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SHIFTING PATTERNS OF TRADE AND INVESTMENT

Not long ago, an American sociologist who has made a particular study of Canadian affairs expressed the opinion that Canada was the one subject on which no American should ever make a public statement.

His reasons for taking this position, the professor explained, were twofold: first, that any American who pontificates about Canada runs an unacceptably high risk of error; and, second, that he runs an even higher risk of being torn to shreds by Canadian critics.

I am inclined to accept the professor's dictum -- both halves of it!

I suppose that if there is one subject upon which it is even more dangerous for an American to hold forth to Canadians than Canada itself, it is the state of Canadian-American relations. Nonetheless, throwing a banker's proper caution to the winds, I propose today to rush in where angels fear to tread.

For the time has come, I strongly believe, for Canadians and Americans alike to conduct a thoughtful re-examination of the relations between our countries and, most particularly, of our economic relations.

In recent years, we Americans have become increasingly aware of differences in policy, outlook and national character between Canada and the United States.

Both the existence of those differences and the increased American comprehension of them are healthy phenomena. To my mind, the presence of a staunchly independent neighbor to the north is of inestimable value to the United States. It gives us the benefit of a viewpoint on world affairs similar enough to our own to be intelligible, yet objective enough to oblige us to think again when it does not coincide with our position. I am even disposed to think that on some of the occasions when U.S. and Canadian foreign policy have diverged, Canada's behavior has helped to compensate for U.S. errors in judgment.

But in their absorption with their natural and sometimes productive differences, Americans and Canadians must not lose sight of the essential fact that governs relations between their countries. That fact is that Canada and the United States are inextricably linked by common interests and common problems.

If proof of this statement is needed, we have only to look at two issues which today loom large in the minds of businessmen and politicians on both sides of the border. I am referring to the question of U.S. investment in Canada and to the situation both countries face in their attempts to expand their world trade. These two questions are, of course, interrelated, but let me begin with the issue of trade expansion.

Both Canada and the U.S. have extended their foreign trade remarkably in recent years, not only between themselves but with the world at large. That is a gratifying fact. But along with it must go the sobering realization that the economic health of both countries demands that this rate of growth continue and, if possible, be increased. Yet, more and more, the U.S. and Canada find themselves "odd men out" in dealings with the other great trading nations.

The reason for this is the world trend toward development of trade blocs -- groups of nations committed to exchanging goods with each other on terms more favorable than those they grant outsiders. In little more than a decade we have seen the emergence of the European Common Market, the European Free Trade Area, the Central American Common Market and the Latin American Free Trade Area. Members of these blocs alone now account for slightly more than 50 per cent of total world trade. And other, similar blocs are in various stages of planning or development in Asia and Africa.

So far, the emergence of the great trading blocs has, on balance, contributed to the growth of world trade. But, naturally enough, the prime concern of these blocs is with the economic welfare of their own members. It seems inevitable, moreover, that, as a general proposition, trade between the members of a given bloc will grow at a faster rate than their trade with outsiders. That, after all, is one of the purposes of forming a trade bloc.

In any case, the growing importance of trade blocs has already narrowed the scope of multilateral tariff reductions. Events of recent years have clearly demonstrated that the General Agreement on Tariffs and Trade, more familiarly known as GATT, is not sufficient to reverse this trend. Already, Canadian and U.S. trade negotiators, instead of bargaining separately with representatives of each of the six Common Market nations, find themselves facing a joint Common Market negotiating team. And, informally, some of the other blocs have begun to present a common front in trade negotiations, too. The significance of this seems to me inescapable. It means that, regardless of the outcome of what has come to be called the Kennedy Round -- and the prognosis for those negotiations is still unclear -- Canada and the U.S. will not be able to expand their trade outside North America as rapidly in the future as they have in the

past. Or, more precisely, they will not be able to do so if they continue to rely exclusively on the multilateral approach to tariff reduction.

Under these circumstances, it seems to me, any logical man is inexorably driven to ask himself this question: Should not Canada and the U.S. move toward establishment of a Free Trade Area of their own. I am aware that this is far from a new idea -- that it is, in fact, in one form or another, more than a century old. I am aware, too -- although I must hasten to disavow any claim to expert knowledge of Canadian history or politics -- that it was espousal of a reciprocal trade agreement with the United States which led to Sir Wilfrid Laurier's downfall in 1911, and that to this day many Canadians find the idea of any closer economic association with my country disturbing.

But I submit that the fact that able men have dreamed of free trade between Canada and the U.S. for more than a hundred years indicates the vitality of the concept. I would also suggest that nothing could be more sterile than to rehash the traditional arguments for and against free trade between our countries. We must, instead, consider the desirability of a Canadian-American Free Trade Area in the context of the 1960s and 70s rather than in the context of the 1860s or 1911.

You will notice that I have consistently spoken of a Free Trade Area rather than a customs union. I have done so for many reasons, one of which was reflected in a speech my good friend and your distinguished Minister of Trade, Robert Winters, delivered in New York last Fall.

"We Canadians," said Mr. Winters, "find, in our wider relations with the world as a whole, the counter-weight and perspective we need in order to exist next to the most powerful nation on earth."

One of the advantages of a Free Trade Area is that it would not be as restrictive as a customs union and would thus allow both Canada and the U.S. to pursue the wider relations of which Mr. Winters spoke. It would, for example, permit Canada to maintain her Commonwealth preference agreements. And it could -- and should -- be an open-ended arrangement. In time, a Canadian-American Free Trade Area might be extended to include Mexico, thus creating a truly North American market. It also seems to me conceivable that if the United Kingdom is unsuccessful in its current effort to join the European Common Market, the British Government, too, might ultimately find membership in a Canadian-American Free Trade Area attractive.

All of this, however, would be in the future. In immediate terms, the all-important question to ask is this: What effect would it have on the economies of Canada and the U.S.?

Here, the best guidepost we have is provided by the automotive trade agreement of 1965. You are all, I am sure, familiar with the results of that agreement in general terms, but it might be useful to look at the precise figures again. Canadian auto exports to the United States have risen roughly fourfold from their \$166 million level in 1965, while total U.S. auto-related exports to Canada also increased substantially from their much higher base. Preliminary estimates indicate a net balance-of-trade effect of some \$200 million in Canada's favor, reducing Canada's automotive trade deficit with the United States from \$720 million in 1965 to about \$500 million last year. In other words, the result has been a considerable two-way expansion of trade, with Canadian exports rising sharply, and this has opened up new job opportunities for Canadian workers.

The automotive trade agreement, in fact, has been so advantageous to Canada that it has gravely embarrassed opponents of free trade between our countries. Some of them have even fallen back upon the argument that the automotive industry represents a unique case. But, of course, it does not. There are several manufacturing industries in Canada -- among them rubber goods, drugs, chemicals and electrical goods -- which operate under conditions similar to those which gave rise to the automotive trade pact. These are industries in which there is heavy American investment and which would stand to gain dramatically from longer production runs.

Those who deny the feasibility or desirability of free trade between the U.S. and Canada overlook the degree to which trade between the two countries is already free. In dollar value, more than half the goods which cross the border do so without paying duty. The impact which this can have on a Canadian industry is strikingly visible in the field of agricultural machinery. There, thanks to the absence of tariff, large and efficient Canadian plants operate with great success on a continental basis.

The truth is that, even where tariff barriers apply, Canadian industry has significantly increased its penetration of the U.S. market. Three-quarters of Canada's industrial exports -- which have been increasing at the rate of 16 per cent a year since 1959 -- now go to the U.S. And where such exports accounted for only one-eighth of Canada's total U.S. shipments in 1958, they now account for nearly one-third.

This is scarcely surprising. For, inherently, Canadian industry is far more competitive with U.S. industry than is often believed. In view of this, why hasn't Canadian industry grown far faster than it has? The answer which most economists offer to that question was restated recently by your Finance Minister, Mitchell Sharp.

"The competitive weakness of many Canadian industries," Mr. Sharp said, "is due not to bad management, outdated techniques or inadequate equipment. Where weakness exists, it can most often be traced to an inadequate scale of production."

Or, to put it another way, to the fact that existing tariff structures deny the majority of Canadian manufacturers access to the 200 million consumers of the United States. A basic economic need of Canada is a broader market that would encourage greater specialization and an increase in the scale of production.

I am not suggesting that free trade would provide an automatic remedy for all the problems of Canadian industry. I certainly do not suggest that it could be accomplished without careful planning and even some economic dislocation. To survive without benefit of tariff, a considerable number of Canadian industries would have to move from high cost production of a full line of goods to lower cost production of a few selected items for the entire North American market. A certain number of U.S. industries, too, would be hard hit by the loss of the relative monopoly position they have enjoyed within the American market because of tariff protection.

Clearly, then, the transition to free trade would have to be gradual. Moreover, extreme care would have to be taken to ensure that undue hardship was not inflicted upon producers in either country. But, as the experience of the European Free Trade Association has demonstrated, it is entirely possible to work out satisfactory formulae for such a transition. Perhaps, because free trade would obviously have a greater impact upon Canadian industry than upon U.S. industry, a longer transitional period might be accorded Canadian manufacturers. Perhaps, too, the first move toward free trade might simply be to establish arrangements similar to the automotive trade agreement in some of the other similarly situated industries which I cited a few moments ago.

There are, of course, people who argue that more such bilateral agreements are the only practical steps that can be taken at this time, and that any general commitment to free trade between the U.S. and Canada must be avoided at all costs. Still others espouse attempts to win Canadian industry greater access to U.S. markets by the indirect device of multinational tariff reductions. But I myself see no halfway house which would be nearly as effective as a Free Trade Area in promoting the economic goals which both Canada and the U.S. pursue -- namely, a rapid expansion of foreign trade, a general increase in business activity and a higher standard of living for their citizens.

A Canadian-American Free Trade Area would, of course, be unworkable without free movement of capital between the two countries. But so, indeed, would any healthy economic relationship including the one we now enjoy.

Free movement of capital has played a vital role in the development of North America. The United States right up through the 19th century relied heavily on European capital to finance its growth. Nowadays, of course, Canadian capital plays its role in the U.S. economy. Such firms as Massey-Ferguson, MacMillan and Bloedel, the Moore Corporation and the various enterprises controlled by Garfield Weston have made a dynamic contribution to the U.S. economy.

But it is, of course, the huge U.S. investment in Canada which gets paramount attention in any public discussion of North American capital movements. Even in the quiet confines of Chase Manhattan Plaza, it has not escaped our notice that much of the attention paid to U.S. direct investment by Canadians is highly critical.

Most of this criticism comes from men of good will and good sense. These men, as I understand it, do not deny the contribution which U.S. investment has made to Canada's development in the past nor do they deny the need for some

continuation of U.S. investment. But they do feel strongly that it is not healthy for a nation so highly developed as Canada to have roughly half of its industrial capacity controlled by citizens of another nation. Specifically, I gather, their prime concern is that Canadian subsidiaries of U.S. companies are not fully responsive to the political and economic policies of the Canadian government and that, as a result, Canada's independent identity is threatened.

Few Americans would dismiss these arguments out of hand. We recognize that they are founded not on irrational dislike for the U.S. but on an understandable pride in Canada and concern for its future. Nonetheless, on the basis of my own understanding of the role U.S. investment plays in Canada, I would appraise the situation somewhat differently.

In a publication doubtless familiar to many of you called Economic Goals for Canada to 1970, the Economic Council of Canada has made a detailed analysis of Canadian capital requirements. The Council estimates that, if your country is to maintain an annual growth rate of 5.5 per cent in real gross national product, it will have to find investment capital amounting to nearly \$17 billion a year by 1970. With the avowed purpose of achieving the maximum possible Canadian ownership of industry, your government is trying to insure that as much of this capital as possible is obtained from Canadian sources, both private and public. This is a laudable and necessary effort. But even its most ardent advocates merely hope that this program will reduce somewhat Canada's traditional dependence on foreign capital; they do not for a moment suggest that the capital requirements projected by the Economic Council can be met by Canadian sources alone.

Yet, despite this, men of responsibility and influence in your country continue to call for restrictions on U.S. investment and U.S. investors in Canada.

Whenever I hear of such proposals I am reminded of an observation once made by Prof. James Eayrs of the University of Toronto. It is, wrote Prof. Eayrs, "a characteristic attitude of relatively mature societies [that] the makers of public policy, and the public itself, know enough about economic life to appreciate two of its basic facts: that there can be no development without capital from somewhere, and that capital from almost anywhere is scarce."

Since I assume that those Canadians who advocate various hobbles on U.S. investment understand the importance of the two propositions cited by Prof. Eayrs, I can only conclude that they believe that U.S. investment will continue to flow into Canada in adequate quantities regardless of restrictions. Yet that seems to me a highly arguable assumption. Put yourself, for a moment, in the position of the U.S. businessman with capital to invest abroad. Canada, for all its traditional attractions, is only one of many areas holding out the promise of profitable operation. The expanding markets of Europe are extraordinarily tempting. The possibilities offered by such rapidly expanding nations as Australia, Korea and Taiwan are manifold.

There are some Canadians who argue that a relative diminution in United States investment in Canada might be a good thing. They are, I believe, mistaken. As the Economic Council of Canada has pointed out: "Policies calculated to create a more insulated and isolated economy will not, and cannot point the way . . . to high economic performance in this country." Such policies would mean higher prices, less demand for labor, less exchange of technology with the United States, and slower economic growth.

Historically, restrictionism on the part of one nation tends to beget restrictionism in others. My good friend Earle McLaughlin of the Royal Bank of Canada has already expressed concern that this could prove true in my own industry as a

result of the Mercantile Bank of Canada case. I can think of few prospects more dismal for both Canada and the United States than indulgence in a game of economic tit for tat.

What is more, there is no real reason why such a game should ever begin. For, in my opinion, those who wish to restrict the free exchange of goods and capital between our countries have -- however sincerely -- misinterpreted the available facts.

One economic argument often invoked to justify restrictionism is that Canada regularly runs a large deficit in its trade with the United States. When that argument is countered with the reminder that U.S. investment in Canada offsets much of the trade deficit, the restrictionists respond that the cost of servicing the U.S. investment is an onerous burden upon the Canadian economy. That would be a powerful argument if it were true -- but it is not. The fact is that, today, payments abroad for interest and dividends represent less than 10 per cent of Canada's foreign exchange earnings on current account, whereas in the 1930's the figure was 25 per cent. Relatively speaking, in other words, the cost to Canada of the foreign capital which it imports has been steadily declining.

Another argument often made by the restrictionists also seems to me to be based on a misreading of the evidence. This is the notion that any great degree of economic interdependence between our countries will somehow impair Canada's political independence. Certainly, establishment of a Free Trade Area need not have that effect. Trade dependence does not lead inevitably to political union. If that were so, the U.S. and Canada would long since have been united. One need only recall the lack of political co-ordination among members of the European Free Trade Association -- or, for that matter, among members of the European Common Market.

As for the contention that U.S. investment in Canada somehow poses a threat to this country's separate character or political freedom of action, I see no real indication that this is the case. I will concede that there may be a direct correlation between the size of U.S. investment in Canada and the manner in which Canadian statesmen regard the U.S. But, if so, the rule would seem to be: the greater U.S. investment grows, the greater the tendency of Canadian statesmen to pull Uncle Sam's whiskers.

More seriously, most of the Canadian economists with whom I am familiar agree that the criticisms so frequently made of the behavior of U.S. subsidiaries in Canada are, for the most part, either unproven or misinformed. It has been my observation that the great majority of such companies have worked in the past fifteen years for a true Canadian identity and have gladly accepted the guidance of the Canadian government in this respect. Specifically, the notion that U.S. affiliates do not contribute sufficiently to Canada's export drive founders on one fact: they account for over 40% of all Canadian exports to the U.S. and almost 40% of total Canadian exports to third countries. Another often-raised specter -- the danger that U.S. subsidiaries will feel obliged to adhere to U.S. anti-trust laws and our Trading with the Enemy Act -- has assumed reality in only a very few cases. The solution to that problem surely lies in political negotiations between Ottawa and Washington, not in a crackdown on U.S. investment.

Not long ago, Prime Minister Pearson said: "I believe that there is still a distinctively Canadian contribution to be made in the world." I accept that wholeheartedly, just as I accept that there is still a distinctively American contribution to be made in the world. It is precisely because I desire to see both our countries make their distinctive contributions as fully and effectively as possible that I lay so much emphasis on the unrestricted movement of goods and capital between Canada and the U.S. Such interdependence, I believe, would

strengthen the economic sinews of the U.S., and better enable my country to discharge its immense obligations to its allies and to the emerging nations. For your country, it would mean a dramatic increase in economic potential, which, inevitably, would enhance Canada's international influence.

Given the degree to which nature and recent history have bound Canada and the United States together, I doubt that there will ever again be a time when mutual aloofness will be a practicable relationship between us. Certainly that time is not now at a moment in history when we both find ourselves being left out of one world bloc after another. At such a moment, rather than trying to find ways to disengage from each other, it would seem only prudent for us to spend more time considering how we can work together more effectively for our common benefit.

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