CANADA AND THE FTAA: The hemispheric bloc temptation

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With the failure of the Seattle meeting of the World Trade Organization (WTO) to effectively launch a new round of global trade negotiations, Canada might tempted to see a Western Hemispheric bloc as a good substitute and a sound refuge in the face of rising global protectionism.

The governments of the Americas are committed to establish, by 2005, a Free Trade Area of the Americas (FTAA). The FTAA process was initiated in 1994 at the Miami Summit of the Chiefs of States of the Americas and formal negotiations on the agreement began 18 months ago. This paper examines the latter undertaking, its many rationales, its prospects, and its potential implications for Canada. Canada has been the foremost promoter of the FTAA, and the single most important driving force behind the process as it has evolved over the last five years.

Essentially we argue that the hemisphere is not a real option for Canada's trade strategy, that the establishment of a FTAA is not likely to serve the region in the short or medium term, or to bring Canada closer to its key members, and finally that focused bilateral efforts rather than regional negotiations might better serve Canadian interests. In the current context, a "retreat" into the hemisphere risks increasing Canada's trade dependence on the US, certainly this country's biggest strategic concern at the moment. There is simply no substitute to muddling through at the global level.

1 Latin America in Canada's trade and investment picture

According to Statistics Canada, in 1998, Canada exported $5.8bn dollars worth of products to Latin America and the Caribbean (LAC), compared to $4.1bn in 1994, an annual increase of 9 percent. Imports from the region are more substantial, growing from $8bn to $13bn during the same period, an even more impressive 13 percent per year. In relative terms, however, these numbers remain very small. Canada is a massive trader and both its total exports and imports have been growing at a similar pace in the same period. In fact, the relative weight of LAC in Canada's trade has barely changed since NAFTA was signed and the FTAA process was launched, with exports to the region stalled below 2 percent of total exports and the region's share of global imports barely increasing.

This sobering picture should be nuanced a bit because these numbers do not include trade in services. Moreover, free trade with the United States, from where many Canadian products are shipped to other destinations, leads to an artificial exaggeration of trade with that country, and a corresponding shrinkage of trade estimates to and from all others. The numbers given must thus be used with care, and considered low estimates. Any reasonable factor of correction, however – say 20 or even 30 percent - would still leave the region as a minor economic partner for Canada.

This impression is reinforced by a look at the evolution of investment figures since 1970. Canada's investment position in LAC has been advancing at a healthy pace in recent years. Yet, and in spite of significant growth since 1989 (22 percent a year), the Americas —excluding the US— have not yet regained the position they had in 1970 in Canada's global investment picture. Moreover, more than half of the stock of Canadian investments in the region is concentrated in a few Caribbean banking centres (the Bahamas, Barbados and Bermuda). Leaving those countries aside, one sees stocks of investments in the region that represent 6 percent of Canada's total direct foreign direct investment abroad, i.e. less than half the proportion they had in 1970.

Figure 3 Canada's Hemispheric Investment Position

Once again, this picture must be handled with care, since data collectors rely to a significant extent on voluntary disclosure on the part of investors. If anything, however, this might underestimate the extent to which Canadian investment in the region is located in the financial paradises.

Beyond trade and investment numbers, a deeper reality has been developing over the last twenty years: Canada is now more tightly integrated into the North-American economy than ever before. This integration transcends trade relations and is in fact based on investment strategies and industrial structures that consider North

America as a single unit. The most important manifestation of this connection is the prominence of intrafirm exchanges in the trade between Canada, the United States and Mexico, particularly in the automobile industry. There are few indications that this North American economic unit is likely to expand South beyond Mexico; it will certainly not do so over the next decade. Canada is now part of a North American financial and industrial unit, one that includes the United States and Mexico, but no one else. For better or worse, NAFTA has an economic basis that is utterly lacking for a FTAA.

This background look is not complete without a look at the potential of the region, since the FTAA promises “access to a market of 800 million people, with a combined GDP of $ 15 trillion.”[i] In spite of all the caveats mentioned above with respect to data, this image of size, which Canadian government documents use ad nauseum, is probably the most misleading because the US represents close to 40 percent of the population of the hemisphere, and more than 75 percent of its combined GDP; NAFTA countries—including Canada—have about 50% of the hemisphere’s population and more than 80% of its GDP. The real new potential of an FTAA would thus be closer to 400 million people and a GDP of $2.4tn. This is certainly sizable, but not what is advertised. Finally, close to half of that market is made up of Brazil—the country least enamoured of a FTAA—and more than 70% by Mercosur, the trade group that Brazil leads.

2 The FTAA: Its logic and prospects

The project of a free trade area from Alaska to Tierra del Fuego was formulated at the end of the 1980s by US President George Bush at a time of strong competitive tensions among the world’s largest economic powers, and of a deadlock in the negotiations for global trade liberalization. The original logic of the modern FTAA is that of a fortress America, to be constructed against fortresses Asia and Europe. The context in which this original proposal made sense was profoundly altered by the conclusion of the Uruguay Round in 1993. The establishment of the WTO has put to rest the prospect of the division of the world into three conflicting trade blocs, the problems in Seattle notwithstanding. In the new context, there is little need for further liberalization at the hemispheric level. This is expressed most clearly in the relative lack of interest in free trade in the United States, in the corporate sector in many countries of the hemisphere, and in most countries of the region.

For Latin America and the Caribbean, the equation would change markedly if the United States were willing to open up its huge market. Free access to US consumers, especially for agricultural products, is ultimately the prize and, from LAC's standpoint, the most important reason to play the hemispheric trade game at all. The problem is that there is little willingness in the US to further open its market in the context of a trade deficit that could reach US $300bn in 1999.

This issue of access to the US market is also at the root of the resistance to the project coming from the two most important Latin American countries, Mexico and Brazil. With NAFTA, Mexico obtained guaranteed access to the US market, and paid dearly for it, with a massive restructuring of its economy and a liberalization of financial markets that left it powerless to resist an assault on its currency during the 1994 peso crisis. From Mexico's perspective, a FTAA would mean sharing the prize without getting much in return. Mexico has its own free trade agreements with most of Central and Latin America and has just concluded an agreement with the European Union (EU). No wonder the Mexican government has not been enthusiastic about the FTAA project.

Brazil does not have free access to the US market. This lack of ready access, particularly for a few key agricultural products, is something about which Brazil complains loudly. The structure of the FTAA game, however, is not advantageous to Brazil. The US holds the key card, with a credible commitment to liberalize likely to bring most countries on board, leaving those with special grievances, such as Brazil, isolated and even then, with a strong incentive to sign. Hence Brazil's strategy is to slow the FTAA process down as much as possible while it builds up a negotiating coalition. Centred on Mercosur (with Argentina, Paraguay and Uruguay) and its associate members (Bolivia and Chile), Brazil is working hard to extend Mercosur to all of South America. Since 1993 it has promoted a South American Free Trade Area (SAFTA) that, in Brazil's view, would provide the political clout for a more balanced FTAA negotiation. In the meantime, the Brazilian government has been able to secure the place of co-chair, with the United States, of the last and most crucial phase of the FTAA negotiating process in 2004. Brazil's fight against the inclusion of labour and environmental standards in the FTAA process complements its go-slow strategy because it limits the potential for the inclusion of what this major player sees as non-tariff barriers. By excluding these issues, advocates of the FTAA, particularly in the US and Canada, will have much more difficulty selling the agreement to unions and the environmentalist lobby. President Clinton's reference to labour practices in Brazil in his remarks in Seattle provoked an angry response in a country which has liberalized considerably in recent years.[ii] The President's remarks will also likely reinforce Brazil's opposition to the FTAA.

3 Canada's game

Since joining the NAFTA negotiations, Canada has been committed to expanding the liberalized North American trade regime to the entire hemisphere. Canada successfully pushed for an accession clause to be included in the NAFTA Treaty. It tried hard to get Chile on board and, when the Clinton administration was unable to get fast-track authority from Congress, moved to sign a basically NAFTA-level bilateral agreement with that country. Most significantly, Canada has been the most consistent and energetic supporter of the FTAA process, both in its preparatory phase (1994-1998) and since the formal launching of the negotiation process at the April 1998 Santiago Summit of the Americas.

There appear to be five overlapping rationales for this Canadian stance.

a) The all-out liberalization strategy: This strategy assumes that Canada can only benefit from the extension of trade liberalization and that the latter should be pursued wherever, and with whomever, it can advance most quickly: if the Americas can liberalize faster than the rest of the world, Canada should strive to realize that potential. This is predicated on the assumption that regional agreements are easier to negotiate than global ones and cover a wider range of topics.

b) The proactive diversification strategy: This argument is a throwback to an old dream, that of more diversified trading partners. Trade dependence on the US is higher than ever, and this makes Canada's internationalized economy stupendously vulnerable to the policy and market whims of its southern neighbour. A FTAA, as a Third Option in a new guise, would open up the potential for some trade diversification.

c) The continental bloc strategy: This rationale contemplates the global trade game and emphasizes the two basic advantages of regional bloc formation. If the global process were ever paralyzed, as it was in the 1980s, the spectre of a powerful Western Hemispheric free trade area could nudge the rest of the world, in particular the Europeans and Japanese, into showing more flexibility. Moreover, in the eventuality of a global trade war or even of an inter-bloc one, a big regional bloc would offer a large enough market to "retreat to."

d) The defensive anti hub-and spoke strategy: The fourth rationale is more strictly defensive, and derives directly from Canada's NAFTA experience. After signing the Canada-United States Free Trade Agreement, Canada was confronted with the possibility of a "hub-and-spoke" trade structure in North America. The US, which was already negotiating with Mexico, appeared likely to become the only one of the three countries with access to all three markets and consequently, the most appealing one for investors. Canada requested, and was granted, a seat at the table from which NAFTA emerged. Such a real danger could reemerge on a hemispheric scale, with the US proceeding alone and setting up the "spokes" through bilateral agreements. What better way to avoid this than to take the lead in a multilateral process, the FTAA?

e) The building of a reputation in Latin America strategy: This perspective has its roots in Canada's late discovery of its own neighbourhood (we joined the OAS only a decade ago). Having committed itself to the hemisphere Canada is anxious to establish itself as a significant player and to support the process of liberalization and democratization currently underway. Its hemispheric interlocutors see Canada as less threatening than the US, as an honest broker and helpful fixer.

These justifications require careful scrutiny, however.

i) First, there are tensions amongst rationales a/b and c: If the FTAA is successfully negotiated and either global talks make little progress in the longer term or, worse, there is a rise in trade tensions between the United States and the EU, Canada would become even more North-Americanized in the context of a confrontational fortress game. Unlike Mexico, Canada has no serious preferential access to European markets, a reality that the negotiation of a bilateral agreement with the EFTA countries will not ameliorate. Canada therefore should make every effort to ensure that the US or any other bloc leaders never use the competitive bloc card. Compared to the implications of such a trade war, the dangers of a US-centred hub and spoke structure look quite minor.

ii) Second, it is not clear that the countries of South and Central America are able economically or politically at this juncture to absorb more liberalization shocks. All over the continent, economic and political tensions are lessening the capacity and interest of the region's governments in further liberalization at the hemispheric or global level. Moreover, few of the governments in the hemisphere are receptive to the demands being made by Canada and the US for the participation of civil society in the FTAA process. From their perspective the emphasis on civil society involvement is inappropriate and beyond their capacity. What happened in Seattle will only strengthen this view.

iii) Third, it is not obvious that Canada has much to gain economically, at least in the short to medium term, from a FTAA, especially given the problems that many members of the region are currently experiencing and are likely to experience if they move to liberalize further. This appears to be recognized by Canadian business, which remains focused on the US and whose enthusiasm for the FTAA, once considerable, has declined markedly. Most civil society organizations, for their part, are simply opposed to the project and conceive their participation in it as a way to limit its liberalizing impact.

iv) Fourth, countering a hypothetical US-centred hub-and-spoke trade strategy only calls for one's presence at the meetings. Taking the lead at the FTAA level offers no guarantee against these dangers. Mexico has been in fact setting up just such a hub-and-spoke system, through bilateral free trade agreements with Central America, Chile and now Europe; meanwhile Canada has been busy in a FTAA process where, with Mexico's full appreciation, nothing was happening.

v) Fifth, by pushing a project that is so clearly centred on access to the US market, Canada runs the risk of losing some of its own identity as an independent hemispheric player and, more important, of alienating reluctant hemispheric participants, Brazil in particular, without having much to offer to reestablish a sound relationship. Given that for Canada the only really big prize in the hemisphere is Brazil, a FTAA that is perceived as a threat there does not seem like a wise way to build a better relationship. As long as the aircraft subsidies confrontation continues at the WTO between the two countries, it might be wise to avoid additional sources of tension.

vi) Finally there is the issue of capacity, even for a country ostensibly as well endowed with human and financial resources as Canada. The reality is that our negotiators are stretched very thin. We have just surrendered the gavel on the FTAA, having held it for 18 months. By all accounts our leadership was impressive; it was Canadian efforts that kept the FTAA process alive. Though we no longer chair the overall process, we will chair the government procurement group over the next period. This is in addition to the various working groups in which we are participating, some of which are very active. The WTO negotiations are off to the worst possible start; Canada is making slow progress toward an agreement with the EFTA countries; NAFTA working groups continue their work as do NAFTA and WTO dispute settlement panels. The total commitment of human resources these various activities demand is staggering. Given this list and the complexity of the WTO agenda as well as our need to pay more attention to our relationship with the United States, active participation and investment in the FTAA is clearly not the best place to put the energy and talents of our highly dedicated but stretched trade negotiators.

4. Conclusion

The case for the FTAA and especially for strong Canadian support for it is weak. It is not clear that a preferential free trade agreement is an unmitigated benefit for the hemisphere, that its establishment would not worsen global trade tensions, that the prospects for meaningful liberalization in the region are good, and that, whatever the outcome of the current negotiation process, Canada has much to gain—if anything—from it. The FTAA lacks the investment and trade foundations that NAFTA and especially the FTA had for this country; its use as a trump card in the global trade game could backfire and further deepen Canada's trade dependence on the US market; continuing alignment with US positions is weakening our independent political standing in the region; finally, a complex and heavy 34-country negotiation process might not be the best instrument to help Canadian trade and investment in the region increase from their currently abysmal levels.

It could be argued that because little is at stake, there is therefore little to lose. Following the "logic" of recent decades, Canada might continue to expend an effort out of proportion to the potential benefits and continue to be an active player—THE most active player—in the FTAA game. Given the implications for Canada of deepening global trade tensions a perhaps more cogent perspective would be to take stock of the massive assault on our foreign policy capacity over the last decade, and settle on a few choices that would better focus our policy efforts, targeting areas where there is, for good or ill, something of significant consequence at stake for Canadians. The priority must be the fledging global trade architecture. A good start in the hemisphere could be the establishment of a really sound relationship with

Brazil. Involvement in the FTAA could be scaled down to little more than a presence at the meetings to closely monitor what progress, if any, is made and to ensure that regional efforts do not damage the global process.

From a political standpoint, such a disengagement would make perfect sense, since the government's option for the FTAA is somewhat strange: the business sector is not particularly interested; unions, environmentalists and nationalists are opposed; the US is not keen on it; our place in hemispheric circles does not depend on it; Mexico and Brazil, the two most important Latin American countries, oppose the endeavour; and its success in the context of growing trade tensions would likely consolidate Canada's dependence on the US market. Frankly, what is the point?

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[i] Figures cited in Ian Jack, "Opposing agendas trip up Americas trade talks," *Financial Post*, November 4, 1999, p. C3.

[ii] Roger Cohen, "Clinton Remark on Child Labor Irks Brazil," *New York Times*, December 7, 1999 (web edition).