestic policy in social services. Follow the Romanow Commission recommendation that halting the privatization of health care (and other basic public services) will help to shore up the NAFTA social services exemption and reduce the threat of challenge by foreign investors.
  - Rebuild the environmental regulatory capacity gutted over the last 15 years. It was neither mandated by NAFTA nor does NAFTA prevent the reinstatement of effective environmental regulations.
  - Use the remaining policy freedom in energy to assert and ensure that security of domestic supply and the needs of domestic consumers take precedence over exports.
  - Implement a ban on bulk water exports.
  - Reduce monopoly protection provisions for the big pharmaceutical corporations and bring back compulsory licensing (still legal under NAFTA and the WTO) to help reverse the skyrocketing

drug prices that have greatly strained our Medicare system.

- Make aggressive use of remaining industrial policy tools to, for example, add value to our natural resources in an environmentally sustainable manner, and make Canada a leader in green technologies.
- Make aggressive use of the public sector investment funds, procurement and Crown corporations to further national economic and environmental objectives, including regional and community economic development.
- Ensure that foreign ownership and other regulations in key sectors such as broadcasting, banking, and basic telecommunications are maintained and strengthened.

- Deal with Canada-U.S. issues and irritants on a case-by-case basis. Remember, U.S. harassment of key exports are, like Canadian winters, a fact of life. The emphasis should be on cooperation to solve problems without compromising policy flexibility. Where possible, disputes should be resolved through existing trilateral or multilateral mechanisms. For example, in the softwood lumber dispute, government should resist, despite business pressure, the temptation to resolve it outside these frameworks by restructuring the management of our publicly-owned forests along U.S. lines. And finally, work with like-minded individuals and groups in the U.S. Congress and civil society, nationally and at the state level, to further common interests. (This applies as well to working in international arenas.)

- Seek ways to prune back the most egregious aspects of NAFTA. Work with NAFTA partners to strengthen social services and cultural exemptions, and eliminate the investor-state dispute mechanism. Ensure that the work of the myriad NAFTA committees is open and publicly accountable. Where harmonization of standards and regulations is being negotiated, ensure that harmonization moves upward to the highest standard, and that it serves as a floor allowing jurisdictions to adopt higher standards. Where mutual recognition of standards is being considered, make sure that this is not a back-door way of exerting pressure to lower standards. Strengthen the ability of existing institutions to more effectively counter market pressure to weaken standards and protections.

> Follow the Romanow Commission recommendation that halting the privatization of health care (and other basic public services) will help to shore up the NAFTA social services exemption and reduce the threat of challenge by foreign investors.

- Favour multilateral forums, where powerful counterweights to American domination can be created, and where Canada, working with like-minded governments, has a better chance of achieving its objectives and containing U.S. unilateralism. For example, the WTO dispute mechanism, with its separate body of law and common rules (and definitions) on subsidies, is an improvement on what was achieved trilaterally in NAFTA.

- Work in multilateral forums to forge agreements in the area of human rights, environment, health, culture, and taxation that are enforceable and supersede the rules in agreements like the WTO and NAFTA. Examples of treaties that attempt to reach these goals are the Montreal Bio-safety Protocol, the Stockholm Convention on Persistent Organic Pollutants, the Framework on Tobacco Control, and the Cultural Diversity Instrument initiative where the Canadian government is taking the lead. Canada should also seek international accords to regulate corporate activity in areas such as transfer pricing and tax havens in order to relieve the pressure on countries to lower business and income tax regimes.

- Work in the FTAA negotiations with other progressive governments to overturn some of the worst aspects of the NAFTA-based proposals such as investor-state, and possibly reshape or even scuttle them. Use the negotiations to broaden relations with the other countries of the hemisphere. Resist U.S. efforts to forge hub-and-spoke relationships (through, for example, a proliferation of bilateral deals) and work with them to challenge the hyperpower's imperial excesses.

- Revisit the 1972 Trudeau "third option" to diversify trade, economic and cultural relationships with other nations—India, Japan, Korea, Europe, Brazil, etc. It failed because there was no real follow-up effort to make it work and because of resistance from a continentalist bureaucracy. The FTA was supposed to be a testing ground, a springboard to the world market for Canadian entrepreneurs. It hasn't turned out that way. Revisit the third option and try harder this time to make Canada a real global player. Diversification can be pursued without more "free trade" agreements.

Conclusion

The politicians, bureaucrats, business lobbyists, think-tanks and media pundits who brought us NAFTA dismiss NAFTA's negative effects and deny its failed promises as they push ahead with their deep integration agenda. They claim that we can go down this road without compromising our sovereignty, but warn of the dire consequences of being offside with U.S. policy. This path promises ever deeper integration (read: assimilation), but with no articulation of what kind of Canada would exist at the end of it all.

I have argued that further integration at the policy or regulatory level should be avoided, or reshaped where possible and reversed where feasible. Where necessary, integration should be negotiated under equitable terms that are clearly in the national interest. This would rule out customs union-type steps, which further compress policy space and beget further integration.

Canada should conduct its economic relations with the United States in a spirit of cooperation and mutual respect, as befits friendly neighbours with deep interlocking interests. The key word is *cooperation*, not *capitulation*. Canada should act like a proud sovereign nation, not like a colonial supplicant.

I have outlined an approach that might be characterized as the deliberate pursuit of small steps, but with a coherent vision of reclaiming national policy freedom and flexibility for the purpose of improving the social and economic well-being of its citizens. I have stressed that trade is a tool that may advance this goal, but not necessarily. The point is that trade is not an end in itself, and should not be driving policy.

We should not allow ourselves to be duped once again by the self-interested voices of the influential minority that wants to take another "leap of faith" that will lock Canada ever more tightly into the American orbit. The record of the last 15 years should be reason enough for us not to continue down this path.

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