THE AUTO PACT: FORERUNNER OF FREE TRADE

Michael Hart

In January 1965, Prime Minister Lester B. Pearson flew to the LBJ Ranch in Texas to sign the Canada-US Auto Pact with President Lyndon B. Johnson. The Auto Pact enabled the free export of automobiles from one country to the other, which would become the motor of the Canadian economy, and the forerunner of the Free Trade Agreement. The negotiation of the Auto Pact equally foretold the passionate debate that would be unleashed a generation later. In this exclusive excerpt from his new book, A Trading Nation*, published by UBC Press, Michael Hart tells the compelling story of one of the most important trade policy agreements of the 20th century. The author was himself a senior member of the Canadian negotiating team in the free trade talks of 1986-87, and is now Simon Reisman Professor at the Norman Paterson School of International Affairs at Carleton University in Ottawa.*

En janvier 1965, le Premier ministre du Canada Lester B. Pearson s'envolait à destination du Texas pour signer le Pacte canado-américain de l'automobile au ranch du président américain Lyndon B. Johnson. En libéralisant l'exportation des véhicules automobiles entre nos deux pays, cette entente allait devenir le moteur de l'économie canadienne, préfigurant l'Accord de libre-échange (ALE). La négociation du Pacte de l'auto aura de même anticipé le débat passionné auquel l'ALE donnerait lieu une génération plus tard. Dans ce passage exclusif du dernier ouvrage de Michael Hart, intitulé A Trading Nation *et publié chez UBC Press, nous découvrons l'étonnante histoire d'une entente commerciale figurant parmi les plus importantes du XX*e *siècle. Lui-même un membre clé de l'équipe de négociation canadienne lors des discussions sur le libre-échange de 1986-1987, l'auteur enseigne aujourd'hui à la chaire Simon Reisman de la Norman Paterson School of International Affairs de l'Université Carleton à Ottawa.*

Policy efforts to improve Canada's competitive position in the auto industry provided a litmus test of the Pearson government's efforts to build better relations with President John F. Kennedy. By the end of 1963, however, Kennedy had been swept away by the tragedy of Dallas. The automotive negotiations took place with the Johnson administration and plumbed whether the Kennedy glow would last. The negotiations also provided a further reminder of the limits of economic nationalism, with Walter Gordon brooding over the negotiation of an agreement that would further consolidate the continental integration of one of the largest industrial sectors in Canada. The circumstances leading to the Auto Pact provide a textbook example of the impact of both US and Canadian trade and industrial policy on investment and production patterns in Canada.

The Auto Pact's origin lay in attempts to address the weak competitive position of the Canadian automotive industry, which flowed from a variety of factors including technological developments, the revival of the European industries, the weakening benefits of traditional links to British and Commonwealth markets, and the structure of the Canadian industry. Investment in Canadian automotive production had followed classic import-substitution patterns. Canadian entrepreneurs, such as the McLaughlin family in Oshawa, had started by building cars under licence from American firms. The consolidation of a number of smaller firms in the United States into General Motors in the 1920s had swept the Canadian operations into the larger firm, and the new parent company had continued to invest in Canadian production. Ford had made similar inroads in Canada, as had Chrysler and some of the smaller and more specialized producers of trucks. Given the high tariff walls of the 1920s and 1930s, it had made sense to assemble cars and trucks for the Canadian market in Canada. The preferences available on Canadian-assembled cars and trucks in the United Kingdom, Australia, and other Commonwealth countries had provided the basis for a respectable export trade. In the years 1931-34, for example, Canada had exported 27.6 percent of its domestic automotive production.

The war had brought that trade to an end as automotive production facilities were converted to meet wartime needs. When these plants returned to normal peacetime production after 1945, they enjoyed boom times keeping up with burgeoning domestic demand. Little attention needed to be paid to exports in the postwar economy. There was at best a limited market in Europe for the large, gas-guzzling family saloons favoured in both Canada and the United States. More importantly, the major auto assemblers now preferred to meet demand in Europe, South Africa and Australia with branch-plant operations producing vehicles designed for those markets. As a result, the Canadian production facilities concentrated on producing a narrow range of vehicles for the Canadian market, satisfying the rest of demand with US imports.

By the 1960s, the North American automobile industry, in the words of Paul Wonnacott, "was a comfortable oligopoly." It was an oligopoly, however, that brought more comfort to Americans than Canadians. As a result of the established pattern of protection, Canadians paid considerably more for cars than did Americans and had to choose from among a narrower range of vehicles. In addition, Canadian workers earned about 30 percent less than their US counterparts. When the costs of the excise tax, the manufacturers' sales tax and the extra costs of Canada's less efficient distribution system were added, Canadians often paid as much as 50 percent more than Americans did for the same car. It is little wonder, therefore, that Canadian consumption of vehicles was a third less on a per capita basis than that of Americans. It is also not surprising that by the end of the 1950s Canadians were turning to cheaper imports, principally from the United Kingdom, Germany and Japan. In 1960, 28.1 percent of the sales of new vehicles in Canada represented imports, compared to 7.6 percent in the United States. Prospects for the Canadian industry did not look promising: unemployment in the automotive industry was rising, as were costs.

To address the competitiveness gap, the Diefenbaker government in 1960 appointed economist Vincent Bladen, dean of the Faculty of Arts and Sciences at the University of Toronto, to investigate the Canadian automotive industry and compare its structure and competitiveness to those of other countries. Following an exhaustive inquiry, Bladen found that only GM was making a modest profit in Canada. He concluded that short, fragmented production runs were the principal reason for the inefficiency of the Canadian industry. He recommended, among other things, that the government adjust protection in Canada to reward firms prepared to export by letting them count their export sales as part of their domestic production base, thus allowing them to import more parts on a duty-free basis. Bladen suggested, in addition, that cars imported by Canadian producers qualify for duty-free entry as long as the minimum Canadian production levels were maintained. With these conclusions, Bladen indicated that the future of the industry lay in narrowing its lines of production and increasing its exports. The means for achieving this objective lay in the more efficient deployment of the Canadian tariff.

Prime Minister Lester B. Pearson and President Lyndon B. Johnson sign the Auto Pact at the LBJ Ranch in January 1965, as External Affairs Minister Paul Martin and Secretary of State Dean Rusk look on.

By specializing and increasing production for export, Canadian-based firms would be able to come closer to achieving economies of scale. Contemporary studies of scale in the industry indicated that firms producing at levels below 300,000 units per year were operating under a severe handicap and that the benefits of economies of scale would continue to rise up to a level of 600,000 units per year. In 1960, General Motors, the largest producer in Canada, manufactured a total of 175,086 passenger cars in Canada. Total Canadian production that year by the Big Three only reached 379,083 vehicles, barely enough even if production were consolidated into a single plant to reap some benefits of economies of scale. The answer to the competitiveness problem of the Canadian industry obviously lay in producing more cars and trucks for export.

The Conservatives did not adopt the specifics of the Bladen plan, but instead decided to take the thrust of his recommendations and use the instruments at the government's disposal to encourage increased production in Canada for export. On 31 October 1962, the government reimposed the suspended 25 percent duty on automatic transmissions but provided that manufacturers could recoup the costs of this tariff, as well as the tariff on imports of engine blocks, by increasing exports of parts above base levels established in the year ending 31 October. A year later, the Liberals broadened the program to provide for the full remission of duties on imports of vehicles and parts based on increased levels of production in Canada. For every dollar of production added in Canada beyond the base levels achieved the previous year, producers could import a dollar of parts and vehicles free of duty. Canada had gone about as far as it could go within the parameters of existing trade and production patterns and the structure of Canadian and US protection. If producers responded to these incentives and increased production in Canada through exports, the cost structure in

Canada might come down to more competitive levels, benefiting both producers and consumers.

Discussion of Canada's various policy approaches had already figured prominently on the agenda of the September 1963 and April 1964 meetings of the Joint Canada-US Committee on Trade and Economic Affairs, with US officials expressing alarm about Canada's approach. The plan, however, was never given an opportunity to prove itself. In May, acting on a complaint from the Modine Manufacturing Company of Racine, Wisconsin, US authorities began an investigation into whether or not the Canadian scheme constituted a bounty or grant within the meaning of section 303 of the Smoot-Hawley Tariff Act of 1930. Should the Modine complaint be upheld, and the odds favoured that it would, Canadian producers exporting to the United States would face not only the US tariff, but also a countervailing duty fully offsetting the benefits of the Canadian duty remission scheme. As a result, no industrial restructuring was likely to take place and Canadians would continue to pay a high premium for production in Canada.

Walter Gordon was furious, as were his officials, if not for the same reason. Gordon's shouts down the telephone line to Treasury Secretary Douglas Dillon, however, proved to little avail. Nevertheless, to head off such a provocative development, President Johnson and Prime Minister Pearson agreed that officials should try to work out a mutually acceptable solution. Exemptionalism would be given a further test. Favouring the successful negotiation of an alternative plan was the fact that virtually all vehicle production and a significant share of parts production in Canada took place in wholly owned US subsidiaries. Over the years these US firms had made large investments in Canada and were well disposed to any plan that would allow them to make better use of these facilities, reducing their costs and raising the prospect of increased sales in Canada.

Throughout the summer and fall of 1964, teams of US and Canadian officials worked furiously at out-of-the-way places like the Seigniory Club in Montebello, Quebec, to find the basis for a mutually satisfactory solution. Anxious cabinet discussions weighed the pros and cons of various approaches, with Walter Gordon agonizing over yet a further increase in US control of the commanding heights of the Canadian economy. By the end of the year, they had succeeded, and in January 1965, Prime Minister Pearson, accompanied by Secretary of State for External Affairs Paul Martin, flew to the Johnson ranch in Texas to sign the Canada-US Automotive Products Agreement. Finance Minister Gordon, whose officials had been key to the success of the negotiations, regarded the agreement with mixed emotions. Although he recognized the need for a solution to the problem Canada faced in trying to increase the productivity and long-term viability of its automotive industry, he regretted that the solution lay in an agreement that would further consolidate the position of the major US firms in Canada.

The solution enshrined in the agreement proved deceptively simple. Canada and the United States entered into a unique sectoral arrangement so structured as to meet the competing objectives of the two countries. On the US side, the objective was to clear the way for the Big Three to rationalize their production in North America. For Canada, the goal was to ensure continued Canadian participation in that rationalization. In the words of the agreement, it would enable "the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries."

The result was an agreement with asymmetrical obligations. Canada agreed to make its protection more efficient, and the United States agreed to exempt Canadian-origin parts and vehicles from its protection. On the US side, original equipment parts and vehicles produced in Canada were granted duty-free entry provided they met a minimum level of Canadian and/or US value-added. On the Canadian side, qualified firms could import original equipment parts and vehicles from anywhere in the world provided they maintained at least a 75 percent ratio of Canadian production of vehicles to their Canadian sales of vehicles and ensured that vehicles produced in Canada maintained a level of Canadian content, measured in dollar terms, equivalent to the level attained during the 1964 model year.

In typical Canadian fashion, however, Canada was not confident that the agreement alone would be sufficient to ensure restructuring of the industry on a basis favourable to Canada. As a result, the government sought letters from the Big Three producers in which they agreed to increase the level of Canadian value added on a continuous basis. In addition to a minimum growth commitment, the firms agreed they would continuously augment the value of Canadian production by at least 60 percent of the value in the growth in Canadian sales. US officials considered the safeguards, both those in the agreement and those contained in the industry letters, to be temporary transitional measures but failed to write this stipulation into the agreement. A three-year review provision might have provided a basis for their elimination, but Canada successfully maintained that they continued to be necessary. As a result, the safeguards stayed in place. This was managed free trade. As Tom Kent, the PM's senior policy adviser, saw it: "Far from abandoning the role of government intervention in the market, the Auto Pact used it to induce the industry to structure its production in a way more beneficial to Canada both than it had under the old tariff regime and than it would have done in an integrated 'free' market."

The agreement successfully passed the hurdle of US Senate consent in 1965, although not without some concern being expressed about its impact on US employment. The United States also succeeded in gaining a waiver in the GATT allowing it to introduce preferential treatment in favour of Canada. The structure of the industry and of international trade in 1965 was still such that producers in Japan and Europe did not raise alarms at this clear contravention of GATT's principle of nondiscrimination. Canada claimed that its obligations were being implemented on a nondiscriminatory basis, a claim that other GATT members did not challenge.

From a Canadian perspective, the Auto Pact marked a huge achievement and seemed a clear vindication of the policy of exemptionalism. Canadian negotiators had successfully appealed to US geopolitical instincts and negotiated an agreement that clearly favoured Canadian objectives. President Johnson was not far off the mark when he told Canadian ambassador Charles Ritchie, "You screwed us on the Auto Pact." It guaranteed for Canada a clear share of the production of one of North America's most important industries. Its backward and forward linkages were of such critical importance that they soon became the mainstay of the Ontario economy. By 1980 the Auto Pact was directly responsible for more than 100,000 jobs and at least as many more in upstream and downstream industries. The traditional Canadian deficit in automotive trade was gradually wiped out and replaced by a consistent surplus. By 1970, Canada enjoyed a merchandise trade surplus with the United States. In 1966, Canada enjoyed a global merchandise trade surplus; by 1970 this had reached $2 billion. The gap between the cost of North American cars to Canadian and American consumers disappeared and, in some years, exchange rate fluctuations could lead to Canadians paying less for an identical car. The available choice was identical.

Not all Canadians were prepared to congratulate the government on its sagacity in negotiating the Auto Pact. Indeed, Canadian members of the United Auto Workers union (UAW) were not at all clear that they would benefit and, in the usual bleat of organized labour, preferred the devil they knew to the one they didn't. Walter Reuther, the US head of the UAW, however, was satisfied and in 1965 that was what counted. Canadian managers of the Big Three were similarly ambivalent, fearing that integration would eliminate what little autonomy they had. Only Ford Canada president Karl Scott expressed unreserved support. But for once, in the words of historian Robert Bothwell, "The law of unintended consequences operated strongly in Canada's favor." The agreement was a huge success and even the Canadian Auto Workers, nationalist successor to the Canadian arm of the UAW, convinced itself that it had always favoured the agreement. On the agreement's twentieth anniversary, General Motors CEO Roger Smith could tell the American Parts Manufacturers' Association that the agreement "is assuredly the most successful trade policy in the history of our industry. And despite some shortcomings, it remains—in my mind at least—an excellent example of a rational and responsible way to resolve thorny trade issues between nations."

The success of the Auto Pact as industrial policy led the Canadian government to use its duty remission technique as the basis for granting Auto Pact status to a growing number of specialty vehicle producers. The technique became popular in other industrial sectors and was used repeatedly in the 1980s to lure Japanese automotive investment to Canada. These so-called transplant firms did not gain Auto Pact status, but Canada did grant them a variety of incentives, including duty remission programs, to convince them to locate some of their North American production facilities in Canada. From a trade policy point of view, the Auto Pact was the crowning achievement of the 1960s, far outstripping any Canadian gains from simultaneous GATT negotiations.

The principal architect of the Auto Pact, Simon Reisman, had been part of the Canadian team in Geneva and Havana negotiating the GATT and ITO. He had continued to play an influential role in Canadian trade policy developments as director of Finance's International Economic Relations Division. He had been seconded to the Gordon Commission in 1956 as one of its directors of research and had co-authored or directed the commission's trade policy studies. By 1964 Reisman was the deputy minister of the Department of Industry and from that perch concluded that multilateralism was good but concrete results were better. Among the influences leading him toward the negotiation of a bilateral Canada-US sectoral trade agreement were the difficulties Canada had faced in GATT negotiations, first during the Dillon Round and again during the Kennedy Round. In both negotiations Canada had learned that its most immediate needs, better and more secure access to the large market to the south, could not be easily reconciled with the multilateral framework. US willingness to make concessions to Canada was hemmed in by the MFN rule requiring that any such concessions had to be shared with the Europeans and the Japanese. Congress was not ready to make such concessions. The Auto Pact, on the other hand, although it occasioned some grumbling in the US Senate, garnered sufficient support to provide Canada with the kind of access it needed to encourage a more efficient and rewarding use of North American resources. There was a lesson here that would continue to percolate with Reisman and among similarly minded officials. In the meantime, Canada continued to do its best in multilateral negotiations, playing the game of maximizing new export opportunities but minimizing exposure to new import competition.

Free trade occurs when there are agreements between two or more countries to reduce barriers to the import and export markets. These treaties usually involve a mutual reduction in duties, taxes, and tariffs so that the economies of every country can benefit from the various trading opportunities. One of the most well-known examples of this approach is the USMC Agreement, which replaces NAFTA to govern free trade across North America. Free trade agreements allow a country to have access to more markets throughout the world. It can encourage local industries to improve their competition while re Download Free Software. Pair Your Computer and Device. Transfer Data to Your Computer.Â GarminÂ®, the Garmin logo, ForerunnerÂ®, Garmin Training CenterÂ®, Auto PauseÂ®, Auto LapÂ®, and Virtual PartnerÂ® are trademarks of Garmin Ltd. or its subsidiaries, registered in the USA and other countries. Garmin Connectâ„¢, ANTâ„¢, ANT Agentâ„¢, ANT+â„¢, GSCâ„¢ 10, and USB ANT Stickâ„¢ are trademarks of Garmin Ltd. or its subsidiaries.Â Other trademarks and trade names are those of their respective owners. Table of Contents. Introduction. iii Contact Garmin.iii Product Registration.iii Free Software.iii Caring for the Device.iv Water Immersion.iv. Getting Started.