CANADIAN GLOBAL AFFAIRS INSTITUTE
INSTITUT CANADIEN DES AFFAIRES MONDIALES

Canada-U.S. Trade: An Enduring Relationship, NAFTA or Not

by David J. Bercuson

February 2018

INTERNATIONAL TRADE SERIES

CANADA-U.S. TRADE: AN ENDURING RELATIONSHIP, NAFTA OR NOT

by David J. Bercuson

CGAI Program Director and Fellow
February 2018

CANADIAN GLOBAL AFFAIRS INSTITUTE
INSTITUT CANADIEN DES AFFAIRES MONDIALES

Prepared for the Canadian Global Affairs Institute
1800, 421 – 7th Avenue S.W., Calgary, AB T2P 4K9
www.cgai.ca

ISBN: 978-1-988493-94-7

Save for the Great Lakes, the border separating Canada and the United States is a political boundary and not a natural one. North of the U.S.-Mexico border, both Canada and the United States share continental geographical and physical boundaries and regions that run north-south. Before initial contact between European settlers and First Nations, the First Nations developed trade patterns and connections that were continent-wide. Historical evidence shows that First Nations of different parts of North America used trade goods from areas that were far removed from them. For the most part, the trade was conducted using the vast river network and Great Lakes of the continental interior.

When New France was settled in the early 17th century, French traders and explorers eventually organized a trade system that was based in Quebec City on the mouth of the St. Lawrence River, to New Orleans at the mouth of the Mississippi River, and which stretched north of Lake Superior to the Rocky Mountains in the far West. On the East Coast of the continent, the British colonies lay from the Florida boundary with the Spanish north to the Gulf of St. Lawrence (which included Nova Scotia and its major Royal Navy base at Halifax). Nova Scotia was long considered the 14th colony; it did not join the American Revolution due to the naval base and considerable British military presence.

When France was expelled from almost all of North America following the Seven Years' War (1754-1763) – also called the French and Indian War in the United States – Britain ruled North America up to the Spanish colonial empire in the West and trade continued to be continent-wide in its scope. It was only after the American Revolution concluded in 1783, and Britain withdrew from the United States, that a political boundary was thrown across much of the continent. Following that, efforts began on the part of the British North Americans and the Americans to define their interests and trade along east-west lines.

But even so, smuggling continued across the new border and the First Nations moved as they wished because the boundary was a settler-imposed barrier and not a natural one. For years after the Treaty of Paris, British troops and their First Nations allies continued to occupy territory belonging to the United States near Lake Michigan and treated the 1783 boundary as if it did not exist.

All this long history is important to bear in mind when examining the gradual integration of the economies of Canada and the United States. Slowly at first – and hindered on both sides of the border by considerations of national interest, politics, and the push and pull of metropolitan centres and their hinterlands – trade between Canada and the United States grew, hampered more by the political boundary than by any natural obstacle.

Until the mid-1840s, Canada – as a British colony – traded almost exclusively with the United Kingdom. British law, designed to hold the growing British Empire together, afforded tariff preferences to its colonies. Thus Canadian timber could cross the Atlantic and be sold more cheaply in the U.K. than could timber from the nearby (to Britain) Baltic countries. That was true of timber, furs and other natural products that Canada produced, including foodstuffs.

After the 1840s, the newly thriving British industrial economy was so far advanced over any rivals that the British came to believe that their factories ought to be able to access the cheapest raw materials possible. Thus arose the notion of free trade – the complete elimination of tariffs on any goods coming into the U.K.

In British North America, the U.K.'s adoption of free trade was a death knell to commerce. Suddenly, Baltic timber became cheaper than Canadian timber in the U.K. market. The nascent Canadian merchant class – ship owners, bankers, insurance companies, port administrators, warehouse owners, even small industrialists – found themselves desperate for new outlets for their products.

That was a key factor behind political unrest in Montreal and the issuance by much of that city's merchant class of the Annexation Manifesto of 1849, calling on British North America to detach itself from the U.K. to become part of the United States. The leaders of the Manifesto movement wanted free access to U.S. markets and were prepared to give up their British colonial identity to do so. The annexation movement was a failure, but the notion that Canada must seek U.S. markets and allow U.S. goods to enter Canada became a permanent factor of colonial politics thereafter. The British, fearing the loss of Canada, secured a 10-year trade treaty with the United States in 1854 – the Elgin-Marcy Treaty – which brought prosperity to many sections of the Canadian colonial economy. Most of the treaty's successes came from the growth of a trade of convenience – BNA communities traded with the closest American market and vice versa. However, the treaty did not last more than a decade when the Republican-dominated U.S. Congress decided in the midst of the American Civil War that it wished no special arrangements with a British colony, partly because official British policy was pro-Southern until the Battle of Gettysburg in July of 1863. Even though British liberals were abolitionist, the government allowed the Alabama, a Confederate commerce raider, to be built in a British shipyard and to sail into the North Atlantic where she conducted numerous raids against northern shipping. In addition, the Civil War congress was highly protectionist and that sentiment continued to rule until the early 20th century.

The Canadian search for markets was a key factor behind the Confederation movement in British North America from 1864-1867. The Canadian merchant class believed that unity of the British North American colonies would open up wider colonial markets by abolishing tariffs between them. But access to the U.S. market remained the winning prize for Canadian political leaders for decades.

Thereafter, the search by Canadian political leaders for an outlet for Canadian products in the United States manifested itself as a search for the re-establishment of reciprocity – at least in natural products. In the 1850s and 1860s, the Canadian commercial class undertook two steps that were designed to enhance trade with the U.S.: Canada adopted the decimal currency and Canadian railways adopted the standard rail gauge that would allow railway cars to move without effort from Canadian to American tracks and vice versa.

In fact, railway access to the United States was the Canadian merchant class's continuing ambition. In 1845, the St. Lawrence and Atlantic Railway was chartered in Maine to run from Portland to the border with Canada. Not long after, the Atlantic and St. Lawrence Railway was chartered in Montreal to meet the St. Lawrence and Atlantic at the border. Eventually, a rail line connected Montreal to Portland, in part ending Montreal's winter isolation when the St. Lawrence River froze over. The line was eventually absorbed by the British-owned Grand Trunk Railway which extended its western terminus from Windsor, Ontario to Chicago. That railway, therefore, ran from Portland, Maine to Chicago. Other railways followed and today there is an extensive network of railways connecting hundreds of points in Canada and the United States. The two major Canadian railways – Canadian Pacific and Canadian National – own thousands of miles of track inside the United States, stretching from the East Coast to the Midwest to the Gulf of Mexico. The rail network is a prime example of North American infrastructure that ties the economies of Canada and the United States together.

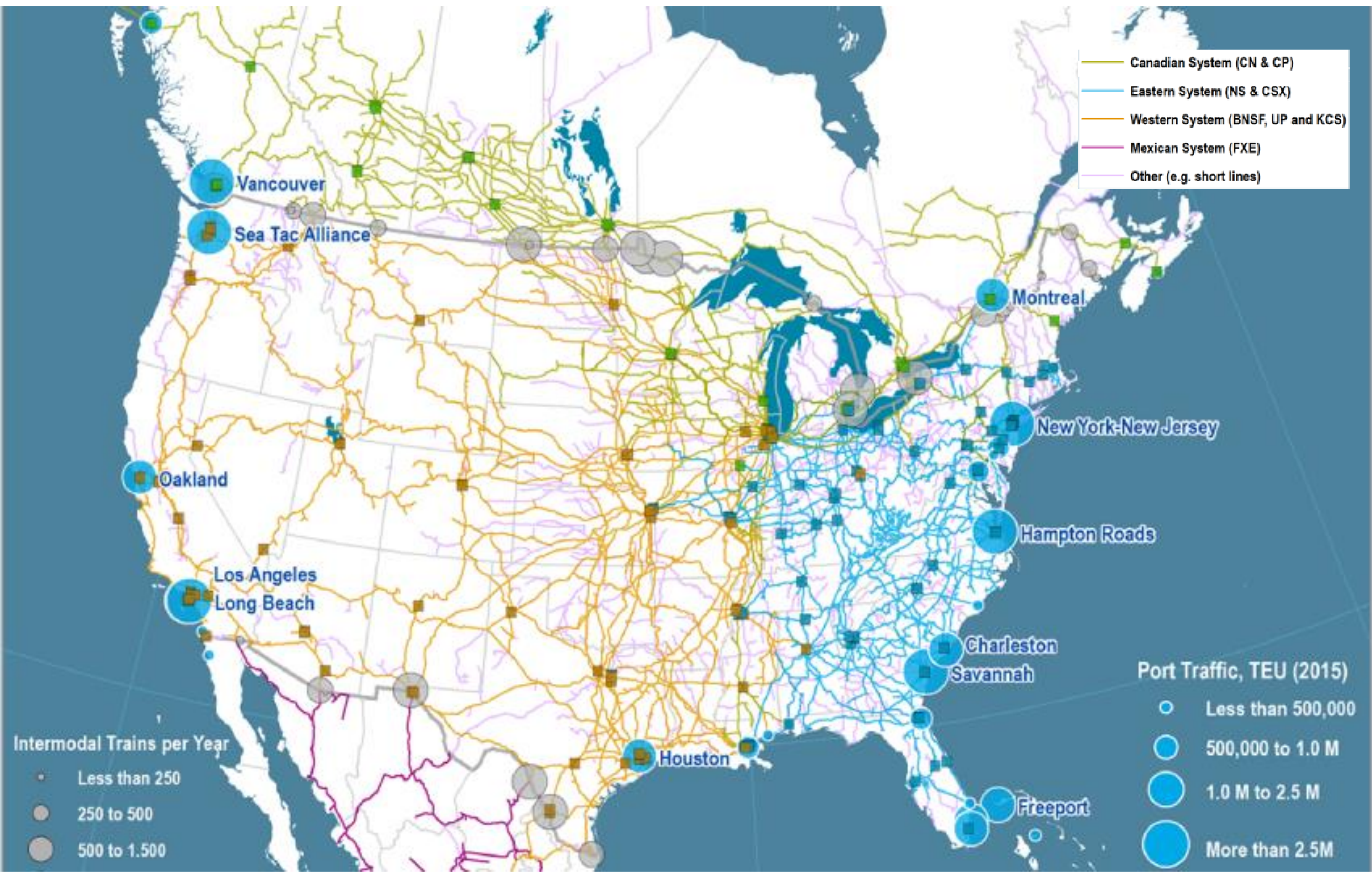

Figure 1: *A graphic illustrating the North American intermodal rail system (Source: Oak Ridge National Laboratory; American Association of Port Authorities; Hofstra University)*

Two other examples of continental infrastructure are the networks of oil and gas pipelines and the electrical power grid that bring Canadian hydrocarbon energy and hydro power to much of the American northeast and the West Coast. The rail, pipelines and electrical transmission grid have become permanent features of the continental infrastructure binding the two national economies.

In Ottawa, Canadian governments after 1867 never gave up on attempting to gain reciprocity with the United States. When Alexander Mackenzie's Liberal Party occupied the government in Ottawa for a five-year term after the Pacific Scandal in 1873, efforts were made to entice Washington into a reciprocity agreement but the protectionist Republicans would have none of it. John A. Macdonald defeated Mackenzie in 1877, and he contrived the national policy tariff on manufactured goods. He was trying to protect Canada's growing industrial base from U.S. imports, but he made it clear that Canada remained very interested in reciprocity in natural products with the United States. Since Canada did little trade with the U.S. in manufactured goods, Macdonald's offer of reciprocity would have covered most of Canadian exports to the United States anyway.

In Canada the main result of the national policy tariff was to encourage American corporations to establish branch plants in Canada, thus avoiding the tariff. This was especially true in the Canadian auto industry where the McLaughlin Motor Car Company, founded in 1907, was purchased by General Motors, but similar results could also be found in the electrical and telephone industries. At the turn of the 20th century, Massey-Harris farm implements sold into the American Midwest because they were competitively priced, advanced products. But Canadian industry was very small compared to the United States and served mostly a domestic market, for example in railway cars and engines. Canadian consumers purchased goods that were primarily built in the United Kingdom because British goods were well-made and cheap in Canada even though they were also subject to Canadian tariffs.

The Canadian effort to strengthen east-west trade north of the Canada-U.S. border was evident in other areas, such as the insistence that the Canadian Pacific Railway, completed in 1885, run to the Pacific north of the Canada-U.S. border. In essence, one of the main factors shaping Canada from the mid-19th century to now has been Canada's effort to strengthen east-west ties of culture, trade and commerce against the natural north-south pull of continental geography. Ties of migration and trade continued between the West Coast of the United States and British Columbia, not only on the coastal strip, but even in the B.C. interior where the hard rock mining industry was directly linked to the hard rock mines that could be found in the American West from Idaho to Arizona and even into Mexico. The movement of immigrants, people, ideas and goods also continued between the Plains states and the Prairies, between Ontario and the Midwest, between Quebec and the New England states and between the Atlantic Provinces with New York and New England. Tens of thousands of French Quebecers migrated to northern New York and New England in search of jobs, and names such as Benoit are ubiquitous in that part of the United States. Many thousands also fought for the north in the American Civil War.

In Canada, reciprocity, or at least lower tariffs if not downright free trade, remained popular in the Liberal Party right up to the mid-1890s. In the 1891 federal election the Liberals, led by Wilfrid Laurier, ran on a platform of a customs union with the United States. Very popular in parts of the Atlantic, western Ontario and the West, the Liberals were soundly defeated in the industrial sections of the country in Quebec and Ontario. When Laurier next led the Liberal Party into the election of 1896, there was no talk of reciprocity but instead, assurances given to Canadian manufacturers and industrial workers that the Liberals would adopt the national policy Macdonald had introduced. When Laurier was elected prime minister in 1896, some tariff concessions were made, but Laurier was enough of a realistic politician to know that it was political suicide to try to dismantle the Canadian tariff regime.

The triumph of the progressive movement in the United States at around the turn of the 20th century impacted American government thinking on tariffs. In Canada, the national government remained open to greater trade with the U.S. in natural products, while trying to shield nascent Canadian industries in fields such as textile manufacturing, rubber products and other areas. Suddenly, reciprocity was in reach. A reciprocity treaty passed the U.S. Senate at the behest of then-president William Howard Taft in 1910 and was offered to Canada. Laurier was delighted that a Canadian aspiration since 1866 appeared to be at hand. But opponents from the Canadian business community, who had built their infrastructure on east-west trade, culminating in trans-Atlantic shipment to Britain, opposed the treaty and soon convinced Conservative leader Robert Borden to defend their cause. All the nascent anti-Americanism that lay just below the surface in many sectors of the Canadian economy, even in farmers in Ontario and Quebec, swung behind the Tories who defeated the Liberals, dooming the treaty.

Ironically, just after the First World War broke out, Borden and his finance minister, Thomas White, had to travel to New York to borrow money to sustain the Canadian war effort because British funds were not available. The effort was successful but demonstrated that Canada would have to rely much more on the United States in the future than it had in the past.

The war greatly increased the flow of trade across the Canada-U.S. border, mainly with Canada shipping raw materials to sustain American munitions manufacturing. By the time the war ended in 1918, Canada-U.S. trade had grown considerably since 1914 and the United States became Canada's largest customer, again in raw materials.

The war also opened Tory eyes to the importance of the American connection when Ottawa strongly opposed the renewal of an Anglo-Japanese naval treaty that Australia and New Zealand greatly desired. Borden and his successor, Arthur Meighen, feared that renewal of that treaty would alienate the United States, which would greatly complicate the Canada-U.S. relationship. Britain dropped the treaty.

No efforts were made in the 1920s to formally enhance Canada-U.S. trade but trade between the two countries grew anyway. Again, U.S. manufactured goods came north while Canadian raw materials flowed south. U.S. investment in Canada also grew in the mining and forest sectors. The Great Depression stimulated a major growth in American protectionism, culminating in the

Smoot-Hawley tariff of 1930, which placed prohibitive rates on imports into the United States in the mistaken assumption that the Depression's causes lay primarily outside the United States. Canada, under Conservative prime minister R.B. Bennett, responded with high tariffs also and sought a freer trade agreement with Britain and the Dominions of the British Empire Commonwealth, which was only partially successful.

Figure 2: *Canadian Prime Minister R.B. Bennett visits President Franklin D. Roosevelt at the White House in 1933. (Source: Harris & Ewing Photographic Studio)*

When Franklin Roosevelt took office in 1933, the tone of the U.S. administration changed substantially. Talks began between the Roosevelt administration and the Bennett government aimed at a partial reciprocity agreement. The discussions proved fruitful, but the Americans balked at signing the agreement during Bennett's term in office. FDR did not want to boost Bennett's electoral chances and held off on signing the treaty until Mackenzie King was re-elected in 1935. King had received his graduate education in the United States and had worked as a labour relations expert for American mining interests during the First World War. He knew the United States and was far friendlier towards the great republic than Bennett had been. The 1936 Reciprocity Treaty began a trend that is still evident today in legislative efforts on both sides of the border to stimulate, rather than retard, cross-border trade. It was followed two years later by yet another reciprocity treaty that further extended the list of products in the original agreement.

During the Second World War, cross-border trade received a significant boost with Canada beginning to send large numbers of manufactured products to the United States including trucks, warships and aircraft. The Hyde Park Agreement of 1941 essentially created one Canada-U.S. manufacturing regime for munitions and weapons. By 1945 the two countries were each other's best customers despite the continuation of tariffs on a whole range of goods.

At the end of the war, Canadians had lots of money to spend after nine years of Depression and six years of war and virtually forced savings. Soldiers came home from the war to start families, raise children, and buy houses, cars, washing machines and radios from the United States. There was a run on the Canadian dollar with so much of it disappearing to the U.S. Canada proposed a free trade agreement with the U.S. which the Americans were ready to accept. But at the last minute, King vetoed the treaty for fear that it would loosen Canadian ties to the Commonwealth and bring Canada closer to the United States. His fears were misplaced (as Canada discovered after the Canada-United States Free Trade Agreement was signed in 1989), but the drive for growing Canada-U.S. trade went on anyway.

The growing together of the two economies was perhaps best symbolized by completion of the St. Lawrence Seaway in 1959 and the creation of the bi-national Seaway Authority to administer it. In the 1960s, the conclusion of a sectoral agreement in auto parts manufacturing and cars swelled Canada-U.S. trade even further as rail links, pipelines and electrical transmission lines expanded and Canadians began to invest heavily in the United States. This was followed by the Canada-U.S. FTA in 1989 and NAFTA three years later.

Today, the trade ties between the two countries have become institutionalized in hundreds of ways and have grown so strong that nothing will tear them asunder. There is a Canada-U.S. market in agricultural products, automobiles, forest products, oil, gas and hydroelectric power, and in dozens of service industries. Canadians are heavily invested in the United States, especially in the banking and securities sector while U.S. investment in Canada remains strong. The ties are deeply rooted and well established, create millions of jobs on both sides of the border, and will continue whether or not there is a NAFTA or a Canada-U.S. free trade agreement. Trying to sunder Canada-U.S. trade would be like taking a chain saw to separate Siamese twins.

So what will happen if current NAFTA talks fail? Current levels of trade will continue in almost all major sectors although the political and litigious barriers to the free flow of trade will rise. It is also probable that consumer and producer groups in the United States will quickly grow tired of politicians and bureaucrats interfering in questions of economic convenience. Canadian exporters will work with U.S. consumer groups to fight disruptions of cross-border trade and U.S. producers who work harmoniously with their Canadian counterparts in, for example, the food and cattle industries, will raise hell with efforts to hive off the U.S. market from both Canadian and Mexican farmers. American home buyers will balk at paying protected prices for the lumber to build their homes and the auto industry will strongly resist any effort to interfere with well-established, tri-national, value chains. Governors of the more than 30 states whose main customer is Canada will complain, as will U.S. trade associations. Of the top 10 states in the Canada-U.S. trade, eight gave their electoral votes in the 2016 presidential election to Donald Trump. Mayors of cities whose major source of trade and investment is Canada will complain also. It is not that Canada has "friends" in the United States; it is that Americans have national interests in continuing trade and investment between Canada and the U.S. as freely as possible.

NAFTA works well but needs updating and improvement. However, from the Canadian point of view, the search for access to U.S. markets, which goes back at least to the 1840s, is as Canadian as hockey and will continue no matter which brand of politicians may temporarily rule in Washington. Water will always flow downhill from the simple fact of gravity; trade in goods and services between Canada and the United States has become too well established over the past 170 years to be dammed up now. Americans themselves will be Canada's partners in re-establishing NAFTA, or the Canada-U.S. free trade agreement, no matter what that new agreement is eventually called.

About the Author

Dr. David J. Bercuson *is Director of the Centre for Military, Security and Strategic Studies at the University of Calgary, Area Director, International Policy for the School of Public Policy, University of Calgary and Program Director and Fellow, Canadian Global Affairs Institute.*

Canadian Global Affairs Institute

The Canadian Global Affairs Institute focuses on the entire range of Canada's international relations in all its forms including (in partnership with the University of Calgary's School of Public Policy), trade investment and international capacity building. Successor to the Canadian Defence and Foreign Affairs Institute (CDFAI, which was established in 2001), the Institute works to inform Canadians about the importance of having a respected and influential voice in those parts of the globe where Canada has significant interests due to trade and investment, origins of Canada's population, geographic security (and especially security of North America in conjunction with the United States), social development, or the peace and freedom of allied nations. The Institute aims to demonstrate to Canadians the importance of comprehensive foreign, defence and trade policies which both express our values and represent our interests.

The Institute was created to bridge the gap between what Canadians need to know about Canadian international activities and what they do know. Historically Canadians have tended to look abroad out of a search for markets because Canada depends heavily on foreign trade. In the modern post-Cold War world, however, global security and stability have become the bedrocks of global commerce and the free movement of people, goods and ideas across international boundaries. Canada has striven to open the world since the 1930s and was a driving factor behind the adoption of the main structures which underpin globalization such as the International Monetary Fund, the World Bank, the World Trade Organization and emerging free trade networks connecting dozens of international economies. The Canadian Global Affairs Institute recognizes Canada's contribution to a globalized world and aims to inform Canadians about Canada's role in that process and the connection between globalization and security.

In all its activities the Institute is a charitable, non-partisan, non-advocacy organization that provides a platform for a variety of viewpoints. It is supported financially by the contributions of individuals, foundations, and corporations. Conclusions or opinions expressed in Institute publications and programs are those of the author(s) and do not necessarily reflect the views of Institute staff, fellows, directors, advisors or any individuals or organizations that provide financial support to, or collaborate with, the Institute.