

## **THE UNITED STATES VS. CANADA: BLOOD FLOWS IN THE FIRST TRADE WAR**

Just as the United States and Canada were beginning crucial negotiations to establish a Free Trade Area between the two countries, the Reagan Administration slapped a 35 percent tariff on imported Canadian cedar shingles. This move drew little more than a yawn in the U.S., but it triggered headlines in Canada. These cedar exports are critical to the economies of several communities, and the outraged Canadians responded predictably. They retaliated by slapping tariffs on various U.S. goods, such as computer products and printed materials. In response, predictably, there now are calls in Washington for counterretaliation by the U.S. What is shaping up is a classic trade war. And this war would be just a skirmish in what could erupt if the U.S. embarked on the path of trade protection.

The U.S. and Canada have the world's largest bilateral trade, amounting to nearly \$117 billion in 1985. And because Canada is America's largest trading partner, a trade war would cripple U.S. exports and cost thousands of jobs. Late last year Canadian Prime Minister Brian Mulroney suggested that the U.S. and Canada enter negotiations to establish a Free Trade Area (FTA). Under such an arrangement, both countries would drop all tariffs and quota restrictions on trade and open their markets completely to each others' exports. Such an FTA could benefit both countries enormously by expanding bilateral trade, and it would set an important example for the rest of the world. Final agreement on an FTA would be subject to congressional approval.

Yet on May 23, the day after the conclusion of the first U.S.-Canadian negotiating session, the Administration accepted a recommendation by the International Trade Commission (an independent, quasi-judicial U.S. government board that deals with trade cases) to impose a 35 percent tariff on the \$180 million of cedar roofing and siding shingles imported annually from Canada. These imports are said to harm the U.S. shingle industry.

The Canadians were outraged by the poor timing and the blatantly protectionist nature of the action. The Reagan Administration

apparently had broken its promise to consult with Canada if such trade action were anticipated. Understandably, this could threaten seriously the FTA negotiations, where mutual trust, consideration, and cooperation are essential if there are to be concessions by each side.

In retaliation for the U.S. action, Canada has raised tariffs--only recently lowered--on a number of products. U.S. manufacturers of computer parts and semiconductors will now have to pay an extra \$30 million annually in duties for goods they sell in Canada--thus raising the prices they must charge Canadian customers and thus making these products less competitive. U.S. publishers similarly will pay \$25 million extra to sell various books and periodicals in Canada. Further, Canadian tariffs will be imposed on such currently duty-free commodities as wood products, tea, oats, asphalt, oil, and rail cars. This is only the first immediate reaction to the Reagan Administration's protectionist efforts for the U.S. cedar shingle industry.

The Reagan Administration acted under pressure from Congress to show that it is "tough" on the trade issue. The lawmakers thus should note carefully how this first trade war is developing. Congress cannot attack special interest protectionism in foreign countries and then practice it at home, for retaliation will quickly follow. Many in Congress maintain that, since other countries are more dependent on the U.S. market than the U.S. is on theirs, the U.S. can restrict its market without fear of countermeasures. This was and is nonsense. Canada sends 75 percent of its exports to the U.S., yet did not hesitate to retaliate.

In the early 1930s, in a "mutual assured destruction" approach to trade policy, countries retaliated against what they believed to be unfair trade by their partners. An irreversible chain reaction was soon underway, leading to more than a decade of worldwide depression. For the Reagan Administration to enter a tariff battle with Canada, one of the few countries seeking freer trade, and to do so just as trade negotiations are beginning is foolish and costly. If the Administration is to have any success in free trade negotiations with Japan or Europe, which are already cynical about U.S. intentions, it must rebuild its damaged credibility with Canada. Learning this lesson is the only possible victory in a U.S.-Canada trade war.

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For further information:

Edward L. Hudgins, Testimony on the Proposed U.S.-Canada Free Trade Area, Senate Finance Committee, March 19, 1986.

Richard G. Lipsey and Murray G. Smith, Taking the Initiative: Canada's Trade Options in a Turbulent World (Toronto: C. D. Howe Institute, 1985).