

MR. ANGELL: Commissioner Zoellick.

MR. ZOELLICK: If I could ask the Chair's indulgence, can I ask two questions?

MR. ANGELL: Yes. As the day goes on, we're --

MR. ZOELLICK: Thank you. The first is to Commissioner Jackson -- Johnson. I'm sorry.

I thought your examples were very good. And I definitely am sympathetic to your concern about lower costs for inputs with your case of EPA and the other example. It strikes me that's blatant protectionism and it hurts America because it increases the costs of production for your farmers.

I'd like to press you on this idea you mentioned, however, that if we ban a product for input and that other countries use it, that we shouldn't allow them to export to us, because frankly I'm concerned about how it could be turned on us.

And what I was thinking of was that, Japan and Europe are much more regulated than we are, and I could imagine a whole host of situations where they have regulations we don't, and they say, Gee, this has

increased the costs of production for us, we shouldn't take American goods.

And let me give you one that's not in the banned category but any European would say that their cost of energy is a lot higher than ours in part because of taxes.

Your farmers use a lot of energy. So what if Europeans decide they don't want to accept our agricultural goods because it's produced with cheaper energy? That's my question for you.

And for Dr. Kresl, I was interested in your comments about the cultural issue, because I think with globalization this is going to grow as a problem. I know the past U.S. position has been to not accept the cultural exemption because we're afraid how it would be misused.

You've focused on accepting responses on the supply side, for example, subsidizing something related to culture, as opposed to demand side limitations.

And I think in some ways with the Internet, part of this problem is going to go away if people can have access to choices among products, anyway.

But do you have any other thoughts about how one could deal with this cultural issue in a way that recognized the power of the concern but circumscribed it so it didn't become a protectionist loophole that ate up the trade system?

So if Commissioner Johnson and Dr. --

MR. JOHNSON: Sure. Thank you Mr. Chairman and Commissioner.

I am tempted to simply say, well, so be it. But I don't suppose that's really a good response.

MR. ZOELLICK: Not for many American exporters. No.

MR. JOHNSON: But you know, it gets to a pretty fundamental question before us, which is, we have a set of standards in this country.

When a pesticide, for example, is banned in this country, the folks who ban it are the experts in the area. I'm not going to be one who is going to say, Well, you shouldn't ban that.

If it's a carcinogen, if it's harmful to the environment, whatever the issue is, if it's banned, it's banned, and we oughtn't be using it, in particular

if residue from that chemical finds its way onto the commodity produced with that chemical.

MR. ZOELLICK: Excuse me just a minute, Commissioner. Excuse me. I wasn't clear. That's a question of the safety of what we import. And I'm totally with you that --

MR. JOHNSON: Okay.

MR. ZOELLICK: -- if something in terms of if it's unsafe in their product to us, fine.

What I was going to was --

MR. JOHNSON: Price difference --

MR. ZOELLICK: -- if the difference in production doesn't affect the product. But I just think you have to be -- you might just want to think through, if we're going to start to regulate for the world, okay, then they may start to regulate for us, and where does that lead us.

MR. JOHNSON: But I'm not sure how you differentiate between the two.

If we have a product that is banned, in most cases, they're banned for safety reasons or health reasons. I mean, that's the reason we have products that we can't use.

And the ones that I particularly am referring to in North Dakota, a series of seed treatments, for example, that are in a certain chemical family that tend to be carcinogenics.

EPA has gone in and said, They're going to be phased out. They are banned. We're no longer allowed to use them.

They move through the plant as the plant grows, find their way into the seed that is harvested and becomes a part of our food supply.

And principally, those are the kinds of products that have been banned, and those are the products for which the import tolerance -- this is another important part of it -- the import tolerance is zero, meaning that EPA has said, While there may be some permitted uses in this country, the risk cup is full.

You know, we've accepted as much risk as we're going to, and so there are no more permitted uses.

Why, then, do we allow commodities produced with those same products to be imported?

To me, there is no good reason why you would do it.

And I don't know how you draw the distinction. Was it banned for a health reason or was it banned for an environmental safety reason?

MR. ZOELLICK: Well, the difference would be is if it's a safety to the product and the consumer. You could imagine things that were regulated or banned for safety related to the production method.

MR. JOHNSON: Yes. And in those cases, there would be an import tolerance that would most likely remain allowing that commodity to be brought in.

It is those for which the import tolerance is zero that it should not be allowed to come in.

MR. ZOELLICK: I could imagine a product, just for example --

MR. ANGELL: The Chair thanks both of you. Clearly I think both points have been made.

In the interests of the persons speaking, if we could turn to Professor Kresl and your portion of the question.

MR. KRESL: Yes. I think this is going to be an increasing issue worldwide in trade relations, the cultural policy.

It was interesting to me that in the NAFTA, in the Canada-U.S. deal, there was authorization for Canada to do many things in its cultural policy, but the U.S. had the right to retaliate of equal commercial value and so on.

And that's our response, to say we don't really recognize the culture is different. We'll give you a little leeway, but it's going to cost you.

The French picked up on the fact that Canada had made some success in this and brought that to the European Union, working with Canada's example. And then, all of a sudden, there's a global network of cultural policy headed in Sweden.

The issue is becoming bigger and bigger, I think, and it's one very difficult to deal with, because on the one hand, it's Americanization, whether they watch American programs. On the other hand, it's globalization, where all the barriers come down and people are exposed to things they weren't before.

And in part it's modernization, where they move to the city, the woman gets a job, and they no longer buy their chicken and kill it at home, they buy the frozen TV dinner.

And is that American lifestyle or modern or what?

So that issue is going to be very powerful with us.

I'm concerned about the conflict and the time it takes to deal with this and the reaction against the U.S. that you have in various countries and spill over to other issues.

I recognize that nations have a right to do something with regard to their cultural industries and work that out. That would be helpful.

And as I said if we could agree that certain types of intervention are acceptable and others are not, and countries could move along in those directions, I think the issue would be greatly diminished as a conflict issue in the World Trade Organization and between Canada-U.S.

MR. ZOELLICK: I'm looking for some guiding principles that -- and perhaps if you have any others. I mean --

MR. KRESL: With regard to what?

MR. ZOELLICK: How one can carve out a cultural category that limits the trade distortions and that acknowledges the issue for the sake of countries that are trying to protect aspects of their culture but tries to limit their ability to use it as a protectionist device.

My classic is a film, a Shakespearian film, made with British actors in Hollywood. Is that a cultural intrusion when it goes to England?

MR. KRESL: Yes. I know. When I put it in a social goods category, it's meant to be similar to the K through 12 education, where we all have an interest in that, national defense, where we all have an interest in that --

MR. ZOELLICK: I was just wondering --

MR. KRESL: But I mean the point is that the market doesn't work, and it goes back to a political decision in a democratic political process.

And it's like saying there's an iceberg in that fog, and you don't know exactly the dimensions of the iceberg, but you recognize it's there.

And then it's the difficult question of trying to sort these things out among the parties. I don't think that there's a quick and easy response to your question.

But I think the recognition that it is an important issue and there is some substance to it would get us on a discussion path that might lead to some sort of resolution of the issue, I would hope.

MR. ZOELLICK: Thank you.

MR. ANGELL: Thank you. Commissioner D'Amato.

MR. D'AMATO: Thank you, Mr. Chairman. I would like to follow up on this with Mr. Kresl.

I'm not sure I followed what you were saying on the cultural side. We had substantial testimony in New York on this issue from Richard Masur who was the head of the Screen Actors Guild at one point, on the Canadian matter.

And under the banner of whatever cultural values, the Canadians are engaged in wholesale theft of

American production. I mean, there's nothing cultural about it.

It's an economic subsidy issue of very large dimensions under tax credits based on wage rates, which produces a differential in film production costs of over 30 percent, which is too enticing for most investors and venture capitalists not to accept.

So we have this hemorrhaging of American film in Canada out of California and the state of Maryland, as Ms. Feinberg knows, we have the same in Maryland, going to Canada. This is based on Canadian subsidies, a government-led trade distortion.

What is the reaction that you would recommend? How do we deal with that? What's the answer on that one, forgetting the cultural issue?

MR. KRESL: Yes. Well, I know that film and television production has increased in Canada. We still have a \$2 billion trade surplus with Canada in these goods, so it's not at crisis situation yet in terms of the trade account.

MR. D'AMATO: But it is for the industry.

MR. KRESL: Yes. But I think there's a response to growth curves, you know, lazy S kind of

pattern you reach a level and you're there. You may be moving from one point to another, and it's rather scary.

The Canadians' point, of course, is that you have 95, 97 percent of films on screens shown in Canada are American films. And they're there because we've purchased the film distribution system and the rights to them go with --

You buy the rights to show a film in the United States, and the Canadian one is thrown in as an add-on. It's not negotiated separately. So Canada is treated as just another state in that sense in our distribution system. And they react against that saying they can't get screen time.

This kind of an issue then drives governments to a lot of funny policies, just like water does out here, culture does in Canada.

And you've got constituencies who are trying to promote cultural industries -- it's a very fuzzy concept. Are you only going to support films that have a Canadian story or what?

And if you get a Canadian story, if you don't have the infrastructure there to produce the

film, then you don't get it produced, so there's no Canadian story being told.

So they say we have to support rather broadly so that the talent is there so that we can do this important Canadian story film.

It's not a very neat issue to discuss in terms of policy.

If there are subsidies that distort, then we have to talk about that. I think there are ways they could subsidize production in a general way which would not discriminate against Americans, for example, which might be acceptable.

Culture has always been something of an exception to trade negotiations.

MR. D'AMATO: Yes. But the subsidies are for films that have already been -- the scripts have already been written, the episodes are homicides, so there is no Canadian story in these films. These are simply films that go to Canada that have already been written -- there's no story line in it for Canada.

They just take wholesale the production from the United States and do it in Canada because it's subsidized.

MR. KRESL: My favorite was HBO had a contract for Canadian films some time ago, and they showed -- this was several years ago -- they showed several of them. And one of them was Evil Eyes, which was a story financed by the Canadian Government about Great Dane size rats in the Toronto subway system, no cultural values whatsoever.

But they were supporting that. And I say, What an idiotic, stupid thing. But the point is it kept a director and a film crew gainfully employed until the Margaret Atwood film or the Roberts and Davies film project came up and they could do it there.

Now, it's a very fuzzy border around this, admittedly, no easy answers on it. I think there will be a lot of discussions before some sort of, I would hope, general agreements can be worked out with regard to culture.

There's a lot of scope here for blatant protectionist measures. The problem with the demand side stuff, it is blatantly a diversion of a stream of revenues from a foreign vendor to a national vendor, and that's like saying we have to produce our own shoes.

And how you get from that to saying that there's something of real national cultural value here is a fuzzy, fuzzy area, I admit.

MR. D'AMATO: There's a TV program called D.C. It was going to be filmed in Baltimore. It was stolen and went to Toronto. This is a D.C. story line. There's no culture here. This is straight pilfering through subsidization. I don't get the fuzziness at all.

MR. KRESL: Well, of course, from Mary Pickford on, all their people went to Hollywood so they could work. You know, they argue that.

On both sides of this issue, you get a lot of crazy comments and policies on both sides of it.

MR. D'AMATO: It's an interesting issue.

MR. KRESL: It really is.

MR. D'AMATO: I have one quick question for Mr. Feinberg.

MR. ANGELL: Yes. You get the indulgence.

MR. D'AMATO: Professor Feinberg, on your discussion of intra-firm trading and the efficiencies brought about by that, I take that your assessment, then, of the U.S.-Canadian relationship is that

American firms are not really engaged in a race to the bottom in terms of locating in Canada.

I think that's what I'm getting from your comments, that it's more of a specialization issue than it is a race to the bottom in terms of standards, looking for lower standards by American firms, therefore, relocating to take advantage of weaker standards in Canada?

MS. FEINBERG: Your interpretation of my assessment of the U.S.-Canadian trade relationship is correct. Trade liberalization has dramatically increased the volume of intra-firm trade between the U.S. and Canada, and this has led to much greater efficiency—particularly in the Canadian economy.

As I had mentioned, this was not always the case. Historically, high Canadian tariffs attracted a great deal of foreign investment in Canada by U.S. multinationals. If companies wanted to sell in the Canadian market, they had to produce there. The result was highly inefficient Canadian industry in which, for example, you had appliance manufacturers in Canada producing 20 different sizes and colors of refrigerators for a market that was the size of

California. Firms could not benefit from production economies of scale, and the Canadian market became concentrated and had very little local competition.

This is the historical background for why there is so much production in Canada by U.S. firms. "Racing to the bottom" was not the impetus for producing in Canada—quite the contrary since production costs were so high there. U.S. firms initially located there for market access.

As Canada started to liberalize trade, the result has been considerable reconfiguration of production among U.S. multinational affiliates there. For example, some MNC affiliates have chosen to consolidate functions like middle management and administration in the U.S. and have taken those operations out of Canada. As a general rule, affiliates in Canada are producing fewer product varieties in larger production runs for the entire North American market. This has allowed U.S. companies to benefit from specialization and to treat their Canadian operations almost as they would operations in different U.S. states. There is so much more intra-firm trade now because trade liberalization has allowed

U.S. plants to produce for the U.S. and Canadian markets and Canadian plants to produce for both markets as well. I'd guess this has created efficiencies in both the U.S. and Canada—a race to the top.

MR. D'AMATO: Have you made any comparisons of firms that you looked at in the Canadian trade that might also be firms that went into other markets such as Mexico and looked at the difference between the motivations in terms of the intra-firm transfers in the Canadian case as opposed to the Mexican case?

Have you had an opportunity to look at any other examples of intra-firm transfers in other nations like Mexico?

MS. FEINBERG: I have not yet done a study of the impact of trade liberalization with Mexico on the location decisions of U.S. multinationals. At the time I did the Canadian studies, the data I was working with, which I obtained from the Bureau of Economic Analysis at the Department of Commerce, only went up to 1992. I have recently obtained data going up to 1996, so I plan to do a NAFTA study over the course of the next year.

MR. ANGELL: Commissioner Weidenbaum.

MR. WEIDENBAUM: My question is aimed at one of the two professors. Hopefully one of them will have a response.

What I'm looking for is what standards can we use to compare U.S.-Canada trade, especially the balance? So let me show you how my thinking is progressing.

We know, from a variety of studies of international trade, that the closer two countries are, the more they trade with each other. And obviously, sharing a large common border, you expect a lot of trade. But it doesn't tell you much about the balance.

But this must not be the only situation where you have, in terms of population, a very large country right next to a much smaller country.

From studies of other comparable situations, is there any standard for expecting what the balance of trade would be, in which direction or how much?

MR. KRESL: You're looking at other unequal exchanges, so to speak?

MR. WEIDENBAUM: Yes.

MR. KRESL: I don't have the data offhand. But just to go back to the Canada-U.S. situation, the trade deficit is balanced by investment income to the United States. A lot of it is portfolio investment, and a lot of it comes from crown corporations and provincial governments borrowing in the U.S. market.

And we know who wrote the history of the U.S. financial system -- Bray Hammond -- 1854, the single largest financial actor in the New York financial market was the Bank of Montreal.

So it's one of great duration, and sending money down here and borrowing long-term and so forth, so that our relationship, I think, is different than say Holland and Germany or Sweden and Norway.

MR. WEIDENBAUM: Or the United Kingdom and Ireland or Russia and Poland or Italy and --

MR. KRESL: But see, I think there has been much more enmity there in those places.

And we've been -- with the collapse of Britain, really after the First World War, with New York emerging as a financial center, we really dominated Canadian finance.

Now, when you're looking at European countries, it's Barings and it's Rothchild's, and it's the French and the German houses, and it's a much more open environment.

With Canada, it's been U.S. capital there. Almost 85 percent of the direct foreign investment was the U.S. when 54 percent of total capital was foreign owned, 85 was U.S.

So that you don't find that other places. You don't find that Sweden dominated Norway or Germany Holland to the same extent, I think.

MR. D'AMATO: Australia and New Zealand?

MR. KRESL: I think it's a fairly unique situation. In part it goes back to what Susan was talking about, companies making decisions based on a North American market and finance being structured the same way, an exclusive, almost a client relationship, Canada to the U.S. And I don't think you find that other places.

MS. FEINBERG: I agree that the Canada-U.S. situation is unique, but there are lessons to be learned from it. Because of proximity, common language and infrastructure, Canada was one of the first places

outside the U.S. that American companies located. So many U.S. multinational companies gained their initial international experience in the Canadian market. As I said, I think that although the Canadian market is unique, there are lessons to be learned for the future when considering places like Mexico as it develops. I certainly think American multinationals will eventually reconfigure their North American production to take advantage of the Mexican market.

MR. ANGELL: Commissioner --

MR. KRESL: But we had a free trade agreement in 1854, 150 years ago. We had a reciprocal trade agreement between the two countries until 1866. And it came up in Canada, you know, 1896 and 1911 and 1948. Its come up, the closeness of the relationship with U.S.

There has been hostility from time to time, but they've recognized that this is the sea in which they have to swim.

And you don't find that with small countries in Eastern Europe. There's Germany, there's Britain, there's Russia, there's Austria. They're competing interests. And you don't see that in Canada.

MR. ANGELL: Commissioner Lewis.

MR. LEWIS: Professor Feinberg, I'd like to ask you a question. I'm very interested in the exports from the United States to countries like Thailand or Indonesia, to affiliates over there, and the exports back to the United States.

Is information available on other countries from where you got your information about the U.S.-Canada relationship?

MS. FEINBERG: The Bureau of Economic Analysis is a division of the Department of Commerce, and it collects data every year on the domestic and foreign operations of U.S. multinational corporations and the U.S. operations of foreign multinational corporations. When the Bureau of Economic Analysis conducts their Benchmark Surveys every four or five years, they make a very systematic attempt to capture the whole population of relevant U.S. and foreign multinationals.

MR. LEWIS: Trading with affiliates?

MS. FEINBERG: Yes.

MR. LEWIS: Now, suppose a United States footwear company sells raw materials to a company in

Asia that's really not a subsidiary, but they have a contract to get the entire output from that company, so it's essentially like a subsidiary, but it's not a subsidiary.

And then they buy the complete output back into the United States. Is there any similarity to that in Canada, or would these kind of statistics also be captured, or is it only parent-subsidiary relationships?

MS. FEINBERG: The BEA data captures more than parent-subsidiary relationships. It captures sales from subsidiaries to unaffiliated buyers in the host country, the U.S. and other countries. It also captures sales from subsidiaries to other divisions of the same multinational company in the host country, the U.S., and other countries. Although the BEA data is the best in the world of its kind, you still can't capture very micro details such as whether sales that go from the U.S. to Thailand are ultimately destined for other markets. The kind of detail you're asking about would not be able to be captured using the BEA data.

MR. LEWIS: You could just get aggregate U.S. to Thailand?

MS. FEINBERG: From the data the BEA makes available publicly, we know shipments by county and industry. The question you're asking involves knowing the timing of transactions. For Example, whether a country sells products to one market to perform some small value-added there, to ship to another market then back to the U.S. All we know from the BEA data is annual shipments to and from the U.S. and different markets. We can also calculate local value-added in different markets by netting out how much each foreign subsidiary imports from the U.S., but questions about the timing of transactions cannot be investigated with this data.

MR. LEWIS: Yes. Thank you. You also interviewed people in the companies?

MS. FEINBERG: Yes, I did.

MR. LEWIS: Were they candid with you in terms of what they were exporting to their subsidiaries in Canada and back?

MS. FEINBERG: Yes.

MR. LEWIS: Thank you very much.

MR. ANGELL: The Chair would like to thank all the panel members for their participation. And very appreciative that you have time to make your flight. Have a good evening.

MS. FEINBERG: Thank you.

MR. ANGELL: The Chair would like advice from anyone in the audience or any of the staff in regard to the presence of individuals who would like to be involved in the next session.

Are there individuals that would like to participate in an open mic session? And staff of the Commission are not afforded the opportunity.

MR. RUMSFELD: What about Commissioners?

MR. ANGELL: Commissioners, Commissioner Rumsfeld, are certainly eligible to step out of their Commission chair and go to the open mic. But you could also have a mic right where you are.

Then, the Chair would like to thank Chairman Weidenbaum for his support in this session.

And I appreciate very much that Commissioners Zoellick, D'Amato, Rumsfeld and Wessel have been here to the end.

Thank you, and good evening.