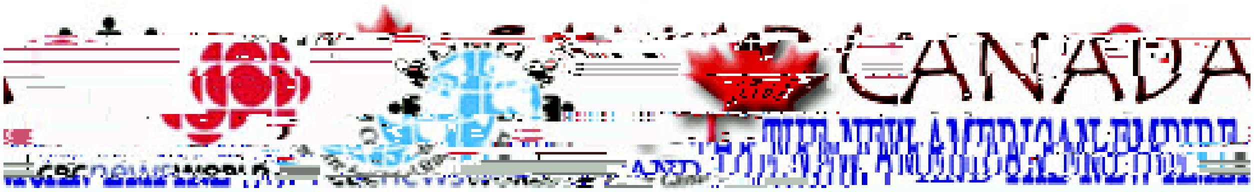

Canada in North America:
Prosperity and Sovereignty Through Continental Economic Integration

by

Thomas J. Courchene
Queen's University and IRPP

Sovereignty and FTAs

The remarkable Canadian reality is that our social philosophy and policies have progressively diverged from those in the US over the very time frame that we have progressively integrated economically with the Americans. In effect, we have successfully married the dynamism of the American economic model with the cohesion of the continental European social model, and we have no intention of surrendering either. Indeed, these models are mutually supportive. In particular, our demonstrated ability to create a sharing society in the upper half of North America has been in no small measure due to our ability to forge ever closer trade and economic links with the Americans.

However, this vision of Canada runs counter to the widespread belief that NAFTA and other international agreements are reducing Canadian sovereignty. Part of the reason for this disconnect is that concepts like sovereignty and democracy, which are typically defined in relation to the traditional (Westphalian) model of the nation state, need to be rethought and redefined in this era where the nation state itself is under full evolutionary flight. But I believe that a persuasive case can be made that trade agreements are sovereignty enhancing *even within the traditional framework*.

Toward this end, an appropriate starting point is Garrett Hardin's 1968 *Science* article *The Tragedy of the Commons* where the "commons" is the English common grazing pasture. By the very nature of a commons, every herder will be enticed to add yet another sheep to his/her flock. This is so because the herder receives all of the proceeds from the sale of an additional sheep while the costs of the resulting overgrazing are spread across all animals and herders. As Hardin aptly notes, freedom in a commons brings ruin to all. One obvious solution is an agreement that assigns property rights to the pasture, in which case it ceases to be a commons.

En route to viewing free trade agreements (FTAs) as allocating economic property rights in an economic commons, we fast forward to the environment and to the Kyoto Protocol. The rationale for the Protocol is to address the "global environmental commons." Again, freedom in this global environmental commons spells ruin to all. And again, the obvious solution is to develop a set of rules and procedures that serve to constrain the various actors (e.g., polluters and their national governments). While these agreements/protocols will surely limit the room to manoeuvre of national governments, they will equally surely increase effective national and international control over the future of the environment. This is sovereignty enhancing.

With this as backdrop, the focus finally shifts to the relationship among globalization, FTAs, and sovereignty. In the era of high tariffs and limited capital mobility, nations held effective property rights over their economic space and, in aggregate, over global economic space. However, the processes of globalization have progressively undermined this territorial economic sovereignty. For example, highly mobile capital can and will flow over, around and through political and policy boundaries, so much so that nations are losing the ability to control key aspects of their economies *within their own borders*. In light of the above, the result should be clear: Globalization has converted the Westphalian system of economic property rights into a veritable *global economic commons*. Once again, freedom in this commons will spell ruin for all if nations attempt to outbid each other for capital. This *is* an erosion of national sovereignty.

How do nations reclaim their sovereignty? Again, one obvious avenue is via international economic protocols or FTAs. In effect, such FTAs allow nations to pool shares of their sovereignty in order to, *inter alia,* countervail capital (e.g., to develop domestic and international rules and standards to regulate capital flows) which will in turn serve to reassert control over the economic commons. However, because factor mobility and globalization are efficiency-enhancing and wealth-creating, nations will not attempt to reproduce the pre-globalization version of national economic space. Rather, the focus will be on rules, procedures and standards under which the free (or freer) mobility of goods and factors can proceed.

While FTAs, like environmental protocols, will admittedly limit the room to manoeuvre on the part of national policy makers, the more important result is that they will allow nations a role in formulating multilateral principles and procedures that not only will provide an enhanced degree of order and certainty to the international economic system but, in addition, will permit national governments to regain and/or effectively reassert *domestic* control over selected policy areas. This is clearly sovereignty enhancing. Indeed, applying this line of reasoning to the EU led information-era guru, Manuel Castells, to proclaim that nationalism (in the sense of regaining control over national economies), not federalism, is the political goal of the EU.

These principles and analysis are especially relevant for Canada because we were in danger of finding ourselves almost alone among our trading partners in not having guaranteed access to a market upwards of a hundred million people, let alone the 300+ million of the EU. Indeed, what brought Canadian business onside in terms of the Canada-US FTA was the fear that rising US protectionism in the mid-1980s would erode the rather dramatic export penetration by Canadian-based companies into US markets earlier in the decade. Intriguingly, the resulting FTA/NAFTA increases our ability to manoeuvre in areas well beyond the economic sphere. This claim can be recast as follows. What Canadians want from the Americans is access to their markets. With respect, we do not want their values, or their institutions, or their policies. This is exactly what the FTA and NAFTA have delivered to us – access to the American market. In turn, this provided the economic and political confidence to design our policy space in our own likeness and image, the latest health accord being the most recent exemplar. Indeed, NAFTA may have enhanced our ability to manoeuvre politically since it is not obvious that, absent NAFTA and the FTA, Canada would have taken the position it did on sending troops to Iraq.

None of this is intended to imply that NAFTA and its FTA forerunner have gone far enough in guaranteeing access, in outlawing discriminatory practices, in providing fair and transparent dispute resolution procedures, etc., let alone in taking politics out of trade. But surely the underlying intent of having joint determination of supranational rules and regulations over trade and commerce is, on the economic front, to secure the gains from trade and, on the societal front, to rework property rights relating to trade and commerce in ways that allow Canada much greater certainty in terms of the overall environment within which it legislates and implements its chosen policies. Moreover, the FTA and NAFTA were designed from the outset to be more sovereignty- friendly than were the series of EU agreements. For example, the operational principle in Europe is the "single market" or "home-country rule" which by its very nature drives the EU toward uniform regulations. In contrast, NAFTA's operating principle is "national treatment" which is both "sovereignty preserving" in the abstract, and sovereignty enhancing with respect to the *status quo ante*. Under national treatment Canada is free to enact those policies that it deems appropriate, subject only to the proviso that Canadian policy must not discriminate between American and Canadian agents.

NAFTA at 20: Updating, Broadening, Deepening

In the current time frame, not only have most Canadians bought into NAFTA (including, it seems, the Canadian Labour Congress) but several factors have coalesced to advance the case for even further trade integration. One of these contributing factors is the still-on-going series of conferences occasioned by the 15th anniversary of the FTA and the 10th anniversary of NAFTA. Invariably these papers tend to focus on the case for broadening or deepening NAFTA or on what NAFTA at 20 could or should look like. Another is the reality that there are some problematic areas in our trading relationships that NAFTA has not resolved (softwood lumber) or even addressed (transportation). A third factor arises from the very success of the FTA/NAFTA in expanding trade. Specifically, north-south trade has increased so dramatically that Canada and the provinces are now much more vulnerable to policies or events that impede access to US markets. Relatedly, production chains and industry clusters are often fully integrated cross-border so that access also needs to be timely (as in just-in-time production processes) or the cluster will have an incentive to move wholly into the US. Finally, but hardly exhaustively, there is 9/11 and the new US single-mindedness – "homeland security." Spearheaded by the Canadian Council of Chief Executives (CCCE), 9/11 has triggered a groundswell of interest and activity in Canada toward rethinking NAFTA in the larger context of an overall security perimeter encompassing homeland security as well as economic security. As the CCCE has noted (d'Aquino,2003), North American economic integration is *irreversible* and North American economic and physical security is *indivisible*. And herein lies the ingredients for a potential "grand bargain." (Gotlieb, 2003).

Updating NAFTA

Accordingly, most of the remainder of the paper will elaborate briefly on the case for rethinking and reworking NAFTA, under the rubric of what Uinversity of Toronto's John Kirton, calls the Tim Horton or "double-double" approach to rethinking NAFTA – *double broadening and double deepening*. These are above and beyond requisite updating necessitated by what Michael Hart and Bill Dymond refer to as the "tyranny of small differences:"

> Cumbersome rules of origin, discriminatory government procurement restrictions, complex antidumping procedures, intrusive countervailing duty investigations,

immigration procedures, and other restrictive measures remain in place, discouraging

> Canadian initiatives would be required in areas of interest to the United States, specifically border security, immigration, and defense. Energy security is another key area where Canada should build on its existing strengths. In exchange for these initiatives, Canada should seek customs-union- and common-market-like arrangements that achieve deeper integration but recognize deep attachments to political independence and distinctive national institutions.

The CCCE position paper (d'Aquino, 2003) embeds Dobson's energy security proposal within a broader "North American resource security pact," encompassing oil, gas, electricity, coal, uranium, metals, forest products and agriculture. What the CCCE hopes to accomplish is to trade off resource security for the US for the resolution of long-standing issues and irritants relating to pricing, subsidies and regulatory practices in selected resource products (e.g. lumber).

In terms of institutional depth or internal governance, NAFTA stands in sharp contrast to the EU. On the one hand, NAFTA is among the most highly detailed international agreement ever negotiated: "NAFTA is broader in scope of coverage ... than the WTO agreement ... [and] was drafted at a level of detail substantially higher than the EC treaty (Abbott, 2000,542). On the other hand, and unlike the EC treaty, NAFTA has essentially no discretionary internal governance institutions and, therefore, no ability to adapt and adjust from within. The inevitable result is what has earlier been referred to as the "tyranny of small differences" – a progressive and governments on both sides of the border harmonize or otherwise reconcile their approaches to this common challenge. Wolfe would argue that it is this complex and comprehensive web of arrangements that needs to be deepened and broadened in order to advance common interests in North America. One might refer to this as an argument for *democratizing North American integration* by viewing or relegating NAFTA to the role of one (albeit the most important) of many frameworks/agreements for conducting trade and economic relationships in North America.

An alternative approach (Blank 2002) is to *democratize NAFTA* itself. Canada, Mexico and the US are all federal systems and between them have close to 100 sub-national governments (excluding cities/municipalities). Moreover, their sub-national governments are increasingly engaged in cross-border associations or agreements such as the Council of Great Lakes Governors (with Quebec and Ontario as associate members), the New England Governors and Eastern Canadian Premiers, the Pacific Northwest Economic Region, the Montana-Alberta Bilateral/Advisory Council, with similar associations across the Mexican-US border. Why not have these associations formerly come under the NAFTA umbrella? And just as provincial experimentation in one province can inform policy design and delivery in all provinces, so might sub-national cross-border "best practices" be a fertile ground for informing and updating NAFTA. Implicit in both approaches (democratizing integration and democratizing NAFTA) is that some trade disputes that currently defy resolution, because they get caught up in the high politics of the Ottawa-Washington-Mexico City power corridor, might be more amenable to resolution by the relevant sub-national, cross-border interests operating in a more pluralistic, decentralized and subsidiarity-driven framework. Others have suggested joint annual meetings of sub-national (or even national) parliamentarians on NAFTA-related issues where the national delegations would report to their national NAFTA secretariats. (A version of this currently exists). All of this would serve to tilt NAFTA in the direction of a North American community of economic interests. Daniel Schwanen (2004) has provided one longer-term perspective of what such a North American community might look like.

NAMU and NAFTA

In light of the fact that Canada is more closely linked trade-wise to the US than is any EU country to the rest of the EU, I have long been persuaded that our exchange rate with the US is far too volatile given that the US is the destination for over 80% of our exports and that Canada needs fixed exchange rates, the optimal longer term version of which is a North American monetary union (NAMU). From the low 70-cent range when FTA negotiations began, the exchange rate appreciated to nearly 90 cents in the early 1990s, fell to the low 60-cent range in the wake of the Asian crisis, and at the time of writing has broken through 78 cents and (in my view) likely to continue to rise. With this degree of volatility foreigners may think twice about producing for the North American market from a Canadian location, which is no doubt one of the reasons why Canada's share of North American inward FDI has sharply fallen off of late. Note that his volatility or currency misalignment is a much greater problem as we shift away from a resource-based economy to a knowledge/based economy, since the former is fixed geographically whereas our knowledge base is mobile internationally. As Courchene and Harris (1999) argued, substantial overvaluation for long periods leads to downsizing, off-shoring and exit, while substantial undervaluation provides incentives for the migration of human capital and underinvestment in productivity enhancing technology, the net result of which is that Canada will be more resource-based and less human-capital intensive than would be the case under fixed procedures (CVAD) to rules-based adjudication, without recognizing that the Americans will in turn insist on ensuring that Canada does not use 1990s-style exchange rate depreciation to deepening Canada-US integration in terms of obtaining CVAD/subsidies codes is more likely to come from the multi-lateral WTO route. Whether we will be closer to a currency union will not be a depend on the Bank or Finance, but rather on the cumulative currency choices of Canadians, businesses and consumers alike. My principal concern here is that if the opportunity arises for a monetary union we will have done our homework, as was the sae for the FTA.

If there is a problem with this scenario, it is likely to be that the US economic star may be shining less brightly under the burden of its massive twin deficits and the Chinese economic miracle. Were this to occur, NAFTA will be viewed as a godsend since US protection will likely be rife and we are running huge current account surpluses with the Americans. But this does not differ from the overall message, namely that Canada's economic prosperity and policy sovereignty drive off continental integration, the latest (but not last) version of which is the FTA/NAFTA framework.

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References

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