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CN TRADE RELATIONS FORUM:
THE NEW OBAMA ADMINISTRATION AND THE DEMOCRATIC CONGRESS: IMPLICATIONS FOR CANADA–US TRADE RELATIONS

December 11, 2008, by Gary Hufbauer
March 10, 2009 by Gary Horlick

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Foreword

The Western Centre for Economic Research (WCER), with sponsorship from CN Rail, regularly holds forums to bring highly knowledgeable and prominent speakers to the University of Alberta. These CN Trade Relations Forums include a public presentation and informal small group discussions on trade policy matters that could significantly affect the trade and economic prospects for Alberta, Western Canada, and Canada as a whole.

With 2008 being a US election year and the prospects of a new US Administration and Congress pursuing different directions and priorities, the WCER focused the sessions on gaining insights from prominent US trade policy practitioners on the prospects for changes in Canada -- US trade relations. Two CN Trade Relations forums were held. In December, 2008, Dr. Gary Hufbauer of the Peterson Institute for International Economics, Washington, DC, presented an overview of potential changes in directions under newly elected President Barack Obama and a Democratic controlled Congress. In March, 2009, Gary Horlick, internationally respected trade law practitioner from Washington, DC, examined the early trade policy and economic measures pursued by the new US Administration and Congress and outlined prospective trade related concerns.

Transcripts of Dr. Hufbauer's and Mr. Horlick's presentations and of the respective question and answer sessions have been combined in this WCER Information Bulletin, "The New Obama Administration and the Democratic Congress: Implications for Canada -- US Trade Relations". It is hoped that this record will provide readers with useful background information and early indications of priority issues for Canada – US trade relations.

Given the importance of Canada – US trade relations to the economic well-being of Western Canada, the WCER will follow these same themes in CN Trade Relations Forums in 2009 – 2010. Thus, additional prominent and knowledgeable speakers will be asked to provide their insights, perspectives, and recommendations related to the new and evolving directions and priorities of the Obama Administration and the Democratic Congress and their potential impact on Canada – US trade and economic relations. The Western Centre for Economic Research gratefully acknowledges the support of CN Rail in sponsoring these forums.

Helmut Mach
Director, Western Centre for Economic Research
CN Executive Professor of Canada – US Trade Relations

What Should Canada Expect from President Obama?
Dr. Gary Hufbauer, Peterson Institute of Economics
December 11, 2008

Introduction by Helmut Mach

Director, Western Centre for Economic Research

Welcome to our CN Trade Relations Forum on Canada-U.S. Trade Relations under the potential administration of the President Elect Obama. I would like to thank CN Rail for their ongoing support and sponsorship of activities at the WCER dealing with trade relations. These events cannot be done without this continued support and interest. We have with us today Dr. Gary Hufbauer of the Peterson Institute of Economics in Washington D.C. Dr. Hufbauer is a renowned expert on international economics and trade issues. He has been a senior official at the U.S. Treasury and an advisor to George Schulz when he was Secretary. He has been a very extensive observer of the North American trading relationships as well as broader international trade organizations and he has written extensively on NAFTA related matters and trade relations between Canada and the U.S. He is an observer of what happens in Washington on matters that affect the North American economy, not just trade issues, but broader issues associated with energy and environmental issues as well. We are very pleased to have him here today to give us first impressions about what the new Obama Administration may mean to Canada and Canada's relationship with the U.S. for the next four years and potentially longer. He will also provide some commentary and recommendations as to what Alberta and Canada can and should be doing in order to ensure that we benefit from this new Administration in the U.S. Dr. Hufbauer will answer questions after his presentation. Please welcome Dr. Gary Hufbauer.

Gary Hufbauer

Thank you very much Helmut, it is great to be back here and see some familiar faces and a familiar room. Thank you all for coming.

Let us start with the first slide (Figure 1) and point out things that are probably familiar to everyone – the very deep recession and the threatened depression ahead. President Elect Obama has been forthright in saying that the stimulus package will be one of the first things he does. I think he will get it enacted by March 1st, 2009 and maybe sooner. This is a package that will come on top of the remaining money in the Troubled Asset Relief Program (TARP), about $350 billion of which has been spent and about $350 billion is still left. It is possible that remaining TARP money will be released during the Bush administration, but probably not until Obama comes to office – and it certainly will not be spent before Obama is President.

Figure 1. Financial Crisis Threatens Economic Depression

- **Legislative priority:** shorten the recession, avoid a depression.
- **Obama: Stimulus package 'will be the first thing I get done as President of the United States.'**
  - The package may reach $600 billion: unemployment insurance, food stamps, auto bailouts, state governments, foreclosure relief, infrastructure, and more.
  - Obama: Government 'cannot worry' about the deficit in the short term.
- **Other measures related to the economy** – including energy security, climate change, and health care – will likewise be framed in terms of job creation and economic recovery. Some of these campaign favorites may be folded into the stimulus program.
- **Obama promises to avoid 'heavy-handed regulation.'** However, the U.S. government may end up as a senior partner in large swaths of the U.S. economy. Terms of the auto bailout will indicate how intrusive government will be in managing private firms.

So there is $350 billion of TARP money left but in addition there will be a new stimulus package. Our guess at the Institute is that the new stimulus will be about $600 billion over a couple of years. The first tranche will be devoted to doing things that put people back to work. That means highways, military replenishment, a lot of money funneled to state governments, welfare, food stamps – programs to get money into the hands of people immediately. In addition, I expect what is left of the Troubled Asset Relief Program, or at least a good chunk of that, will go towards foreclosure relief – that is, an easing of the terms of mortgage loans. Obama has said we cannot worry about the deficit in the short term. That means that the U.S. deficit will probably be above $1 trillion in 2009.

Now, Obama had a very ambitious program in the campaign with health care, energy and climate change. Some of these ambitious ideas may be folded into the stimulus program, particularly in the second year of the stimulus program. The energy security and climate change promises, and possibly some health care, may be part of the next fiscal package. Just a word on health care, which I will not address in detail: we have about 30 million uninsured people in a population of about 300 million. The promise is to cover those people with some kind of health care. We currently spend about 15% of our GDP on health care, which is way above international norms. I know Canada spends about half that and health care is just as good if not better in Canada. Linear arithmetic suggests the United States will spend another 1.5% of GDP on these 30 million uninsured people who are mostly poor. That is a couple hundred billion dollars of additional expenditure right there. How that will be funded remains to be seen.

Obama has surrounded himself with a lot of centrist economists. He has promised to avoid heavy-handed regulation. The test will be the auto bailout. This bailout, which has been passed by the House, is about $14 billion, and is just transition money. It remains to be seen whether the Senate will approve that outlay. If it is passed, it is only transition money. The heavy lifting in terms of restructuring the auto industry will fall into the lap of the next administration. Can Obama avoid heavy-handed regulation? We have an auto industry that is dysfunctional in many respects and the restructuring will be painful. It probably involves cutting union wages and benefits and doing something about the pension and health funding, which are killing the auto industry, and reducing dealerships, narrowing the brands, and closing plants. That is all painful stuff. How the Obama administration handles the auto sector will be a litmus test for its promise to avoid regulation. Do we end up nationalizing the auto industry? The implications remain to be seen and autos will set a precedent for dealing with depressed industries, of which there are many.

Clearly the Obama administration will, as any administration would, want to get out of this recession as quickly as possible. There are two factors which will prolong the recession for quite some time, into 2010 and maybe into 2011. First, if consumers rapidly increase their savings rate from near zero in recent years to 6%, which would be a substantial way to the norm (historically the U.S. savings rate out of household income has been about 9%), that will cut 4% of GDP right there – a pretty big hit. We do not know how fast consumers are going to respond to this unprecedented crisis in terms of their spending behavior. The second big unknown is how far housing prices are going to fall. They have fallen on average 20%, but the pessimists say they have another 10% or 15% to fall. If they fall another 10% or 15%, that will be a pretty big headwind against any public stimulus measures.

There we have it: coming out of the recession in the middle of 2009 would be a hopeful outlook, but may not be in the cards. If it is not in the cards, then much of Obama's first two years will be taken up by recession measures. There will be other industries claiming aid after the auto industry has been helped; foreclosure relief programs will go on and have several installments. Unemployment looks for certain to hit 8% and could hit 9%, which means a lot of distressed people.

Let me turn to his trade stance before the presidential campaign, while Obama was still a senator and not yet fully involved in the presidential race. He has a voting record which is rather against trade liberalization – 7 out of 11 bills (Figure 2).

Figure 2. Obama's Trade Stance before the Presidential Campaign

- **Obama's voting record against trade liberalization**
  - Voted against reducing trade barriers in 7 out of 11 bills.
  - Voted against reducing subsidies in two bills (Emergency Farm Spending and the Byrd Amendment on Antidumping Duties).
- **Free Trade Agreements**
  - Voted against the CAFTA-DR but in favor of the Oman FTA
  - Spoke against the Columbia FTA, arguing that Colombia allows union leaders to be intimidated
- **Supports the Trade Adjustment Assistance program**
  - Voiced support for TAA expansion to service workers, and sectors that could be vulnerable to dislocations

He voted against bills that would reduce farm subsidies. Illinois is a farm state and emergency farm spending has got us up to a level potentially as high as $22 billion, although we have agreed to cap subsidies in the Doha Round, should talks ever come to a completion. We are now spending around $14 billion a year, and perhaps less than that if farm prices are good in the first half of 2009, maybe $10 or

$11 billion. Senator Obama did not want to vote for reducing these subsidies. Then there is the so-called Byrd Amendment which is pretty much a giveaway to companies on anti-dumping duties. I will not go into the details but it was a terrible piece of legislation and was ruled illegal by the World Trade Organization. Obama voted in favour of it.

On free trade agreements, Obama voted against the CAFTA-DR Agreement, which is the Central American Agreement plus the Dominican Republic. The vote was close and very partisan, 217-215 in the House, not so close in the Senate. Obama did vote in favour of the Oman Free Trade Agreement and I should note that he voted in favour of the Peru FTA. He has spoken against the Columbia FTA which is rather unpopular in the U.S. as Columbia is alleged to have a semi-official policy of permitting the intimidation of labour leaders, many of whom have been assassinated; however, if you look at the number of assassinations, they are actually going down, though maybe not fast enough. Obama has supported trade adjustment systems for service workers.

That is Obama's record as a Senator. The famous prior example is John F. Kennedy when he was Senator at a time when Massachusetts was a textile state. Kennedy was very much in favour of textile protectionism. When Kennedy became president he said he held a different office and was, therefore, a different person. He was not in favour of protectionism. There were multi-fibre agreements in his administration, but Kennedy was not the hard protectionist he was as a Massachusetts senator. Obama may very well change.

Let us turn to the presidential campaign (Figure 3).

Figure 3: Trade Stance during the Presidential Campaign

- **Obama voiced protectionist trade rhetoric during the primaries,** attributing a million lost jobs to NAFTA.
  - Economic adviser Austan Goolsbee allegedly assured the Canadian consulate that Obama's policy would not match his anti-trade rhetoric. Following this remark, Goolsbee took a backseat in the campaign.
- During a debate with Clinton, Obama threatened to withdraw from NAFTA if labor and environmental concerns were not renegotiated.
- **Obama moved away from this rhetoric after securing the Democratic nomination.** His choice of advisers, including Paul Volcker, Robert Rubin, and Jason Furman, reflects a pragmatic approach.

There was a famous debate in Ohio where both Clinton and Obama tried to appeal to the anti-NAFTA crowd. Then there was the unfortunate remark of Mr. Goolsbee, a very capable economist, who is now paying the price for his candor. Mr. Goolsbee is in the White House, but he does not have a senior job. He is not head of the Council of Economic Advisors. The Chief Economist in the White House is Larry Summers, so it appears that Goolsbee is paying a very heavy price for his misstep.

However, the important thing about Obama is that he moved away from protectionist rhetoric, once the primaries were over. His cabinet and his team of advisors are a very centrist group, much more than was predicted when he was running. He has Geithner as his Secretary of Treasury; Summers is there; in the background are Paul Volcker, and Robert Rubin; and over in the Commerce department, Governor Richardson.

The only person on the left side of the equator, of any prominence so far, is his Trade Representative, not confirmed but at the forefront. That is Javier Becerra, a congressman from Los Angeles who is famous for two statements, not so much for his votes. He voted for NAFTA and has since said that he very much regrets that vote. In addition, he said that not only is U.S. Trade Policy broken but it is 'completely broken'. This statement was made in a context of explaining why he voted against the Free Trade Agreement with Oman, a treaty which has little commercial content and instead is about our military relationship with Oman. Becerra made another statement at the same time he voted against Oman, about our trade deficit with China. If we put these statements together, it does not look like he is friendly to an open trade policy. In terms of other votes, he voted for Peru, but against the CAFTA-DR. Becerra is clearly not in the pro-trade camp of the Clinton mould, but if confirmed he will be surrounded as Trade Minister by centrist economists who have more senior cabinet positions. So I would not place too much weight on the Becerra appointment.

I tried a couple weeks ago to think of possible names for Obama's other appointments (Figure 4). Here I was completely wrong so I am going to pass over this slide very quickly. I do not have Becerra in the rack up, which shows how hard it is to forecast the nominees. I think Dan Tarullo will get a position in the Administration, but possibly in the Treasury department. He is an expert on international financial arrangements, particularly the Basel agreement and its failures. He may end up as an Undersecretary of Treasury.

Figure 4. Trade Stance After the Presidential Campaign: Shift to the Center?

- **Possible USTR picks:**
  - Lael Brainard: Currently at Brookings; has called for stronger enforcement of U.S. trade laws and trade agreements.
  - Cal Dooley: Founding member of the centrist New Democrat Coalition; helped secure Trade Promotion Authority in 2002.
  - Thomas McLarty: Helped push NAFTA through Congress; former Clinton administration Special Envoy for the Americas.
  - Dan Tarullo: Senior fellow at the Center for American Progress; former international economics adviser to President Clinton; published extensively on the Doha Trade Round.
  - Mike Wessel: Staffer to Dick Gephardt, a fair trader, for over 20 years; currently a member of the U.S.-China Economic and Security Review Commission.

What are the trade policy scenarios during Obama's presidential term? (Figure 5)

Figure 5. Trade Policy Scenarios During the Presidential Term

- **First possibility: 'benign neglect' as the President and Congress let the Doha Round and pending FTAs simmer.**
  - For political reasons, farm subsidy cuts and flexibility on Mode 4 will be difficult to achieve. Hence, by insisting on significant uncompensated concessions from others, the Obama team can keep Doha in a stalemate.
  - Obama: KORUS deal is currently unfair to U.S.; South Korea must offer concessions on beef and autos. But Korea does not want to re-negotiate the deal. Another possible stalemate.
  - Colombia: Insist on a strong record of criminal prosecution of assassins before taking up the FTA for ratification. Another possible stalemate.
  - Put NAFTA issues in a study mode and defer active negotiations.

The first possibility, given all the other priorities on the president's plate – the recession, energy, health care, climate change – is benign neglect for the trade agenda. Just let things simmer along. There is an outside chance that WTO Director General Lamy will put the Doha Round together in the next two weeks within the time frame of the ministers meeting. Next week, just before Christmas. If it is not put together then, all the action passes to the Obama team. But other countries want more from the U.S., notably substantial cuts in agricultural subsidies. That will be very difficult because the farmers are saying that they need their safety net.

Other countries are also calling for more flexibility on Mode 4, which is the part of the General Agreement on Trade and Services that deals with migration of skilled workers. You would think this would be a no brainer but it is a very difficult thing. Politically there is very little flexibility to increase U.S. immigration quotas under trade agreements – it is a jurisdictional issue within the Congress and during a recession any liberalization faces big hurdles. I do not think Obama has a lot of flexibility there. If any country increases its demands then the gap between demands and offers gets larger, and the chance of an actual agreement becomes smaller.

Obama said that the Korea-U.S. FTA was unfair to the U.S., an echo of the primary campaign on autos. Almost the last problem for the Detroit auto industry is the import of autos from Korea. Moreover, there are very few U.S. auto exports to Korea, since we do not make the kind of cars that Koreans want. But, if you want to complain about something, you complain about autos. The Koreans have said that they are not going to renegotiate autos. Beef is another issue. There, the U.S. is stuck on the other side of the dilemma that hit Alberta over BSE. The Koreans are saying that they do not want any beef that is older than 30 months, and they want to inspect all arriving shipments. Senator Bachus and a couple other senators have said they will not even talk about the Korea FTA until Korea liberalizes the beef trade.

On Colombia, I suppose one thing that Obama can do is ask Colombia to pursue more vigorous prosecution of assassinations, including more investigative resources. My guess is that the Colombian government is doing about as much as it can to trace the assassins, but you can always put in more effort.

Both the Colombia and Korea FTAs have heavy foreign policy implications. Turning to Colombia first, the U.S. has a weak diplomatic position in South America. We are as unpopular as we have been in a long time. U.S. popularity is not at an all time low, but it is at a low point. Our two closest friends in South America are Peru and Chile, with which we have FTAs. Colombia could be a close friend. We have a big anti-drug program in Columbia, spending about $3 to $4 billion dollars over the next few years. If the FTA is rejected in a very public way, this will not improve relations with Colombia. Uribe, the president, is coming to the end of his term. He wants to run for another term but he needs to change the constitution to do that. Unfortunately there is some kind of money scandal going on, so Uribe will not likely be able to change the constitution, meaning he is on his way out. The next president will not likely be as friendly to the U.S. as Uribe is, so diplomatic friction is looming.

Korea has been a U.S. military ally for 60 years, but Korea now conducts more trade with China than with the U.S. If Korea sees itself as being slapped in the face by a U.S. rejection, that has to be bad for a whole range of issues. So, again, for foreign policy reasons, I think both the Colombia and Korea FTA deals will be done.

What about NAFTA, which got so much attention during the campaign? NAFTA became the symbol of globalization and exaggerated ideas of what trade does to U.S. employment, especially manufacturing jobs and wages. NAFTA became a lightning rod for all that the criticism. Of course, when the U.S. debate refers to NAFTA it is talking about Mexico. Canada is just not a party to the negative political equation.

What will Obama do about NAFTA? Helmut Mach wrote a very good op-ed about the subject yesterday for the *Edmonton Journal.*[1] Mach's point, which is absolutely right, was that the left wing of the Democratic Party will push Obama to deliver on campaign promises to address labour and the environment, and renegotiate FTAs. Obama's centrist economists and his secretary of state, Clinton, will be pushing against that agenda. So what does Obama do?

Probably Obama will ask his Trade Minister to explore with the Mexicans what can be done, but without offering very much. Not threatening to withdraw but trying to put NAFTA on the backburner, and keeping the issues alive just enough to satisfy Congressmen who are anti-NAFTA rather than the Congress as a whole. That is my guess on NAFTA – I do not think very much will come of the talks in the near term. President Calderon might say if we want to renegotiate, let's talk about agriculture. A lot of corn, soybeans, feed grains, and meat are shipped in both directions. Agricultural trade between the U.S. and Mexico has grown tremendously. Calderon would face pressures to restrict this trade if we reopen negotiations. It would be a two-way conversation, probably not a very friendly one. Secretary of State Clinton and Obama recognize this outlook, so they will probably try and push back NAFTA talks.

That is my first scenario. Quiet, benign neglect. Let's look at the second possibility (Figure 6). In this scenario, the Obama Administration will try to open negotiations on subjects that do not threaten established industries, and to use enriched environmental and labour standards to placate opposition within the Democratic Party. The big issue in this scenario is the trade dimension of climate measures. This is a big issue because the climate agenda can have a lot protection

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[1] http://www.business.ualberta.ca/wcer/Pages/News/Opinion/Machoped121008.pdf

built into it. In fact, if you look at the six to eight important bills that have been tabled in Congress, all have border measures of different severity, but all would impact trade quite a bit. In this context, the U.S. might open negotiations, particularly with Canada and maybe with Mexico, on climate change and energy security. If you are serious about energy security over the next ten years, that requires a robust program on alternative energy sources. Alternative energy today really means nuclear energy, which has its own political problems. Nuclear energy supplies about 20% of our power, while wind and solar together supply about 2% of our power. Ethanol neither conserves energy nor reduces CO_2, but it gets strong support because the farm block loves it. If you are serious about energy security over the next two decades, you have to think about reliable sources of fossil fuels – especially oil and natural gas. That is a probable focus in the first term of the Obama administration.

Figure 6. Trade Policy Scenarios (continued)

- **Second possibility: negotiate agreements in new areas that do not threaten established industries. Use labor and environmental standards to gain broad-based support.**
  - Negotiate the trade dimension of climate change measures.
  - Open negotiations with Canada and Mexico on forward looking concerns, notably energy security and climate change

The third possible scenario I see is to return to a traditional trade package, rather like the Clinton administration (Figure 7). The main reason for this would be foreign policy – to advance an outward looking economic policy as an adjunct to foreign policy. At our institute, we believe that the outward looking economic policy has been a pillar of U.S. and world prosperity in the post-WW2 era, but the negative voices are, for the moment, stronger than our own. That means the trade agenda has to be sold in terms of foreign policy. Curiously, Secretary of State Clinton could be a big advocate, even though, as senator, she was always skeptical of NAFTA. Clinton is in a different position now so I could see her becoming an enthusiast, as other secretaries of state have been – pushing trade liberalization as an adjunct to foreign policy.

Figure 7. Trade Policy Scenarios (continued)
■ **Third possibility: return to a traditional trade package. This approach would require a hard sell to the Democratic Congress.** • Foreign policy considerations could be marshaled to enact old agreements and support new ones. – Passage of Colombia, Panama, KORUS FTAs, pretty much in the form negotiated by the Bush Administration. – Use the P4 agreement as a springboard to stay engaged in Asia. Sticking point: many Asians view labor and environmental standards as disguised protectionism. • U.S.-Europe FTA on services might be possible. Could be spurred by recently launched negotiations between the EU and Canada. • U.S.-Japan services agreement is another possibility.

Let me mention the P4 agreement, which is hardly known and maybe that is its most favorable attribute. P4 is an agreement between New Zealand, Brunei, Singapore and Chile, and is a gold standard free trade agreement. The U.S. has joined in, ostensibly to talk about the investment chapter in this agreement, but more importantly because it might be a springboard for a wider engagement with Asia. Vietnam wants to join; the Philippines want to join; Japan is looking at it; Korea is looking at it. P4 could be the centerpiece for true free trade in Asia, which is why the U.S. is looking at it. It remains to be seen whether the Obama administration will look favorably on P4. So long as we just talk about association with four countries that many people cannot locate on a map, it will not be politically contentious. P4 represents a low-key way of going forward.

Service agreements with Europe and Japan might be achieved in an outward-looking scenario. Free trade agreements that only cover services are compatible with the WTO and, reading the fine print in the GATT, such agreements can be implemented in stages. You do not have to free up all services trade at once. There is a lot of flexibility in shaping an agreement on trade in services. But this part of an outward-looking agenda is not on the horizon before 2010.

Let me now turn to immigration of skilled workers (Figure 8). The United States is in an unfortunate situation described in a paper on our website by Jacob Kirkegaard (grand nephew of the famous Kirkegaard). Kirkegaard examines the skilled competition of the U.S. labour force, and reaches the sad conclusion that the U.S. has been getting dumber, not smarter, over the last few decades.[2] Many other countries are getting smarter – obviously China, also India, Russia, Brazil, and more. So the U.S. is losing ground in the skills race. The most unfortunate part of this story is that the United States has very tight policies for visas on skilled immigrants.

What might be done? Obama in the past has supported an increase in H1B visas, but only as stop-gap measure. He might do this for immigrants with advanced degrees. The main obstacle here, as with everything I have talked about, is the recession. As long as we are in a recession, the opposition to immigration will remain strong. The public mind does not differentiate between illegal immigration from

[2] http://petersoninstitute.org/publications/papers/paper.cfm?ResearchID=972 (March 25, 2009)

Mexico on the one hand, and skilled immigration from around the world on the other. All immigrants are lumped together. So it is very hard to sell legislative relief. Bush made a very good try, but he could not even persuade his own party. Republicans killed it.

Figure 8 Immigration of Skilled Workers

- **Obama: U.S. has a 'skills shortage, not a worker shortage.'**
  - Supports an increase in H1B visas as a 'stopgap measure,' but believes that more Americans need to earn advanced degrees in order to fill jobs.
  - Pledges to improve H1B visa program and possibly replace some H1B visas with permanent visas.
  - Pledges to make immigrants less dependent on employers for right to stay in the U.S.
- Obama will find it difficult to gain a consensus on immigration reform, just as President Bush did.
- Liberal immigration rules between the U.S. and Canada are not likely to be disturbed.

Let me turn to climate and energy, which are central to Alberta (Figure 9.). Climate action will be framed in familiar terms. John Podesta, who is now a senior official in the new government, has said that measures to avert climate change actually create jobs and do not cost anything. That, of course, is a politically popular message: doing something about climate change and green energy will actually creates U.S. jobs. I think most economists see this as too rosy a picture. Still, this picture helps sell limits on greenhouse gas emissions. If you go with the 'green jobs' approach, however, you probably rule out tough cap-and-trade provisions for the next few years.

Figure 9. Climate and Energy

- **Due to economic turmoil, climate action will be framed in terms of 'green collar jobs,' 'green investment,' 'green economy,' etc.** Actions will not visibly detract from economic recovery.
- In fact, Obama and advisers, notably John Podesta, view climate and energy policy as synergistic with economic stimulus and job creation.
- This approach rules out carbon taxes or carbon auctions in 2009, unless the money is visibly dedicated to highly popular causes.

Turning to the energy plan (Figure 10.), what Obama has in mind is a program costing $150 billion over 10 years. I think that number will go up, since you have everything in the program. You saw that Obama appointed Steven Chu, the noble laureate, as his Secretary of Energy. It was an impressive prize for Obama to persuade someone so prestigious to take this position. Chu has good administrative experience with his lab in Berkeley, which employs about 4,500 people. The Department of Energy has about 45,000, but Chu can scale up from 4,500. He is all in favour of alternative energy strategies.

Figure 10. Obama's Energy Plan

- **$150 billion government investment in clean energy over 10 years,** including clean coal, renewable energy, biofuels, and grid transformation.
- **10% renewable portfolio standard (RPS)** by 2012, 25% by 2025; renewable energy will include solar, wind and geothermal.
- **Production tax credit** for energy efficient technology, including fuel efficient cars.
  - Goal: 1 million hybrid cars in use by 2015.
- **Judicious use of 'safe' nuclear power;** but so far no talk of federal preemption of the permitting process.
- **Nationwide low carbon fuels standard (LCFS):** reduce carbon intensity of fuels by 10% by 2020.
  - Major implications for Alberta's oil sands.
- During the primaries, Obama proposed $50 million to jump-start the creation of an IAEA-controlled global nuclear fuel bank to provide nuclear power without jeopardizing U.S. military security.

The two most immediate alternative energies are nuclear and wind. The political problems with nuclear are well known. Chu has said he is not in favour of the Yucca mountain depository, so the department will have to come up with a different solution for disposal. While nuclear faces political opposition, public opinion is tipping. However, the permit process is very long, perhaps 10 years, though it might be shortened under new regulations.

Wind has its own problems. The core problem is that it is hard to build transmission facilities from where wind energy is concentrated to the largest power markets. Cities and states can, and do, object to new transmission lines. In order to accomplish serious wind power transmission, the U.S. needs federal preemption to establish power line routes. That is a big step. In fact, we do not have a unified power grid in the U.S.; instead we have three separate grids. You know about the problem of building transmission lines in the wake of the power blackout several years ago.

Those are the obvious problems. Obama has promised new money, but these other difficult problems of overriding serious objectives to alternative energy sources, have not yet been addressed. The implications for Alberta in all of this are fairly serious: there is risk as well as opportunity. The big opportunity for Alberta is on the energy security side of this agenda; the big risk is on the 'dirty oil' side of the agenda. Right now the politics are pretty fluid.

I did not mention that Obama has created a climate-energy czar in the White House: Carol Browner, a very well known figure from the Clinton years. She is somehow going to coordinate the EPA and Mr. Chu's department. Climate and energy security will go together and be a big matter, but probably not until the second half of 2009 at the earliest.

Let us turn now to greenhouse gases (Figure 11). Obama has promised to reduce emissions by 80% by 2050. That date is so long away that it has no meaning for his term or terms in office. The question is what he does here and now.

Climate change issues will be addressed in three fora. Legislation will move forward in Congress, especially influenced by Henry Waxman in the House. The Copenhagen negotiations will move forward internationally. And President Obama was handed a very powerful tool when the Supreme Court ruled that, under the

Clean Air Act of 1972, the EPA can regulate CO_2 and other greenhouse gas emissions. We will see how Obama meshes the three fora. I think it would be possible for Canada to open a fourth forum by advocating a North American approach to energy security and climate change. This would have to be launched by an Alberta and Canadian initiative; the U.S. will not come to Canada or Alberta to ask. If Alberta sees it in its interest to form some kind of alliance with the U.S. on these two files, the best time to find an open door in the United States will be in the first few months of the Obama administration.

Figure 11. Regulation of Greenhouse Gases

- **Obama favors a nationwide cap-and-trade program** aiming to reduce emissions 80% by 2050.
  - Due to the financial crisis, may not be able to pass legislation until late 2009 or 2010. However, Waxman as chair of the House Energy and Commerce Committee improves the odds.
    - A cap-and-trade bill granting the president scope to change the measures is arguably necessary to negotiate credibly at Copenhagen.
  - Any cap-and-trade bill will almost certainly include trade competitiveness provisions.
- ***Massachusetts v. EPA***: Supreme Court has instructed EPA to make an endangerment finding on CO2 under the Clean Air Act, possibly leading to EPA regulation if Congress does not pass its own cap-and-trade bill.
  - Obama energy adviser Jason Grumet: Congress has 18 months to pass a cap-and-trade bill before the EPA regulates under the Clean Air Act.

Let me turn quickly to the international side of the climate file. Looking at the Copenhagen talks, our view at the Institute is that negotiations will be pushed back on account of the world recession, and they will not come to fruition until 2010, or possibly as late as 2011. We think it would be useful for Canada and the U.S. to consider a joint approach establishing targets and paths for Copenhagen. But, as I said, this depends on a Canadian initiative. Mexico might join, but that is a more difficult proposition. What Mexico would bring to the party is that, because its emissions per capita are much lower, the averaged emissions across the three countries would put more space in the North American envelope. This would make it easier for us to meet the targets, but Mexico would have to have some benefit from sharing its CO_2 space. For this reason, including Mexico might be more difficult than launching a Canada-U.S. partnership.

Let me turn now to the final slide (Figure 12). It is more on Copenhagen.

Figure 12. International Climate Action

- **Can Copenhagen negotiations survive the economic downturn?** Must the summit be pushed back?
  - The U.S. and Canada might consider setting a common North American emissions target to anticipate agreement in the Copenhagen process.
  - Mexico might join in setting a North American target, provided infrastructure spending is included in the package. Note that a North American CO_2 emissions target would be easier to meet if Mexican emissions are averaged with U.S. and Canadian emissions.
  - Copenhagen negotiations, Congressional legislation, and EPA/Clean Air Act regulation are three avenues toward the same objective. An international framework for regulating greenhouse gas emissions combined with national legislation to meet the goals of that framework is the ideal policy outcome. Which of the three avenues should be pursued first, and how will the terms leverage action via the other two methods?
  - Lawyers disagree over whether Clean Air regulation of CO_2 sources could be effective. Clean Air regulation might not be an end in itself but rather used to signal political will to the international community and reluctant members of Congress to embrace greenhouse gas regulation.

The Copenhagen talks will test Obama's skill, because on the one hand you have a Congress that wants to write its own legislation, but on the other hand Congress does not want the pain of doing something that is highly unpopular. The amount of money at stake in climate regulations, on our calculations for the U.S. alone, is hundreds of billions of dollars a year. Trade policy battles are typically fought over much smaller amounts – typically $1, $2, $3 billion dollars a year. By comparison, climate change involves a huge amount of money. This will be the biggest trade show on earth. The President cannot write Congress out of the show, but how does he fit Congress into the international talks? Congress cannot get too far ahead of the international talks. Other countries will complain that they are being forced to take it or leave it if Congress writes hard and fast rules before Copenhagen. On the other hand, if the Copenhagen process gets too far ahead, you get into the Kyoto problem – Congress might reject the international accord. I am pretty sure that Congress would resent taking detailed direction from Copenhagen and enacting it as U.S. law. So you have to keep both processes going at the same time. Under EPA authority, the administration can write the CO_2 regulations as it wishes; Obama can use that power as a hammer both on Congress and on Copenhagen. Then, as I say, there is a possibility of working with Canada to create a stronger, more unified position for North America.

Let me just conclude by saying that the cabinet that Obama has assembled is amazing in terms of its quality. In terms of the profile, it is unlike anything I have seen, going back to the days when I first worked in the Treasury, over 40 years ago now. There has not been a cabinet entering office on day one that compares with the sort of strength Obama has assembled. Some administrations left with cabinets filled with high profile credentials, but they did not start that way. Obama is starting with a truly exceptional team. Expectations are very high. It seems almost inevitable that expectations will be disappointed, but I suppose if anybody can meet the expectations of our day, it is Obama and his team. Thank you very much.

Questions

Joseph Doucet, Business School, U of A

Gary, you mentioned that the U.S. deficit is not a primary issue for President-Elect Obama, but not too long ago the American consumer was concerned with $4 gasoline. A lot of the energy issues are going to be very, very expensive. Does the public's reaction to more expensive energy suggest that, in the near term, most of the added cost is going to go on the government's balance sheet as opposed to the consumer?

Dr. Hufbauer

There is an attempt to say that the energy plan will not cost anything, even that it will increase jobs and make the economy more efficient. There is a big political effort by proponents of legislation to play down the cost factor. I think that translates into what you said, which is a fair amount of public money pumped into the energy sector as a way to disguise the actual cost, and obscure the price tag, particularly at the household level.

I think action will come slowly. Action means public money and mandates on industry, which comes down to performance standards. The auto industry has already faced performance standards and will have to face more. But the performance standards approach may be extended to other industries. Cement is one; steel is another. Maybe we do this through mandates that will be claimed not to cost the public anything. The final part of this disguised cost approach is the free allowance of emission permits. We economists say that free permits are like giving money to someone. The way free permits are sold politically is to keep the cost of electricity low. In Europe, where they give free CO_2 allowances for business, as far as analysis shows, the power companies pocketed a lot of the benefits.

I think it will require a 10 year process to get true energy and emissions costs into the pricing system and get them off the public budget. I do not think that it can be done quickly from a political standpoint. But ultimately, it will be done.

Now the second part of your question: the deficit problem we have. The deficit is a major national problem and, if not addressed, it will lead to a much larger crisis in the future. We cannot continue to run these deficits and a tax system without consumption in the tax base. Whether this administration tackles the problem remains to be seen. In the past, it has been too easy to just push the problem off to the next administration.

Sam Featherman, NAIT

There has been a lot said about the underlying problems with credit swaps in the U.S. Do you have any information as to which these assets have been traded to other countries?

Dr. Hufbauer

Well, the derivatives market exploded from $5 trillion to $50 trillion between 2000 and 2007, and has now contracted somewhat. A lot of that was offsetting transactions. The calculations are not exact, and that is part of the problem. The reporting is poor, but the nominal value has come down to perhaps $40 trillion. How much of that went abroad? To their great credit, Canadian banks and insurance funds did not buy very many derivatives, so they escaped. I would say they EU took the biggest hit after the U.S. financial system. Total losses, not counting equity losses, are reckoned to be above $1 trillion. Add on to that, losses in housing and equity markets. The EU, as a whole, is taking a quarter at least, or maybe a third, of total losses. There were some losses in South America. I do not think there were enormous losses from derivatives in the Asian markets. But of course everyone is suffering from depressed real estate and equity prices.

Greg Anderson, Political Science, U of A

I wanted to ask what you think the future of trade promotion authority is. You mentioned Colombia and it seems that the house rule changed back in the spring. I wonder what you think of the future of it, the utility of it in U.S. trade policy. Can they do things *ad hoc*, or can they kind of fast track it?

Dr. Hufbauer

I think the temptation of the Obama Administration is to do it *ad hoc* because they have such a large majority in Congress and because most Republicans are in favour of trade agreements. If the administration wants a trade agreement, it can get what is called a 'closed rule' in the House; that is up to the speaker. If there is a closed rule, there are no amendments, and with a closed rule, the speaker can set the time of the vote. In the Senate, there is a possibility of a filibuster, but that seems unlikely. So, Obama may not need fast track authority for the agenda he wants to negotiate.

There are two places, however, where he might need authority. First, to implement what is agreed in Copenhagen, if it modifies what has already been enacted by Congress; second, to start a new round of negotiations with the WTO.

Helmut Mach, Western Centre for Economic Research, U of A

Gary, you outlined areas of Obama's priorities that are very domestic and you also mentioned areas where Canada and Alberta could be significantly affected by what Obama does with this domestic orientation on energy and environmental issues. In those circumstances, what should Canada and Alberta be doing?

Dr. Hufbauer

Of course Canada and Alberta can sit back and watch the parade, but my advice has two recommendations.

First, Canada should get into the inside circle of negotiations, both in Copenhagen and in the Congress. Canada should pay attention to any draft regulations issued by the EPA. That means Canadian ministers should, in my view, spend time in Washington and meet with Congressmen. As I have said during my last two visits to Edmonton, Americans have little appreciation of what Canada means for energy. Alberta is central in the energy picture, but American leaders need to know the story. Lay out the facts and what is being done on CCS and what is being done in the oil sands. It is hard to get Congressmen to travel. Get to staff members in the Congress and the administration, just to tell the facts, because information has been so heavily filtered by extreme environmental groups.

Second, take action if legislation on CO_2 comes that is adverse to Canada's interest. I am a believer in public relations campaigns, heavily targeted on Washington. This means snappy billboards in subways, or TV ads, to lay out the facts and change the climate of public opinion as issues move forward. I think such efforts are well worth the investment if adverse measures come up in the context of cap-and-trade.

Mr. Viswanathan, NAIT Retiree

What about the U.S. dollar?

Dr. Hufbauer

I think the U.S. dollar is enjoying a strength right now because the financial system of the world has the shakes and credit risks are amazingly high. Levels of trust are much lower than what they were just a year ago. That has caused people to flee to the dollar, so that 10-year Treasury bonds yield only 4%, and that makes no sense. The dollar will eventually go back to its pre-crisis value, in about a year or so.

How far the dollar eventually falls turns on the U.S. ability to stabilize its public finances. If the Obama administration does not show the path of fiscal stability, I think the dollar will continue to fall.

Helmut Mach, Western Centre for Economic Research, U of A

In the past when the U.S. dollar was depreciating, there was an associated and dramatic rise in the price of oil. Some of that was justified by demand expectations, and some of it was explained as a reaction to the decline of U.S. dollar. People were putting money into oil as a way of protecting their wealth. In the past one or two months, oil prices have dropped significantly. The forecasts of oil are more modest with oil being in the mid $50 range for the next year or 18 months. If the U.S. dollar starts dropping again, as you suggested, do you think there will be a commensurate push on oil prices from the dollar drop rather than the demand side?

Dr. Hufbauer

Some experts are predicting that oil will reach $200 a barrel by 2019 or 2020 in present dollar terms and I tend to subscribe to that view. Coming back to your question, yes, I think oil was a big financial asset, and in the future it will return to that status, and not just for hedge funds and pension funds. It would not surprise me if countries with large foreign exchange holdings, such as China and India, put some of their holdings into oil. To answer directly, I think that if the dollar drops, that will happen. But supply and demand will drive oil prices over the long-term.

Meagan Jenna, History and Classics, U of A

You mentioned that there would be some kind of crisis unless the U.S. could reduce the deficit to a more manageable level. I was wondering what kind of sacrifices the U.S. would have to make to get the deficit down to that level and what, more specifically, would happen if they managed to do that.

Dr. Hufbauer

What I think needs to be done, and what is difficult to get agreement on, is to cut the trajectory of expenditure on Social Security and Medicare. Those are our two largest entitlement programs, but in addition we have other benefits of modest size which are also hard to cut. Remember Bush added prescription drugs to the list. And Obama will include uninsured coverage which will add another couple hundred billion dollars per year. So the administration and Congress need to flatten out the growth in entitlement by some painful means. All other spending is relative small.

On the tax side, the U.S. has relatively low taxes, but we have loaded taxes onto capital income. This targets high earners, corporations, and businesses. If Congress increases those taxes, it will become more difficult to expand business in the U.S. At some point we need to consider some form of broad based consumption tax. I do not think you can collect much income tax from low income people. But you can collect a broad-based consumption tax. But it is so painful to do, and it may take a crisis to do it.

Bruce Walker

With Waxman taking over the Energy and Commerce Committee in the House, what kind of effect will there be for Alberta and the tar sands?

Dr. Hufbauer

In terms of rhetoric Waxman and Obama may continue to beat the horse on limiting imports from Alberta. In terms of legislation, they will not push to limit energy imports from Alberta; there is no gain from pushing energy independence from Alberta oil.

Bill Hume, North American Construction

With the system everyone talks about – and I am an engineer not an economist – there seems to be a huge wealth transfer between the Have to Have-Not Nations and that it is not really doing anything to affect climate change. But everyone has been saying that it is politically painless and very acceptable to the green side. It seems ridiculous.

Dr. Hufbauer

Well, your skepticism is well placed. The cap-and-trade system might not do anything, and it might be only a political band-aid. Most economists feel that to affect CO_2 emissions, the right thing to do is to have a straight up carbon tax, but there is no real push for that approach. At least there is a consensus, if not universal, about cap-and-trade.

Will it be a big wealth transfer? Possibly, but the CDM (Clean Development Mechanism) will probably be operated on a small scale. Canada has its own limits on any future CDM program. Right now CDM is only occurring in the EU, and only on a limited scale. The administrative and corruption problems are formidable.

The Obama Administration's Trade Agenda and Canada
Mr. Gary Horlick
March 10, 2009

Introduction by Helmut Mach

Director, Western Centre for Economic Research

Thank you for coming. I am Helmut Mach, Director of the Western Centre for Economic Research here at the School of Business, U of A. I am also pleased to be the CN Executive Professor of Canada – US Trade Relations, which is made possible by CN Rail. We very much appreciate the continued support of CN Rail in furthering initiatives on understanding issues related to Canada-U.S. Trade relations. As a result of this support, we are able to provide an ongoing series of events and speakers. For those of you here in December, we had Gary Hufbauer from the Institute for International Economics in Washington D.C. He provided a first perspective on what to expect from a new Administration and a new Congress in the United States, just four weeks after the election.

The president has now been inaugurated, Congress is in place and we've had six weeks to see what they can do. We are very fortunate to have Mr. Gary Horlick with us today. Mr. Horlick is one of the world's top trade lawyers. He has advised the Alberta Government, the federal government, and every other provincial governments in Canada save one in various trade cases involving actions with the U.S. He represented Alberta in the very first appeals panel that went through NAFTA's dispute procedures. He is familiar with Alberta having represented a number of products in trade cases. Gary is also a much respected expert on trade remedy laws. He is used by the WTO for advice related to international consideration of trade laws. He currently practices in Washington D.C.; he's been active on a wide variety of issues including perpetual Canada- U.S. softwood lumber wars; and he is a respected analyst and commentator of what is happening in U.S. trade policy.

With the Obama Administration having released its trade agenda and the Administration being in place for six weeks now, we are very fortunate to have Gary to give us perspectives as to what has happened, where things are going and how Canada-U.S. trade relations will play out in the future. Gary's presentation will be followed by a question period.

Gary Horlick

What I want to start with is the politics of the current government, because that is where they will start. Anyone elected for the first time immediately starts thinking about the next election. Almost everything else is subordinated to getting re-elected.

The numbers have been crunched, so we have some data as to how Obama won. He won a majority of all age groups under 65, which is good news if he's to run in 2012 because, at the risk of sounding crass, the one group he didn't win is only going to get smaller. A key point in terms of trade, he does not owe his election to any one state or demographic or interest group. He won a big enough victory that nobody can claim that they won him the election. Having said that, a really noticeable factor is that he greatly increased the number of Hispanic votes he won. Some of you may remember the chatter in the primaries that he would have trouble with Hispanics. Republicans won 45% of the Hispanic vote in 2004, which was decisive in President Bush's victory. President Obama won 67% of the Hispanic vote running against an opponent, Senator McCain, who has been very friendly to Hispanics in terms of immigration. The Hispanic vote is a growing group, so people will be watching them for 2012. Hispanics have not been supportive on Free Trade issues, which may sound strange if you believe that most Hispanics are immigrants, but in fact about half of them are not.

The second political fact for Obama concerning trade is that it is a very divisive issue within the Democratic Party. The Democratic Party bases a lot of its support on labour unions, which are a tiny percentage of the economy. Labour unions are less than 7.5% of the U.S. private workforce, but they have large influence in the Democratic Party, and are decidedly anti-trade. Part of that comes from the fact that although they are such a small percentage, they are highly concentrated in the manufacturing sectors which are less competitive.

That said, the other keys to the Democratic Party that nobody even mentions anymore because it is so obvious, are New York and California. Everybody says that It is Ohio and Pennsylvania, but those are just the contested states. If the Democrats do not win New York and California, they have no chance at all. The Republicans did not seriously contest those two states. New York and California, as you can tell looking at a map, depend on trade. So you have real tension in the Democratic Party. The Unions have decided they hate trade, while the money and the people come from states and industries which depend on trade. If you are a Democratic president, the best thing you can do is ignore trade.

The problem for the Obama Administration is Congress. They did not say that they didn't want to deal with any trade issues, but talking with people within the Obama Administration you can see that they would have been much happier not having to deal with trade starting from day one. Instead, they would have preferred to institute a stimulus package. The first thing they get is a 'Buy-American' clause attached to it, which starts a trade war.

Democrats increased their majorities in both Houses of Congress. Several of the candidates who won visibly hinged their appeal on anti-trade campaigns. There is a whole war of spin going on in Washington as to whether or not that is true. Most people think it is true, therefore the perception remains. On the other hand, a lot of the seats they won were Republican seats and, therefore, more moderate towards trade. You could argue that the Democratic caucus is more moderate because of these more conservative Democrats from more conservative districts.

The 'Buy-American' fight was aimed not only at China. It is hitting Canada more – as more imports come from Canada. The Obama Administration, after a few worrying days of silence, came out and said the right thing. The Obama Administration said they would do what is necessary to stay within their international obligations *and* do what makes economic sense. The key point here, which is not limited to Canada or the U.S., is that you easily stay within your international obligations and remain vehemently protectionist. Take 'Buy-America' – only 27 WTO members are members of the Government Procurement Agreement. This allows you, while complying with your international trade obligations, to exclude all imports from all other members from government procurement. Indeed, if you go back to the famous Smoot-Hawley Tariff of 1930, international trade obligations were not violated.

The key proviso, clearly thought out, is the '*and makes economic sense.'* The Obama Administration understands that just complying with international trade obligations is no guard against protectionism. The eventual compromise that passed the 'Buy-America' provisions was the requirement that the President can make sure it complies with international trade obligations and can waive the provisions when it suits the public interest. So in effect the fight is postponed – it is not over. Canada must now pay close attention to how the U.S. implements this provision. Do they simply mechanically follow international trade obligations, in which case Canada loses market share in the U.S., or do they use these waiver possibilities? The waivers can get quite arcane. This gets fought out at an incredibly detailed level, at least 10 levels below the president. Canada did not win this round, but did no; lose it; they are just condemned to eternal fighting.

Go back to the politics: you are going to have races in 2010 and 2012 that will depend on the economy. (See Figure 1 below.) To put it bluntly, the Democrats have two years to prove that they have done something about the economy. Nobody thinks they will be able to fix it that quickly, but we are not as patient as a country as we were in the 1930s. If the Dow Jones is still below 7,000 they may be out of office and they know it. You have to be seen as defending U.S. workers, but whatever you do that is anti-trade could well have an anti-growth effect. As you've seen with the 'Buy-America' clause, countries are on edge about this. Not just Canada, but every major trading party said that they would not stand for it. The E.U. responded clearly that they would retaliate.

What you see is an inertial drive to be protectionist. Let me quote Speaker Barbara Boxer, a liberal Democrat from San Francisco – but it is San Francisco where the money comes from Silicon Valley. It is the classic Democratic conundrum – a labour union driven area but at the same time completely driven by trade.

Speaker Boxer said the U.S. appreciated the value of global trade as a motor for economic growth. She also noted that many workers had lost their jobs and were exposed to the global downturn. "We want workers to be assured that we are looking out for their interests as we look to grow the U.S. economy. I do not think that is protectionism, I think that is what any country would do for its workers." She went on to say, "President Obama is not a protectionist president."

What she is saying is that they are going to do 'Buy-America'; we are going to be protectionist, but on the other hand we are not protectionist. I think that is what you are going to see for the next two years. It wasn't just this 'Buy-America' getting into the spirit of this. The bank bailout bill had a clause prohibiting any bank getting government money from hiring anyone with a H1B business visa[3]. This is picky and petty protectionism.

Figure 1. The Politics

- The races in 2010 and 2012 will depend on the overall economy and its effect on perceptions of improved job and prosperity creation
- The Democrats must be seen to be defending U.S. workers, <u>BUT</u>
- Any anti-trade measures which impede growth are likely to be resisted by the people in the White House running the economy (Buy America will be an early test), <u>AND</u>
- Foreign policy considerations will drive some trade issues

That is where the Democrats were, now I am going to look at where they are going – whether they want to or not. Go back to the context. You have the economic stimulus, which means government is a big purchaser; you have 'Buy-America'; you have a Congress that is inherently protectionist; and you have a government that hopes nothing happens. Normally that would give you stagnation. The Administration just released a trade policy statement that said very little. You have to parse these statements regarding trade very carefully. To quote the testimony made by the new U.S. trade representative, "We are not going to look for deals just to make deals." Well, nobody else is either. The usual refrain is: "No deal is better than a bad deal." That, however, does not say anything.

The Obama Administration is not committing to anything at the moment, which is fair enough. They have only been on the job for six weeks, and they have not figured out what direction they want to take yet. Right now you have no confirmed officials at U.S. Trade Representative or the Department of Commerce. You can not read their statements and figure out what they are going to do because they do not know what they are going to do. These are very intelligent people, but they have not decided what they want to do yet. But I have an idea what is going to happen to them and what they will do.

Go back to 1999. (See Figure 2 below.) There were three really big economies in the world: Japan, E.U., and U.S. You only had three possible really big non-WTO trade agreements. You could have Japan-E.U., Japan-U.S., or E.U.-U.S. Japan in 1999 would not do bilateral deals as a matter of policy. That meant you only one possible deal: U.S.-E.U. There are numerous reasons, which Canada is finding out as it negotiates with the E.U., why you can not have a Free Trade Agreement between the U.S. and Europe.

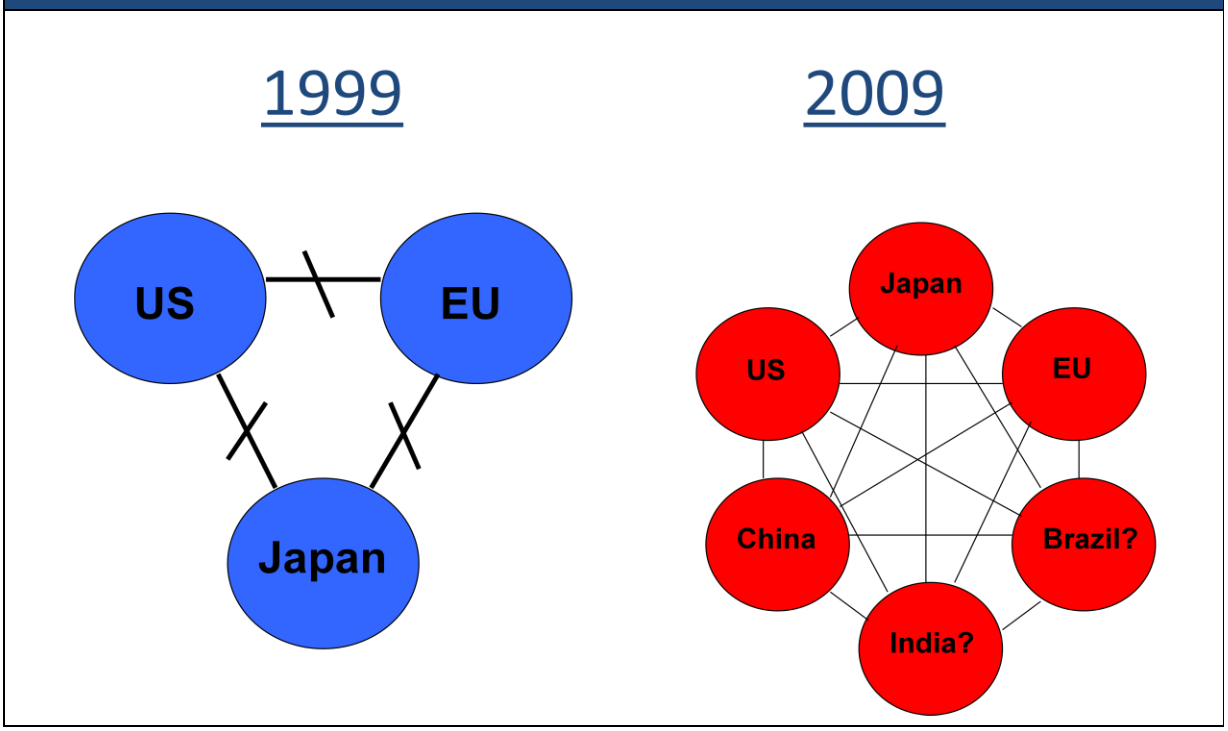
[3] The H1B Visa (Professional in a Specialty Occupation) allows a U.S. employer to fill a position requiring the minimum of a baccalaureate in the particular field with a qualified worker from abroad. The foreign worker must possess that U.S. degree or an acceptable foreign alternative. In some cases, a combination of studies and relevant experience may substitute for the degree if it is determined by a credentials expert to qualify the foreign professional. http://www.murthy.com/h1bvisa.html

Now go to 2009. There are at least four big economies: Japan, E.U., U.S. and China. Japan is now perfectly willing to deal. You have to add probably India and Brazil because, when you think in terms of trade policy, you are thinking five years ahead. When you start negotiating a deal today, you are trying to figure out what is going to matter when it is implemented. If you start today, you are probably not looking at any meaningful implementation for at least five years.

Let us be optimistic about the world economy. Both India and Brazil have weathered this downturn far better than the U.S. because of their banking system. If you count all the possible bilateral deals now, there are 21. If you have multilateral deals within these six major economies, you have six factorial possibilities. Instead of having zero possible deals in 1999, you have a large number of possible deals now. All of these countries are out negotiating deals with fairly large countries. The E.U. and India, for example, are currently negotiating an FTA. Personally, I am sceptical of success for the same reasons the EU has not been able to secure a trade deal with Mercosur.

For the sake of argument, let us imagine the E.U. and India complete a trade agreement. It would not be a very comprehensive deal. Let us say it liberalizes 70% of trade. India has quite high import barriers, and Europe has some high import barriers. The U.S. could dismiss it as being an inconsequential deal, but American business would go berserk. They would fear being discriminated against in Europe and India, and would pressure the government to do something.

Figure 2. Possible Non WTO Trade Deals: 1999 and 2009



The six countries are effectively dominoes. Once one domino falls, you are looking at game theory – it is no longer trade policy. None of those countries can afford to be discriminated against in any other country, *vis à vis* the others. The U.S.

has had a policy under the Bush Administration of negotiating a lot of small agreements. The Canada-U.S. FTA remains, after 20 years, the largest trade deal the U.S. has completed. It is bigger than all the other deals the U.S. has completed combined. The U.S. has made a lot of small deals. If the Korea-U.S. deal is ever completed, that statement will no longer be true. But that will not happen this year and maybe not next year either.

The biggest deal the U.S. has made was 22 years ago. The U.S. has done a lot of deals for foreign policy reasons, for example, Morocco, Oman, Bahrain, and arguably Central America. The only other really big ones were Mexico and Australia, which are tiny compared to U.S.-Canada. The U.S. was unable, because of the way it negotiated, to complete deals with Brazil, Southern Africa, Switzerland, Malaysia, and Thailand. To be blunt, the U.S. would have been better off with the deals it did not make than with the deals it made.

Now you are facing really big deals. Say the E.U. completes a deal with South Africa, which it did. The U.S. failed to do a deal with South Africa. American businesses are unhappy, but it is not a big deal. If the E.U. were to complete a deal with India while the U.S. failed, it would be a different story.

As I said, it takes one domino. I am pretty sure that one of the big deals will happen. If I were to speculate as to where this will happen, I would say the most likely domino to fall will be in the Asia-Pacific region. (See Figure 3 below.) There is a rather small, inoffensive FTA called the Trans-Pacific Partnership (TPP) which is comprised of New Zealand (4 million people); Singapore (5 million people); Chile (17 million people) and Brunei (400 thousand people). That is about 26 million people. It is respectable, but it is a population much smaller than Canada (33 million). Australia and Peru are joining, so it is starting to get bigger. Vietnam is thinking strongly about joining, which is very interesting because Vietnam is where you go when your costs in Eastern China get too high. The U.S. under Bush said it wanted to join.

Obama's Administration has asked to hold off on the talks as it is not sure whether or not it wishes to join. Let us say the U.S. joined, then a huge number of countries would join because they would not want to be left out of getting access to the U.S. market (countries listed here include Canada, Korea, Thailand, Malaysia, Mexico, Japan, Philippines, maybe Brazil, and Columbia).

What you are looking at is dominoes falling. If that happens, then China will think about joining. Such a configuration would include NAFTA and a lot of ASEAN. I am not guaranteeing that this is what will happen first, but this could be where it starts. It might not necessarily happen out of TPP. It probably will not happen out of ASEAN because of Burma/Myanmar. It will not happen out of APEC because it has not happened in 15 years.

Figure 2. The Domino Effect

NAFTA/TPP/?

NZ		Australia				Canada		
Singapore	+	Peru	+	U.S. ?	+	Korea	+	China
Chile		Vietnam				Thailand		
Brueni						Malaysia		
						Mexico		
						Japan		
						Philippines		
						Brazil?		
						Colombia		

If you go back to the European Communities in 1957, formed by six countries, as much for political reasons to prevent another war and to fight the Soviets, there was not a lot of progress. By 1967 Great Britain had to join. Britain didn't want to join; they still do not want to join. If Britain joined, Denmark and Ireland had to join. There is some debate as to whether Spain and Portugal had to join. Once they joined, everyone else had to join. Sweden and Austria did not want to join. If you talk to the average Swede or Austrian they wish they were not in the E.U. because they wind up doing a lot of things they do not want to do.

So if you look at something like the TPP, once Japan or the U.S. joins, everyone else has to join. That is what the Obama Administration is facing. They will be driven by Pacific economic architecture. They are, however, well aware of this, and know that they can not let China design it. The U.S. can not afford to let China design how the Asia-Pacific region works. That will drive their overall trade policies.

What are the consequences of that? First, I think you complete the Doha negotiations in the WTO. There is no guarantee they will do that, but I think that even if you do not complete them, you certainly restart them, possibly as early as the April G20 summit. It helps you prove that you are not being protectionist, even though everyone is being protectionist. That does not mean they will finish Doha; it is difficult to finish now as it was last year. Possibly after the Indian elections in May it will be easier to finish, no one knows. That is the lifeline to which people are clinging.

Second, what do you do in NAFTA? President Obama, during the primary campaign, said first he would renegotiate NAFTA and then changed that to improve NAFTA. During the general election, he said nothing. He did not have to. Senator McCain was running as a pure free trader, so President Obama did not have to get to the left of him. Obama has a vague commitment to do something about NAFTA. The labour unions have already said it is ok to postpone it, as there are more important things to do. The labour unions make a big deal out of NAFTA, but NAFTA itself has very little impact on the U.S. economy. It is just a convenient piñata for the labour unions to beat.

We are now down to improving NAFTA. If you want to get specific about it, in May of 2007 the congressional Democrats and Republicans negotiated a package on labour and the environment, and a few other things like pharmaceuticals, and that became the basis for the U.S. – Peru FTA.. That has to be what Obama will look to do with NAFTA. I was counsel to Peru during the FTA. It was great; as soon as that passed you could tell immediately that the Democrats would vote for one of the four FTAs that were pending. They could not vote for none as that would be bad faith and would reflect badly on the U.S. And they were not going to vote for more than one. We celebrated immediately because we knew it would be us. There were reasons why it could not be Korea, it would not be Panama, nor would it be Columbia, so by the process of elimination we knew it would be Peru.

The environmental deal is fairly complex, but it is basically dependent on both countries having laws conforming to any multilateral environmental deals to which both countries are parties. Presumably Canada already does that. What this does is let the U.S. challenge you under NAFTA dispute resolution as to whether you are actually complying. Most of these multilateral environmental agreements do not have effective dispute resolution mechanisms, if any at all. You are not changing any of the agreements signed, but you are making it easier to have a fight. Needless to say, this works both ways as it means Canada can challenge the U.S. The U.S. is usually pretty blithe about this, assuming it is perfect. NAFTA Chapter 11 proved that this was not exactly true. It could be a source of controversy.

Much more difficult is the labour side, which is why I want to emphasize it. The May 2007 agreement between Republicans and Democrats on labour was that countries with which the U.S. has free trade agreements will have to implement laws reflecting core labour standards under the International Labour Organization (ILO). Previously, both in NAFTA and elsewhere, countries had to enforce their own labour laws, whatever they were – Canada obviously having quite strong labour laws, more protective of workers than the U.S. usually. There is a dispute mechanism in NAFTA that is literally designed not to work.

The new deal is quite different. In practice there are eight ILO conventions. I believe Canada has signed all eight of them, whereas the U.S. has only signed two. So why the U.S. is doing this gets interesting. Arguably it is the Democrats trying to force through changes in U.S. labour law. Leaving that aside, it totally changes the dynamic. Remember, the earlier version was that you would enforce your own laws. The argument you would get in the context of negotiations was what sort of dispute resolution mechanisms you would have. Even to say that now a foreign country could challenge you for not enforcing your own laws would be a big step. This goes one step further: now you have to change your own laws to make sure they conform to these eight conventions. This gets you into the weeds of labour laws quite fast.

One reason why the U.S. will not sign these conventions is the convention that states you can not have people in your military under 18 years old. The U.S. Marines Corps recruit 17 year olds. And there is no way the U.S. is going to change that. The

ILO agreements state that you are not allowed to have political tests for union leaders, while the U.S. bans members of the Communist Party from being leaders of U.S. labour unions. I do not know if there still is a Communist Party in the U.S., but the law is on the books and the odds of it changing are zero. I do not know what the Canadian peculiarities of labour law would be, and you also have the provincial level of labour laws which would cause issues.

What happened with the U.S. – Peru FTA after the Congress approved the agreement was that the United States Trade Representative sent lawyers to Peru to rewrite Peru's labour laws. Think about that. It went right up to the last second. The U.S. Trade Representative would not certify that Peru implemented the agreement until Peru instituted huge changes to its labour and environmental laws, specifically with forestry in mind. So if you agree to this package, you would have U.S. government lawyers try to tell you how to rewrite your labour and environmental laws. I do not think that quite sunk in with people, but that is literally what happened.

If that is what happens in NAFTA, that will occupy a lot of time and energy, not to mention newsprint (so it is not all bad for Alberta). I do not think anyone wants to get drawn into that morass. There is no profit in it; no gains to be won for doing that. It is not electoral issues in the U.S. Labour unions like to beat NAFTA over the head, but nobody will vote over this. The unions have bigger fish to fry, especially with union election methodology in the U.S. So, in theory, that is what President Obama was talking about – the Peru agreement. I just can not see the Obama Administration wanting to spend the time and energy getting into this morass with NAFTA partners, especially not in its first term.

Separately, there is a good argument for improving NAFTA overall. Canada, I am sure, would have some suggestions. Most of my clients are big U.S. multinationals that operate all over the world, including the U.S. and Canada, but also in Europe. You can drive your truck across the great battlefields of Europe, from Germany through Belgium and Netherlands and not know you were crossing three countries. If you try to cross the Peace Bridge in Buffalo, or the tunnel in Detroit, you are looking at 2-4 hours. Trying to cross from Tijuana to San Diego is 16 hours. Companies just scratch their heads at this and reflect on whether or not there actually is an FTA. NAFTA is seriously backwards on this. If you are serious on economic efficiency, NAFTA does not work very well. There is a lot to be done about the thickening of the border, which Canada has obviously been concerned about for years. Improving NAFTA is not out the question, it is just not a high priority for the Obama Administration. Mechanisms have to be found to make NAFTA work.

That leads them to the Pacific area, which will probably be the focus of their efforts. Canada is a major Pacific country. NAFTA as a brand name for the Democrats is tainted. So my thinking on NAFTA is that you work on it outside of NAFTA, and I know Canada tried with the Strategic Partnership. Some new label will have to be found. The Obama Administration will have to make it their own initiative, but some new label will have to be found that permits the kinds of things that economic entities on both sides of the border think are necessary.

In this context, I repeat, and this is really in conclusion, you have to read their words carefully and look at what they are doing. For example, President Obama, during the primaries, made the point that he would never approve the U.S. – Colombia FTA until Colombia had sufficiently proven it would defend labour union leaders in Columbia. This sent shivers down the backs of anyone involved in the Colombia FTA who were afraid they were going to throw aside trade, national security and drug trafficking concerns. However, if you go back and look at the words he used, he said that he would not approve it until he wanted to. Just last week he said he would sit down with Columbia and establish measuring sticks for Colombia to live up to, and once those were done then they would do the deal. When you are running as the opposition you come out and say that you will not do certain things, but careful not to box yourself in to anything.

Essentially, to conclude, the Obama Administration is not boxed in on anything, and the people running trade in the White House are Larry Summers, Jason Fuhrman, and Mike Froman, all of whom are perfectly happy with free but fair trade. They are not protectionist in any way, shape or form. They were all involved in the Clinton Administration; they all worked on NAFTA; they were all involved in bailing out Mexico, etc. So the difficulty is finding something that works strategically. They are all very smart people and strategic thinkers. They must also find something that works politically. This Congress has to run in 2010 and the President has to run in 2012. That will determine what they do in their first term.

Questions

Q1: Connie Smith, Department of Economics

I have a question about the thickening of the border. Canada is the biggest export market for the Americans. Why is it not considered a political issue to make it easier to ship to Canada and create jobs that way?

Gary Horlick

You would think it would be. Having spent an hour trying to get through immigration yesterday, I can tell you that both countries harass their own citizens trying to get into the country. I was the International Trade Counsel for the Senator Finance Committee and one of the responsibilities was oversight for the U.S. Customs Authority. So Customs promised to have a green lane and I walk through Dulles Airport and sure enough, you queued up and someone is waiting to take your card just like Edmonton. We called Customs up and asked “Where’s the green lane?” They told us that was the green lane. Their view of the world is that they have to look you in the eye as they take your card and somehow scientifically that will stop terrorists. The security people are part of it, but all of you know this predated 9/11. So I do not have a good explanation for you.

One ray of hope is something in Doha called ‘Trade Facilitation.’ The WTO Doha negotiations have several topics. One that has attracted the least attention is something called Trade Facilitation, which everyone thinks is aimed at third world countries’ customs services. It would set standards and best practices that everyone would have to meet. The idea is that the U.S. does not need them and Canada does not need them. To be blunt, my best guess is the best way to deal with border issues is through trade facilitation, either in the WTO or in NAFTA (Canada, U.S. and Mexico) and try to get the corporate trade facilitation lobby going. When the E.U. did its single market initiative in the late 1980s, studies, undoubtedly bogus but probably with a grain of truth in them, calculated that just removing the border posts would increase GDP by 1%. That is why you do it. It drives companies crazy. When the U.S. shut the border on September 11th – which is understandable, when something like that happens you shut the border and then figure out what to do – six General Motors plants closed in the U.S. because they could not get the parts from Canada. It is an issue for the U.S. and U.S. business knows it. It is just not a high enough priority right now.

Q2

How bright will Alberta’s oil be on this Administration’s radar?

Gary Horlick

It is a big question. Alberta’s oil, and more specifically Alberta’s oilsands, is a big deal. On the one hand, for the energy security people, this is energy security for the U.S. On the other hand, for the environmental people, primordially they do not like mine owners. It starts with folklore: mine owners are bad; open pit mines are bad; oil is bad; so oilsands are about as bad as you can get. Some environmentalists do not care about oil security because they do not think that we should be using oil at all. Yes, Alberta’s oil and oilsands are going to be a big deal. It will come to head in climate change legislation, which I left out of my speech because I knew somebody would ask me about it. The Senate Majority Leader in the U.S. says he wants to complete and to pass climate change legislation before the August recess. The house just hired a lawyer for the Natural Resources Defence Council to draft the legislation. There are hearings going on nearly every day on the subject. Climate change will become a vehicle through which Alberta's oilsands become a big issue.

Q3

There was a critique of the Bush Administration about politicizing regulation and giving executive instructions about regulators accepting voluntary codes. Will the Obama Administration have a different attitude towards regulation? The SPP was forming trilateral committees to harmonize regulation between Canada and the United States (and presumably Mexico) and presumably on the Bush model. I am just wonder what the implications are for the Obama Administration.

Gary Horlick

Well, as I said, start with the fact that they are really smart people. You start off well. Having said that, politicization of regulation is not something that George W. Bush invented. Every administration is accused of it. The Secretary of Agriculture just sent a letter to the American meat packers to ignore the country of origin labelling and do something different. I do not know how that fits in. Legally it is kind of strange. I am a lawyer and that is not how you do regulations under the Administrative Procedures Act. As for the cooperative regulation, I do not know where they will come out. No one does. A lot of the regulations are politically very sensitive and that tends to be done on political bases rather than trilaterally with other countries. Having said that, if you look at a map and if you were thinking of climate change, you would start with a globe because, obviously, it is a global matter. If the U.S. did everything anyone asked for on climate change and nobody else did anything, it would be wasted. Climate would still change. Basically, if everyone does not do something, you are not going to have much progress on climate change. It is one of those interesting situations where you must have cooperation or any individual action will be wasted. Not perfectly wasted, but a lot of it will be wasted. If you look at the globe and you look at regional spaces, there is one blindingly obvious regional unit, which is U.S., Canada and Mexico. Ecologically, we are not separate from the rest of the globe, but these three countries are, geographically, a quite circumspect area. South America is the other one. Africa somewhat, but less so. You can not really separate Europe from Asia. You would think you would do climate change between the U.S., Canada and Mexico, but you would be wrong.

Q4

Joe Rosario: As you pointed out, Congress is the determinant of trade policy to a large extent. You pointed out the problems with the U.S. not having signed several parts of the ILO. What happens when you get to that second scenario of those and the U.S. has to negotiate with say China, or Brazil, or India? They are not going to bend to those demands – they are going to be looking out for their own interests. Where do you see that taking these kinds of agreements in the future?

Gary Horlick

That is the challenge for the Obama Administration. The U.S. has not been able to make Free Trade Agreements with large countries precisely because it has such a strong view of what it wants. I am not saying the U.S. is wrong by the way, we know what we want and we are not willing to sacrifice much of it. With Korea, which would have been the largest deal since the U.S. – Canada FTA, we were willing to let Korea exclude rice, which is something we would not let anyone else do. So there is some flexibility. That is something the Obama Administration has to figure out. It is very clear the senior Democratic leadership in the House and the Senate, the Chairmen of both Finance and the Ways and Means Committees have said very clearly that they want Doha to go ahead being well aware that labour and environment are not part of Doha. Congress is not a normal government in the Westminster sense. In the Westminster sense, you have a majority in parliament therefore you are the government therefore you can pass things through the parliament. The U.S. is not like that. Everyone says it is because constitutionally they have the power over trade, but that is true of every Westminster-style parliament. It is an issue of the 'power of the purse' which goes back to Simon de Montfort's parliament in 1265. The reason that is much more complex is essentially because U.S. political candidates are not named by their parties. The parties do not come out and say, "The candidate for this constituency will be X." The candidates go out and fight for their seats, so they do not really owe that much to the party. When push comes to shove, Congress is not particularly controlled by the titular head of the party. They can not tell Congress what to do, so they end up with a laundry list, which they call the Template, when they are negotiating and they can not back off on any of it. And they do not. As a result, countries will not sign on to that Template, which now includes labour and environment standards, and we do not have deals with Brazil, Thailand, Malaysia, South Africa. We could not even make a deal with Switzerland, that terrifying juggernaut. So, that is why I put that slide up (Figure 3). A future U.S. administration, possibly the Obama Administration, will have to figure out what they are going to do <u>if</u>, and I underline the if, so far they have not had to, if, for example, Brazil and India or Brazil and China make a deal. If there is one big deal out there, then the Administration will have to make choices because every line in the Template is some lobbyist's demand which has been backed up in Congress. It will not be easy. That is one of the reasons why they quite correctly want to figure out their policy before they go ahead. It is a tough one. Even if the strategy made sense starting in 2001, making all these smaller deals with countries who would agree to our conditions. It is a depletion function – we are running out of countries who will sign on. I just told you the list of people who would not. It is a pretty big list.

Q5

It is a two part question. For the first part, on your list of the domino effect, you had China as a follower and not a leader. Given that China is aggressively pursuing resources right now, do you see them following other deals or do you seem them coming in at another level somewhere?

Gary Horlick

I do not rule out China being a leader in this. I do not know what China will do. China has a very thought out trade policy. This is not some mystical, imperial power. These people are very well grounded in trade policy. You talk to the trade policy people in China and it is no different than talking to people on Sussex Drive or in the Winder Building. China started out in 2000 wanting to do an FTA with Chile. And they told the Chileans, in English, because it was all negotiated in English, "We are doing our first FTA with you because we want to learn how to do an FTA because you are a small, poor country and we import copper and fruits from you." The first thing they discussed is what to start with. The Canada-U.S. FTA, if you remember, was a really hard fought negotiation. They started with 200 blank sheets of paper, and they fought about every word. There was no model. Some of the language came out of the GATT, but most of it they discussed and fought about. Every FTA the U.S. has done since then is effectively the same thing with the names changed. It becomes a template. Now you are on the fifth generation of the U.S. Trade Representative and people who were not present at those negotiations and have no idea why the words are there and why people were insisting on them. It is always easier to start with someone else's draft. So the Chinese and Chileans sat down and thought about what they should start with. The decided to start with the Chilean-Korean FTA, which is, of course, the Chile-U.S. FTA, which is, of course, NAFTA. So China is now signing NAFTA with countries all over the world. Afterwards, China sat down with New Zealand because they wanted to do an FTA with a developed country. New Zealand is a developed country and fairly small, so it suited China's purposes. They are not sitting there unaware of what is going on. They are sitting there executing their plan. I do not know what their plan is, but I am sure someone there does. Maybe they do plan to be the leader, at which point the U.S. cannot afford to have China draft the first big deal, even if it is based on NAFTA. If China jumps the queue, and I do not mean that in a negative sense, it lights a fire under whoever is president of the U.S.

Q5 part 2

The OECD came out recently that Russia and China were hit hardest by the economic downturn and this may have an impact short term on the treasury bonds. What do you forecast as happening with the U.S. treasury bond markets?

Gary Horlick

Nobody has any idea. In the last six months, anyone who thought they knew what they were talking about has proved not to. I do not think China is the hardest hit. They would be kidding themselves to say that. It is been hard hit, and there are ways in which it is suffering, but it is still doing alright. Chinese banks are still going strong, with a trillion dollars reserve. They are hit hard, but they are not the hardest hit. Russia is hit very hard.

Q6 Rolf Mirus, Western Centre for Economic Research

Going back to the issue of the thickening of the border, I think there are two views. One is that Canada should negotiate with the U.S. directly; the other is that they should bring the Mexicans into the negotiations, given the voting power of Mexicans and Spanish-Americans in the U.S. What is your take, from where you sit, which is more promising?

Gary Horlick

Cold bloodedly, Mexican-American voting power has not been an active force on trade deals. There are plenty of reasons to do it either way. The U.S. is going to have a hard time doing something with Canada that it does not do with Mexico. On the other hand, there are different issues on different sides of the border. It is hard enough to get the U.S. to do it for either, which is why I was hinting to try to do it another way. If Doha gets going again, Canada should try and make sure that 'trade facilitation' in Doha does something about the border. It is strange to think of our border as third world.

Q7

I think I follow your reasoning with respect to the dominoes falling. But I wonder, given the economic climate, what is your assessment of the trade regime descending into groups of spaghetti bowl blocks, with some of the larger countries going after groups of smaller fish and looping them in, or drawing them in as the U.S. has done over the last 7-8 years, and these blocks interfering in the multi-lateral realm.

Gary Horlick

We are not going to split into blocks because all these deals that the U.S. has made are with countries that have done deals with Europe and China. So you are not getting blocks, which is good. It is probably the only mistake of the 1930s we will not repeat. What you do get is a spaghetti bowl, which has real practical consequences. For any of you in companies, you have rules of origin, which get very complex. When the Canada-U.S. FTA got done, I painfully worked my way through the rules of origin. It was a new structure of rules of origin for the U.S., so it was worth learning. It was basically the Kyoto Convention on Customs, plus 30 pages of exceptions. Well, every lobbyist got hold of it, so for NAFTA there were 230 pages of exceptions. All of them had differences. U.S.-Chile has differences; U.S.-Peru has differences; and U.S.-Oman has differences. To show you how bad it is, they are not even in the same computer format. You can not put a search in and bring them up. You have to look them up yourself. It is really bad governance. What does that mean? It means that if you are a company and you want to make a laptop in Mexico, you call me up and ask me about the rules of origin. I can tell you, and I will not even charge you because I know. Then you call me up and ask me about rules of origin for Chile. Well, I know they made three changes, but I can not remember what they were because nobody can remember what every change is for every deal. I have to look it up and charge you, and then it is not worth it for you anymore. Instead, you pay the MFN (most favoured nation) rate rather than the zero NAFTA rate. A phenomenal amount of trade under NAFTA does not take advantage of NAFTA's zero tariffs. I have not checked recently, but last time I checked it was 50% because of all the complications in rules of origin. All of these FTAs have different rules of origin. Negotiators can not stop themselves, nor can lobbyists. The WTO to its own shame has not come up with rules of origin to set as a model. I foresee an endless multiplication of bilateral trade deals, not blocks, just endless multiplication, even if Doha succeeds. Let us say you are the CEO of a company and you ask me about Doha. I tell you that I will cut the tariffs on your main product from 7.6% to 3.8% in uneven tranches over 7 years, and you look at me like I am nuts – why bother? However, under FTAs, they go to zero. No more customs valuation disputes; no more classification disputes because they are all zero. You wipe out 20 people in your logistics department. You can see the attraction in these deals, even if they are in spaghetti bowls. The WTO has not been able to do a lot of this stuff. I am a big fan of the WTO, do not get me wrong, but it is bogging down in inertia. Even if it completes a DOHA deal.

Q7

Gary, I seem to gather from what you are saying, it appears that China is outflanking the U.S. in negotiations in other countries, largely because the U.S. is insisting on its particular standards being enforced in other countries, which I would call trade imperialism. There is a lot of discussion in the press that we are slipping into another Great Depression. What signposts would you suggest we look out for in terms of an early warning of whether that's occurring?

Gary Horlick

Let me separate that into two parts. In the first part, as to China outflanking the U.S., we do not think that it will. I think it is more likely that China will do its deals and the U.S. will do its deals. The U.S. is a very large economy, and large economies tend to force their standards on smaller economies. The U.S. is not the largest economy. Europe is. China will be right up there, and Japan is very large. You will have all four of them competing for who sets the standards. Not in direct competition, but in the way it plays out. China so far has fewer agreements than the U.S., but a China-India FTA or a China-Japan FTA would really shake up the U.S., to say the least. I would characterize it as game theory. There are several players taking part, and none are in position to control things. There are at least 4 large players.

As for descent into a great depression, what you have to look for are sharp drops in trade. That is what turned a stock market crash in 1929 and a bank crash in 1931 into a 10 year depression – a reduction of world trade by 65% in three years. We are not there yet but it sure is not pretty. I remember November 20th, at the height of the crisis, the leaders of the world meeting in Washington and promising not to take any protectionist action while the E.U. was imposing anti-dumping duties on Chinese screws. China, in retaliation, started a dumping case on E.U. screws. The U.S. imposed dumping duties, symbolically enough, on paper from Germany, but not just any paper. It was the paper used for credit card receipts, which I found touching. It will not be done by Smoot-Hawley; it will not be one huge tariff increase. It will be death by a thousand cuts. Every country is saying they will not repeat the mistakes of the 1930s while repeating the mistakes of the 1930s. France says it will put 6.5 billion Euros into the French car industry, and oh, by the way they have to give preference to French parts – French, not European. They are also closing plants in the Czech

Republic, but not in France. It is literally the 1930s. I do not want to cause panic because we are not at 1933 levels again, but we are heading that way. The people in the 1930s were not stupid. They are just as smart as we are. There were economic conferences to try to prevent trade wars and they failed.

Q8

More on your assessment on climate change policies. If it is going to be by the end of August that the legislation is rolled out, do we still have a chance to influence it

Gary Horlick

The legislation is wide open as we speak. But for the current economic crisis which has overwhelmed everything else, my speech today would be about climate change. If you asked me a year ago what we would be talking about today, I would have said climate change. Climate change, to put it in its broadest sphere, is control over every human activity that leads to the emission of greenhouse gases. Well, that is a lot of activity; that is everything. This is huge. It is hugely complex. It provides people with the opportunity to control things they like or do not like. It is not only a social engineer's nightmare. It is a lobbyist's paradise. Let us see what we know about the legislation. First, the U.S. will pass this legislation in the next two years. Why? The people who want this legislation have wanted it since 1994, when the Republicans took control of Congress. Even when the Democrats came back into power two years ago, the White House still had a very effective veto. The Democrats have been out of power 14 years. When you talk to them they tell you, not so straightforwardly as this, that they have been waiting for over a decade to do this, and they will not let an economic recession get in the way. They might lose power in two years.

Two, there will almost certainly be international agreement? Why? Because, as I said, whatever the U.S. does, or China does, or Japan does on its own is irrelevant. As I said, it is a global issue. I am not taking positions on the science or anything else, but there will probably be agreements and there will certainly be U.S. legislation.

That raises a third issue of how you stage the two. The U.S. leans towards passing its legislation with a little bit of wiggle room in it and then going off and negotiating, rather than negotiating first and then legislating. Again, this is driven by the fact that the Democrats could lose power in two years. Within that, we also know pretty well that it will be a cap and trade system. Businesses do not want a tax; consumers do not want something called a tax. Economists want a tax, but really, how many economists are there? A carbon or an energy tax might be the optimal choice, but it will not happen. Instead you have cap and trade. There will be a cap; there will be permits that will be traded on exchanges by the people who brought you the financial crisis. You will not be able to do anything that causes greenhouse gases unless you have a permit.

I am overstating it. There will be some exceptions. Well, what do you do about imports? That raises the issue of competitiveness. Congress has been talking about the impact of climate change legislation on competitiveness for two years now. Approximately 90% of the discussion of competitiveness that I have been able to dig up refers to imports that compete with U.S. industries that emit a lot of greenhouse gases: steel, chemicals, cement, and aluminum. So what do you do about those? You make them have permits too. Maybe 9% of the discussion of competitiveness has stated that any legislation will violate the terms of the WTO and NAFTA and a few other things, therefore people will retaliate against us. Maybe 1%, but probably not even that high, has reflected on the fact that the U.S. is not the only country dealing with this, and that there are 190 other countries dealing with this as well. What is that going to do to American exporters?

Think about it, you have 190 countries, each with their own permits. You thought spaghetti bowl with rules of origin was bad. You have to have an international agreement, or else trade will slow down, if it does not grind to a halt completely, just when you do not want it to slow down. International agreement is supposed to be finished by December of this year in Copenhagen. I consider that highly unlikely. It is a very complicated issue. I only deal with the international sphere, but I talk with the people responsible for the rest, and they are telling me that the rubber has not really hit the road yet in terms of negotiations. I am betting it is 2010 before an agreement is reached, not 2009. You do want to have it in a developing country – Copenhagen makes no sense; Bali made no sense.

So what will it do? Well, that is a good question. There will be some sort of cap and trade system because Europe has a cap and trade system; the U.S. will have one; and taxes are no more popular in Canada, or Mexico or Argentina or anywhere else. There will be a worldwide cap and trade system, which is a sort of amazing thought. As I mentioned, social engineering of the highest order of a kind we have never seen. You can argue that we will never reach an international agreement, but I bet we do. Kyoto expires in 2012. If you are the prime minister of India, you can sit there in Doha and say no to everything and you look good politically back home. But even if it is bad for India, because your service sector and your technology sector are going to be damaged, politically it looks good. You can not do that with climate change. They get the same maps that we get. Maps that show who benefits and who loses from climate change. Areas in green like the Northern U.S., Southern Canada, and Kazakhstan that will benefit. Then there are the areas in yellow that will not benefit: India, China, Sub-Saharan Africa. India loses hundreds of thousands of hectares of agricultural land every year to desertification, so does China. So politically there is a reason why India and China will want an agreement. Sorry for the long answer, but it is nowhere near as long as the process will be. There are opportunities to influence this all over the place, and you more or less have to. To turn to Alberta specifically, I do not think enough attention has been paid to NAFTA and the interplay, legally, between this and the energy provisions. The U.S. wants those energy provisions. I think it is worth looking at what the U.S. is proposing on climate change and how it intersects with those.

Conclusion

Helmut Mach

That pretty much wraps it up in terms of our time available. Thank you very much Mr. Horlick for your presentation. Again I would like to express our appreciation to CN and their continued support for our initiatives related to Canada – U.S. trade relations. We will be following up with other events and other speakers throughout the year to keep us informed of what happens in the U.S. and give us further prognosis of what may happen. So look for those over the course of the year. I would also like to thank the staff of the WCER who did the work on putting this together. Thank you and we hope to see you again.