

A short biographical sketch of: **PETER KARL KRESL**

Peter Karl Kresl is Professor of Economics and International Relations at Bucknell University, where he has taught since 1969. His Ph.D. was from the University of Texas in 1970.

His research and teaching interests are in the following general areas: Canadian-American economic relations, urban competitiveness, the European economy, and cultural policy. He has published papers in scholarly journals such as the *American Review of Canadian Studies*, *The Journal of European Integration* and *Urban Studies*, has authored *The Urban Economy and Regional Trade Liberalization*, and has edited *North American Cities and the Global Economy* and *Seen from the South*.

He has presented research papers at many universities in North America, Europe and Asia, and at scholarly meetings around the world, including the Organization for Economic Cooperation Development, Ministère de la culture et de la communication (Quebec), The Center for the New West, and the Metropolitan Council of Minneapolis and St. Paul.

Professor Kresl has been visiting professor in Norway, Sweden and Canada, and has most recently been Seagram Visiting International Fellow at McGill University. He has also served as president of the Association for Canadian Studies in the United States.

Prof. Peter Karl Kresl  
Department of Economics  
Bucknell University  
Lewisburg, PA 17837

Tel: 570-577-1478  
Fax: 570-523-0396  
Kresl@bucknell.edu

## **Talking Points: US Trade Deficit Reduction Commission**

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### **Peter Karl Kresl**

Professor of Economics and International Relations

Bucknell University

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Regarding the US trade deficit in its trade with Canada, I will make a few "background" comments with regard to the general nature of the bi-lateral exchange and then I will focus my attention to the two primary problem areas that plague this otherwise amicable relationship. I will expand on them as requested during the Question and Answer period.

### Background

It has long been argued that Canada and the United States share the world's longest undefended cliché. That cliché characterized the relationship as being one of "hands across the border," "NATO neighbors," "a shared North American consciousness" – and overwhelmingly this is true. While the relationship is not free of conflict and of difference of opinion, the two nations have managed to establish institutions and mechanisms, in both the public and the private sectors, that facilitate resolution of contested issues in ways that leave each party generally satisfied with the outcomes. The potential for nations that share seven common water borders to come to blows is enormous. Establishment of the International Joint Commission before the First World War to manage an array of issues from sea lampreys in the Great Lakes to water diversion schemes has been such a remarkable success that it is studied by other nations, for example those European states that share the Rhine and Danube river systems. There are cross-border meetings of state governors and provincial premiers, special task forces, and a seemingly endless array of private sector linkages ranging from business to education to crime specialists.

In general, trade fits into this pattern although, as will be noted below, a couple of problem areas that appear by nature to be almost impossible to resolve do plague the relationship. Since the Commission is charged with examining the US deficit in trade and since the balance with Canada has been in deficit for several years, it would at first glance, be natural for attention to be paid to this element in the overall deficit. However, of the overall trade deficit for 1998 of over \$230 billion only 8 per cent of it, or \$18.5 billion, was registered with Canada. Since this has been the magnitude of the deficit in trade with Canada for several years, it would not appear that the deficit can be reduced significantly by means of policy to alter the result of this exchange.

The deficit in goods and services is only part of the balance, of course, and when we include investment income we find that the current account has, in recent years, occasionally been in surplus for the US. It turns out that investment is the key to the Canada-US trade relationship. With only about 7 per cent of the population of the European Union, American companies have made direct investments in Canada that are about 25 per cent of the total of US FDI in the EU. These investments are powerful determinants of trade flows. For example, with the Canada-US Auto Pact in place since 1965 US companies have created a dense web of intra-firm reciprocal flows of components and finished vehicles. In Europe, similar investments by US companies have resulted in vehicles being made in Europe for sale in Europe. Thus, while automotive trade comprises about 25 per cent of both US exports and imports with Canada, our trade with Europe is largely a one way flow of vehicles exported to us by European companies. As a result of our FDI in Canada, and of course of Canadian FDI in the US, it is estimated that about two-thirds of merchandise trade between the two countries is intra-firm trade. As these flows are the consequence of rational investment decisions made by companies seeking to make their overall operation as efficient as they can one should be very careful about implementing policies that would significantly counter their business decisions.

Canada is overwhelmingly an importer of manufactured goods, and a substantial exporter of primary goods. Manufactured goods account for over 90 per cent of our exports to Canada, but primary goods are almost 30 per cent of Canada's exports to us. These primary imports are

roughly balanced among forestry products, energy products, and agriculture and fishing. Thus a good share of them are used by US manufacturers. Due to the relative volatility of many of these goods, it is difficult to forecast their growth paths for future years. It has been an article of faith for some Canadian economists that "sooner or later" the demands for primary goods will outstrip the world's ability to produce them and that ultimately resource rents are certain to rise. This position has been argued for decades, if not since Malthus, however secular trends in most raw materials have not performed as proponents of the argument had anticipated. This will be referred to in a few minutes when resource trade is examined as a problem area in Canada-US trade.

As a final note, it must be observed that there is a fundamental imbalance in the bi-national trading relationship. While each nation is the other's largest trading partner, Canada accounts for 20-25 per cent of US total trade however in excess of 80 per cent of Canada's trade is with the US. The US is Canada's only significant trading partner. In spite of a recurring desire to diversify its trade relations, Canada's dependence on the US market has only increased. This being the case, US policy makers might attempt to use this dependency to coerce Canada to be more accommodating to US economic interests. Any student of the Canada-US relationship knows that this would do little more than fuel the passions and political action of the substantial constituencies within Canada that have always been opposed to the strategy of promoting the liberalization of the trade and investment relationship.

### Issues

While the history of the Canada-US trade relationship has been very contentious at times, in recent years the issue has been generally harmonious. Economists on both sides of the border have argued the efficiency gains that liberalization would bring, although there have been significant minorities in each country that have countered that the gains would be minimal and not worth the adjustment cost or that a trade agreement was the first step on a slippery slope that could only result in loss of Canadian sovereignty. There have been two exceptions to this situation: 1) trade in primary goods, and 2) the opening of the Canadian market to imports of cultural goods from the US.

If one reflects on the long border between the two countries it can be seen to be broken into three segments: the Prairies and the West, the Industrial Heartland, and the Atlantic states and provinces. Trade in the Heartland is dominated by manufacturing and, as has been noted, this trade is largely intra-industry and intra-firm trade which has been free of any significant conflict. However at the two extremities trade is to a large extent marked by the non-differentiated primary goods that are traded in the same markets, whether in North America or abroad. Since quality and characteristics do not differentiate the goods producers must be keenly aware of price and of any attempt on the part of another supplier to gain an advantage through a subsidy or any other practice that would confer a price advantage. Agricultural goods are subsidized in one way or another by virtually every state, and other products are produced under differing regimes of marketing, financial incentive or treatment of replenishment of non-renewable resources. The list of primary goods that have generated this sort of conflict is long - salmon, cod and other fish, timber and cedar shakes and shingles, potash, potatoes, hogs, grain and hydroelectric power are only the major ones. Primary goods prices are determined in global markets with events such as stagnation of the Japanese or EU economy, the financial collapse in Asia, political uncertainties and conflicts in producing areas, and the opening of new sources of the product having powerful impacts on supply and/or demand. This means that prices are always subject to sudden change and these changes lead to disruption in the existing supply relationships and the incomes of producers. These producers naturally appeal to their government for assistance. This help can take the form of special income support or such actions as anti-dumping charges or attacks on the legitimacy of practices in the other country. As a consequence, we will probably always have conflict as an inherent feature of primary goods trade.

The trade in culture goods has become the other intractable aspect of Canada-US trade. The US argues that culture goods (film, television programming, books and publishing, and so forth) should be treated as any other commodity ("television is just a toaster with a picture" in the words of one past member of the Federal Trade Commission) and warrant no special treatment. Canada, and the EU, argue that any loss of the vitality of a nation's culture industries leads to a

subtle but inexorable diminution of a people to define itself and to understand itself. According to this latter argument, nation's have a legitimate right to treat culture goods differently that they do other goods. In the Canada-US FTA and NAFTA, culture was treated differently and this has inspired the EU (lead by France) to argue that the same treatment should be accorded in WTO negotiations.

Canadians have argued that it is unhealthy for 97 per cent of their screen time to be given over to US films, for book publishing and distribution in Canada to be left to US firms, and for television to be dominated by US programming. This is a complex issue that requires us to consider the ability of a people to articulate and express its unique national culture, the right of consumers in both countries to have access to the culture goods they prefer to consume, the danger that producers in the culture industries use the legitimate concern for cultural autonomy as a vehicle for ordinary protectionism, and the obligation of a national government to ensure that the people can tell their stories and communicate with each other and be responsible citizens.

The factor that has caused much of the conflict between the two countries in the area of culture goods is Canada's often inappropriate use of policy to defend the integrity of its culture goods industries. This can be seen through an examination of the nature of the conflicts during the past thirty years. During the Trudeau years of the 1970s, Canada intervened on the demand side through a series of policies designed to reduce Canadian demand for US culture goods - cable television priorities, tax treatment of advertising in US periodicals and on US television stations, and so forth. The US was correct in its negative response to these measures. During the Mulroney governments of the following decade, policy turned to intervention on the supply side - subsidies to production. Since it is hard to complain about a policy that increases the choice of consumers there was little for the US to find objectionable. Recently, with the Country Music TV and Sports Illustrated cases, Canada reverted to demand side intervention. This always has the taste of simply another effort to divert a stream of revenues from a foreign to a domestic supplier, and again the US was correct to object.

In contrast with the trade in primary goods, which has an inherent bias toward conflict, the trade in culture goods can be carried on in a harmonious way if both parties will: 1) accept the

argument that a nation has a legitimate right to ensure the vitality of certain sectors of its culture goods industries, and 2) agree that certain intervention, that on supply, is acceptable, but that other intervention, that on demand, is not.

My conclusions with regard to trade between Canada and the US are clear from the above text, but I will reiterate them here:

- 1) That the relationship is an extraordinary one and is one that should be an inspiration to the rest of the world.
- 2) That trade is linked to investment in this exchange more so than is found elsewhere.
- 3) That the composition and magnitude of goods traded is largely a result of decisions made internal to firms, and certainly to industries.
- 4) That policies to alter these flows of goods would have negative efficiency impact.
- 5) That the trade deficit with Canada is a minor part of the US deficit and even its total elimination would not significantly reduce the US deficit.
- 6) That the trade conflict in primary goods can be managed but that it will always be market by conflict.
- 7) That the trade conflict in culture goods can be resolved if certain practices and ground rules can be agreed upon by both governments.

Peter Karl Kresl  
Department of Economics  
Bucknell University  
Lewisburg, PA 17837 USA  
Tel: 570-577-1478, Fax: 570-577-3451 (office)  
Tel: 570-523-0396, Fax: 570-523-0335 (home)