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The importance of the economic relationship between Canada and the U.S.

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Declaration:

I hereby declare that I am the sole author of the thesis entitled “The importance of the economic relationship between Canada and the U.S.”. I duly marked out all quotations. The used literature and sources are stated in the attached list of references.

In Prague on

Signature

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I hereby wish to express my appreciation and gratitude to the supervisor of my thesis, Mr. Ing.
Ilya Bolotov MBA, Ph.D.

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List of abbreviations

UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization
BEA	Bureau of Economic Analysis
WITS	World Integrated Trade Solution
NAFTA	North American Free Trade Agreement
CUSFTA	Canada-United States Free Trade Agreement
USMCA	United States-Mexico-Canada Agreement
USTR	United States Trade Representative
CETA	Comprehensive Economic And Trade Agreement
USITC	United States International Trade Commission
GOC	Government of Canada

Introduction

The ever rising level of globalization and growing interconnectedness of the countries make it easier to establish new economic relationships and prioritize the new partnerships, often forgetting and giving less appreciation and attention to the old partners. Given all these factors, for each country it is extremely important to keep positive economic relations with its existing trade partners, especially those, with which it has had long-lasting partnership that has proven to be successful and vital for the stable development of the economy. Nowadays, one of the examples of such a relationship can be Canada and the United States of America.

The fall of 2018 was a moment of truth for both of these countries. Despite their long-standing mutual history and the importance associated with it, the officials of two countries had to come to an agreement over their future bilateral relations and decide what is best for each of them. Today, it is a widely-known fact that the process of negotiations between the partners was complicated, as often the interests were different and the conditions were not suitable for the participants, which caused multiple delays and missed deadlines. Nevertheless, Canada and the United States managed to find acceptable solutions to the existing problems, and signed a new deal, which would determine the future of their relationship. However, was it really necessary to spend so much time arguing and making concessions that were not always beneficial for participants?

The answer to this question is directly related to the topic of this thesis: “The importance of the economic relationship between Canada and the U.S.” Any action taken by either an individual or the government follows the assessment of the situation, which serves as an incentive for this very action. The decision to take the action is the result of that assessment, and in most cases it means that the objective, for any reason, is important to the subject. Similarly, the case of Canada and the U.S. follows this pattern, meaning that their bilateral relationship is important to them. However, to better understand their economic relationship, it is necessary to assess it from different perspectives, which this thesis aims to. Therefore, among the main goals of this paper are to have an in-depth look at the economic relationship between Canada and the United States, identify problems and dependencies, and try to predict possible scenarios of its future development.

Conducted research and analysis of facts will allow us to complete the goals of this work, however, even without having done the preparation, possessing only general knowledge, it is possible to say

that Canada-USA bilateral relations are of a particular importance for each of them. For that reason, the scope of this research will be narrowed down to the question: “Does Canada-US economic relationship has bigger impact on Canada than on the United States?”

To reach the objectives set in this thesis, we will use the following methodology: observation, comparison and analysis. All these means of research will allow to gather necessary information, adapted to the realities of the world, then use it to compare the countries to each other, supporting the comparison by the analysis of the available data. Due to the unavailability of the appropriate data for the years of 2018 and 2019 at the moment of writing this thesis, for the purpose of analysis we will use the latest data available, which in most cases will be represented by year 2017, and rarely 2016.

Regarding the structure of this work, we will divide it into 3 parts, each having its own subdivision. In the first chapter we will describe the history of the economic relations between Canada and the U.S. and show its progress in time. This chapter will be composed of two parts, where we will find out how the initial free trade efforts were made and how it lead to the creation of NAFTA.

The second chapter will focus on the latest aspects of mutual economic relationship between Canada and the United States. The main goal of this chapter is to analyze macroeconomic and other effects of the bilateral relationship and to define common economic trends. Here, we will also try to identify key segments and industries in the merchandise trade, trade in services, as well as assess the development of the foreign trade investments between these two countries. Lastly, we will give examples of how free trade agreements and activities related to them can lead to other than economic impacts, and what issues may arise.

In chapter 3 we will identify the problems and analyze how President Trump’s policies affect the bilateral relations and the influence they had on NAFTA renegotiation, which ended with signing a new agreement. Then, the key changes in the new deal will be identified, which will also help us try to predict the future possible directions of Canada-US mutual economic relationship under new agreement.

1. Development of the bilateral relations

Before assessing the importance of the current economic relationship between Canada and the United States, it is necessary to point out that their mutual history includes numerous years of cooperation, which has not been equally beneficial for either of these countries during this whole period of time. As any other sphere of bilateral relations, economic relationship between two countries is influenced by a number of different factors, which, for instance, involve concerns such as environmental challenges in terms of climate change, or geopolitical challenges such as terrorism and border security, and this involvement has shaped the direction in which Canada and the U.S. has been moving throughout their cooperative development.¹

In order to demonstrate different specifics of development of the bilateral relations over more than 160 years of ongoing economic evolution, it would be reasonable to divide it into two periods of time: the beginning and development of the early free trade efforts, and the creation of NAFTA leading to the whole new way of mutual economic activities. For the first part, the story will begin in the 18th century, where the first free trade attempts were made.² This will cover almost 2 whole centuries of the evolution of the relationships, and will end at the end of the 20th century before the creation of CUSFTA.

The second part of this chapter will start in the mid-1980s, since when the North America has been steering a new course, where Canada and the U.S. together with Mexico started to build mutual continental integration, culminating in the creation of NAFTA in the 1994.³ Here, the main factors which led to the establishment of this organization will be discussed, unleashing the important changes that had certain implications not only for the economic, but also political cooperation, which in some cases turned out to be somewhat controversial due to the differences between these countries.

¹ Canada–US Economic Relations | The Canadian Encyclopedia. [online]. [Accessed 15.11.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

² BOW, B., CHAPNICK, A. Teaching Canada–US relations: Three great debates. [online]. *International Journal*, 2016, vol. 71, no. 2, p. 291-312 [Accessed 20.12.2018]. DOI: 10.1177/0020702016641710

³ NEVITTE, N. *The North American Trajectory: Cultural, Economic, and Political Ties among the United States, Canada and Mexico* [online]. Routledge, 2017, p. 1-26 [Accessed 20.12.2018]. DOI: 10.4324/9781315133539

1.1. Early free trade efforts

While it is clear that the bilateral relations between Canada and the United States are of a vital importance today, this does not signify that the trading relationship has always been equally friendly. The relationship, on the contrary, has experienced multiple oscillations between the periods of free trade and protectionism. Even though there have been many examples of free trade agreements throughout the existence of the mutual relations, the disagreements have always been present during those intervals, caused by the protectionist feelings in most of the cases.⁴

The Canada-US relationship has a long rich history, and it becomes more and more complex. Nevertheless, despite having different trends and specifics of the relations for over than 160 years, some similarities can be found in the relationship during particular periods of time, allowing us to judge them from a broader prospective. For instance, Alan Smith, a Canadian historian, in his book about the Canadian-American relationship over “the long twentieth century” established four different chronological epochs.⁵ The following eras are:

- Pre-1850. During this period of time America dominated;
- The mid-to-late 19th century. Over this interval, the United States accelerated and helped along Canada’s development;
- The early 20th century. This bout is characterized by countries working together for mutual benefit;
- The post-Second World War. The specifics of this time period are shaped by Canada being more likely to look for counterweights to the U.S. power.⁶

Before going directly into description of these eras, it is worth saying that the early economic history of Canada was an act of reaching to its biggest trading allies, first Britain and then the

⁴ KILGOUR, D., JONES, D.T. *Uneasy Neighbo(u)rs: Canada, The USA and the Dynamics of State, Industry and Culture*. [online]. [s.l.]: John Wiley and Sons, 2009, p. 79-104 [Accessed 21.12.2018] Available from: <https://books.google.ca/books?id=UJpkFA-0PY4C&lpg=PA79&pg=PA79#v=onepage&q&f=false>

⁵ SMITH, Alan. Doing the Continental: Conceptualizations of the Canadian-American Relationship in the Long Twentieth Century. [online]. *Canadian-American Public Policy*, 2000, p. 2 [Accessed 25.12.2018]. ISSN 1047-1073. Available from: <https://www.questia.com/library/journal/1G1-76712782/doing-the-continental-conceptualizations-of-the-canadian-american>

⁶ BOW, B., CHAPNICK, A. Teaching Canada–US relations: Three great debates. [online]. *International Journal*, 2016, vol. 71, no. 2, pp. 291-312 [Accessed 20.12.2018]. DOI: 10.1177/0020702016641710

United States. In the following paragraphs we will take a look at the major pivotal points in the mutual economic history of these countries and how tariffs or their absence shaped their relationships.

The first attempts for managing the trade began in the pre-Confederation period. The term Confederation signifies the “process of federal union in which the British North American colonies of Nova Scotia, New Brunswick and the Province of Canada joined together to form the Dominion of Canada — a new country.”⁷ The Confederation is also widely used to refer to 1 July 1867, the date when the Dominion was created.

Among the primary economic activities in the northern part of the North America in the beginning of the 16th century was the cold fishery, which was later supported by the fur trade, regaining its former importance in the early 1600s.⁸ As mentioned before, the early economic development of Canada was significantly affected by the influence from the Great Britain, and one of the factors that contributed to the free trade evolution in some way was the timber trade, which successfully became a new driving force of the Canadian growth starting from the 18th century, when the Britain’s supplies of timber produced domestically ran out and they started to look for new suppliers.⁹ Initially, Britain encouraged the New England to supply the timber grown there by giving them preferential tariffs on exports, but, after the supplies of timber had become less abundant, Britain turned to the Canadian market and also offered them preferential tariffs, stimulating timber exports to grow for the whole period from the beginning of the 19th century till 1840, when the preferential tariffs were removed.¹⁰

And this was a major turning point for the Canadian economy. After 1840, Canada became to seek new trading partners and finally came to the conclusion that it should develop their relationship with its closest neighbor – USA. As a result, Canadians started to expand their exports of timber to

⁷ Confederation | The Canadian Encyclopedia. [online]. [Accessed 20.11.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/confederation>

⁸ KILGOUR, D., JONES, D.T. *Uneasy Neighbo(u)rs: Canada, The USA and the Dynamics of State, Industry and Culture*. [online]. [s.l.]: John Wiley and Sons, 2009, p. 79-104 [Accessed 21.12.2018] Available from: <https://books.google.ca/books?id=UJpkFA-0PY4C&lpg=PA79&pg=PA79#v=onepage&q&f=false>

⁹ *ibid.*

¹⁰ 9.10 Reciprocity and Free Trade – Canadian History: Pre-Confederation. [online]. [Accessed 25.12.2018]. Available from: <https://opentextbc.ca/preconfederation/chapter/9-10-reciprocity-and-free-trade/>

the United States, followed by growing exports of other commodities.¹¹ This led to the beginning of the story, which would later evolve into the most productive trading relationship in the world.

However, there was another commodity besides timber which had motivated Canada and the U.S. to begin talks about their first trade agreement, and was also an important factor on Canada's way to independence. This refers to corn, or cereal crops in general, and specifically to Corn Laws, introduced by Britain in 1794.¹² The essence of this act consisted in establishing precipitous tariffs designed to protect the Britain's domestic agriculture industry. Nevertheless, the demand of Britain for cereal crops rapidly exceeded the domestic supply, and the country turned to its colonies with a request to put their efforts into production and export of grain. Later, in 1846, Britain decided to concentrate on applying the model of freer trade, and abandoned the Corn Laws, therefore loosening the imperial oversight, which not only gave pre-Canadian colonies an opportunity for economic self-determination, but also allowed them to make their own political decisions. For instance, the "Canadian tariff" was established by the colonies, giving them right to apply 10 per cent duty across the board, and that was a significant step towards their economic and political independence.¹³

After Britain terminated the Corn Laws, the production of grain and flour in North America intensified the competition between the United States and British North America (more precisely, the Upper Canada). The key players of two counterparts in the wheat economy started to express their fears that farmers, millworkers or shipping companies may suffer, and were looking into the possibilities of cooperation. Besides that, the cooperation was encouraged by the industrialization process, where the United States were among the biggest actors. The need for raw materials grew, but the availability of materials was limited due to badly managed and depleted forests and insufficient agricultural lands. All these problems could have been easily solved with help from the British North American colonies, which possessed and produced enough timber and food. The United States and pre-Canadian colonies became even more attractive partners for each other,

¹¹ KILGOUR, D., JONES, D.T. *Uneasy Neighbo(u)rs: Canada, The USA and the Dynamics of State, Industry and Culture*. [online]. [s.l.]: John Wiley and Sons, 2009, p. 79-104 [Accessed 21.12.2018] Available from: <https://books.google.ca/books?id=UJpkFA-0PY4C&lpg=PA79&pg=PA79#v=onepage&q&f=false>

¹² BURN, D. L. Canada and the Repeal of the Corn Laws. [online]. *Cambridge Historical Journal*, 1928, vol. 2, no. 3, p. 252-272 [Accessed 25.12.2018]. ISSN 1474-6913. Available from: <https://www.jstor.org/stable/3020773>

¹³ 9.10 Reciprocity and Free Trade – Canadian History: Pre-Confederation [online] [Accessed 25.12.2018]. Available from: <https://opentextbc.ca/preconfederation/chapter/9-10-reciprocity-and-free-trade/>

moreover, British North American capitalists saw in the American market an appealing opportunity because of the availability of agricultural instruments and textile products, which were often cheaper and much more easily sourced.¹⁴ All these opportunities encouraged both parts to work on developing freer trade, and after years of negotiations the first free trade agreement was signed.

The first example of the integration process between two countries was the Reciprocity Treaty, signed in 1854 by Britain and the United States of America.¹⁵ This treaty, otherwise known as Elgin-Marcy Treaty, was a free trade agreement signed for the period of 10 years, and it eliminated cross-border tariffs, opening entrance for pre-Canadian merchants to the voracious American market and also contributing to the Britain's efforts to create a world without trading barriers.¹⁶ Under the terms of this agreement, American fisherman received access to the abundant east coast fisheries, and the Province of Canada (Québec and Ontario) was allowed to conduct business as a part of free trade with Americans in natural resources and agricultural products, such as grain, timber, meat, cheese, fish and coal.

However, the treaty didn't last long. After 10 years had passed, the United States decided not to prolong the agreement. Even though the renewal of the deal was lobbied by the Canadians, the protectionist pressures coming from the U.S. were stronger, and the treaty was terminated. Another factor which contributed to the abrogation of the agreement by the United States was the fact that Britain supported the Confederation states during the American Civil War, and the anti-British feelings at the end of the Civil War was a key element in the lack of desire to renew the Reciprocity Agreement.¹⁷

This scenario was unexpected by the pre-Canadian colonies, and it made all the colonies come together and consider their economic future, which eventually served as an impulse towards the

¹⁴ 9.10 Reciprocity and Free Trade – Canadian History: Pre-Confederation [online] [Accessed 25.12.2018]. Available from: <https://opentextbc.ca/preconfederation/chapter/9-10-reciprocity-and-free-trade/>

¹⁵ GONZÁLEZ, G.H. Productivity Gap and Asymmetric Trade Relations: The Canada-United States of America Integration Process/Brecha en productividad y relaciones comerciales asimétricas: el proceso de integración de Canadá y Estados Unidos de Norteamérica. [online]. *Economía: Revista del Departamento de Economía, Pontificia Universidad Católica del Perú*; Lima, 2014, vol. 37, no. 73, p. 31-46 [Accessed 22.12.2018]. Available from: <http://search.proquest.com/docview/1544867157/abstract/DA634D255FA24692PQ/1>

¹⁶ 9.10 Reciprocity and Free Trade – Canadian History: Pre-Confederation [online] [Accessed 25.12.2018]. Available from: <https://opentextbc.ca/preconfederation/chapter/9-10-reciprocity-and-free-trade/>

¹⁷ Canada–US Economic Relations | The Canadian Encyclopedia [online] [Accessed 20.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

creation of the Confederation, signed by Canada, Nova Scotia and New Brunswick in 1867.¹⁸ With the ratification of the agreement, all customs duties that were imposed on trade under those three former jurisdictions were abandoned, and pushed the newly created economy towards its growth. But even though Canadians still had fresh memories of the rejection by the U.S., they had been trying to come up with a new free trade agreement over the next 40 years, starting with the tariff act of 1868 by the Prime Minister John A. Macdonald, which was basically an offer of reciprocity.¹⁹ Nevertheless, Macdonald was denied, again, and he then started to look into the possibilities of introducing a protectionist policy for Canada.

And in the 1878 federal election Macdonald and his Conservative party ran their campaign on a protectionist promise, which consisted in the idea of putting Canada first by imposing tariffs on some American goods. In some cases, the tariffs were proposed to be as high as 45 per cent, and this idea was very popular, giving the Macdonald's party a win and leading to the pursuit of so-called National Policy.²⁰ The goal of the National Policy was to protect the domestic industries from the competition abroad by imposing tariffs on imported manufactured goods that were prohibitively expensive, while also lowering duties on imported raw materials and semi-processed products used in manufacturing. However, while this policy was not very successful, and Canadians were not fully satisfied with the economic growth in the 1880s, which encouraged second thoughts about high tariffs, and in some cases people were proposing a full commercial union with the U.S., believing that it may end Canada's political annexation. And in 1893, the Liberal Party proposed to pursue a reciprocity treaty with the U.S., which was met positively by the society, giving the party a win in the 1896 election.²¹ However, no progress in signing a deal was made until 1911, when William Howard Taft, the American president at that time, decided to start developing the bilateral relationship. In 1911, it was reported in the House of Commons that the free trade agreement had been approved, but, despite being agreed by the US Congress, the deal was not signed due to the failed free trade election in Canada. The Liberals were defeated in those

¹⁸ KILGOUR, D., JONES, D.T. *Uneasy Neighbo(u)rs: Canada, The USA and the Dynamics of State, Industry and Culture*. [online]. [s.l.]: John Wiley and Sons, 2009, p. 79-104 [Accessed 21.12.2018] Available from: <https://books.google.ca/books?id=UJpkFA-0PY4C&lpq=PA79&pg=PA79#v=onepage&q&f=false>

¹⁹ HEAMAN, E.A. *Tax, Order, and Good Government: A New Political History of Canada, 1867-1917*. [s.l.]: McGill-Queen's Press - MQUP, 2017, p. 460 ISBN: 978-0-7735-4964-7

²⁰ PORRITT, Edward. Canada's National Policy. [online]. *Political Science Quarterly*, 1917, vol. 32, no. 2, p. 177-208 [Accessed 26.12.2018]. ISSN 0032-3195. DOI: 10.2307/2141729

²¹ Canada-US Economic Relations | The Canadian Encyclopedia [online] [Accessed 21.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

elections by the Conservative Party, who were against the free trade agreement, mainly due to the concerns about possible political annexation by the United States and loss of connection with Britain, which may have costed them many businesses.²² Eventually, even though Canada had spend more than 40 years trying to persuade the U.S. to sign a reciprocity deal, when they finally agreed, Canada changed its mind.

After the fail of the new agreement, the countries took a break from negotiating the reciprocity treat and for almost 20 years preferred to take unilateral actions towards liberalization of trade, constantly swinging the tariffs. In 1913, the United States passed the Underwood Tariff, which consisted in overall reduction of tariff rates and also abolishing tariffs for many products, for instance, zero tariffs were imposed for timber, steel rails, many farm products and agricultural instruments. This step not only improved the competition on the American market, but it was also very favorable for the Canadian businesses, as the value of Canadian merchandise exports increased from \$104 million in 1911 to \$542 million in 1921.²³

However, due to some factors this beneficial cooperation didn't last long enough. In 1921, agricultural crisis emerged in America, and the prices of local farms plummeted, leading to the United States signing the Emergency Tariff Act, which significantly increased tariffs on imported agricultural products. After that, this act was followed by the Fordney-McCumber Tariff in 1922, which raised tariffs on even more foreign goods and served as a total blow to Canadian businesses, and, as a result, this lead to introduction of higher tariffs by Canada, with the whole situation having a negative impact on revenues of both countries.²⁴ For instance, the value of Canadian exports to the United States decreased by more than \$250 million from 1921 to 1922.²⁵ The aggressive tariff exchange did not end until the mid-Great Depression, when the two countries finally decided to begin talks about improving access to mutual markets.

During the Great Depression, both countries were taking significant losses, and the Unites States raising the tariffs, while Canada retaliating immediately with its own measures, was making the

²² Canada–US Economic Relations | The Canadian Encyclopedia [online] [Accessed 21.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

²³ *ibid.*

²⁴ 20th-century international relations - A fragile stability, 1922–29. [online]. *Encyclopedia Britannica*. [Accessed 26.12.2018]. Available from: <https://www.britannica.com/topic/20th-century-international-relations-2085155>

²⁵ Canada–US Economic Relations | The Canadian Encyclopedia [online] [Accessed 21.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

consequences of the depression even worse. And it wasn't until 1933, when Franklin Delano Roosevelt, newly elected president of the United States, met with the Canadian Prime Minister R.B. Bennett with an intention to agree on increasing bilateral trade. President Roosevelt went on to receive the authority to levy tariffs from Congress, when in 1934 the Reciprocal Trade Agreement Act was passed, allowing him to increase or decrease tariffs in bilateral relations with other countries.²⁶ After that, in 1935 the Mackenzie King government negotiated another trade deal with the U.S., and even though it was more restricted than the original Reciprocity Agreement, it was still a modest step in the policy shift towards free trade and gradual decreasing and dismantling of tariffs and other trade barriers. Moreover, in 1938, a subsequent agreement under the Reciprocal Tariff Act was signed, and consisted in reduction of some trade barriers, making the mutual export and import of natural resources and other goods (such as timber, fish, dairy products, or machinery and equipment) easier.²⁷ These agreements turned out to be the first successful trade agreements since the 1854 reciprocity agreement, and contributed to the process of a total termination of the National Policy, which was finished by the creation of the General Agreement on Tariffs and Trade (GATT) after the World War II.

During the Second World War and up to the Cold War, the countries continued to strengthen their relationship, testing mutual established connections and building a base for future development of free trade. In 1941, Canada and the United States attended a summit, which led to the Hyde Park agreement.²⁸ Under this agreement, the main goal for Canada was to bring the trade closer to a balance, which was intended to be achieved by means of co-ordination of war materials production, enabling both countries to reduce duplication of production and dividing the responsibilities to achieve specialization. The United States agreed to buy particular war equipment from Canada, which allowed Canada to cover some part of its traditionally higher imports from the U.S. As a result, Canada was able to increase its exports to the USA from \$442 million in 1940 to \$1.1 billion in 1943.²⁹ Another area where the bilateral trade was developing rapidly at that time was natural

²⁶ The Reciprocal Trade Agreement Act of 1934 | US House of Representatives: History, Art & Archives. [online]. [Accessed 26.12.2018]. Available from: <https://history.house.gov/HistoricalHighlight/Detail/36918>

²⁷ Canada-US Economic Relations | The Canadian Encyclopedia [online] [Accessed 22.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

²⁸ RANDALL, Stephen J., THOMPSON, John H., KEEBLE, Edna. [Canada & the United States: ambivalent allies]. [online]. *Journal of Canadian Studies*; Toronto, 1998, vol. 32, no. 4, p. 168-177 [Accessed 25.12.2018]. ISSN 00219495. Available from: <http://search.proquest.com/docview/203554374/abstract/2D7B1A73859A4CD0PQ/1>

²⁹ Canada-US Economic Relations | The Canadian Encyclopedia [online] [Accessed 22.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

resources. For the purpose of national security, the U.S. needed vast Canadian resources, which included besides others oil and gas, and in 1947 America decided to provide Canadian oil and gas with preferential treatment, and also invested in the emerging Canadian mining industry, creating preconditions for consequent takeover of local businesses by American ones.³⁰ A year later, this was followed by agreements under GATT, which furthermore improved Canadian access to the US market.

The trend of greater economic integration continued in the mid-20th century, when in 1965 Canada-US Automotive Products Agreement, otherwise known as Auto Pact, was ratified.³¹ This agreement established a single automotive continental market, eliminating tariffs on automobiles, trucks, buses and also automotive parts and tires, unifying the manufacturers and seller of automobiles in North America. The agreement also allowed Canada to lower its manufacturing costs, which became possible from producing of fewer models, but in longer production cycles.³² However, we cannot say that the Auto Pact was a full free trade agreement. It was rather a managed trade agreement, as it included some provisions serving as safeguards for Canadian auto market. For instance, the biggest auto manufacturers in the U.S., such as Chrysler, Ford and General Motors, accepted the condition that for every car sold in Canada they should produce one car in Canada, and they should also use at least 60% of Canadian auto parts in the production.³³ On the other hand, Canada agreed not to pursue free trade with automotive industries from other countries. This was a crucial step in the booming bilateral relationship between Canada and the United States, as it helped to adjust the economic relations to the position where it was clear that the trade should be beneficial for both countries.

However, this trade agreement turned out to be more beneficial for Canada than for the U.S. The level of investment and car production in Canada increased significantly, and allowed Canada to

³⁰ ARONSEN, L. *American National Security and Economic Relations with Canada, 1945-1954*. [s.l.]: ABC-CLIO, 1997, p. 149-179. ISBN: 978-0-275-95891-6

³¹ RANDALL, Stephen J., THOMPSON, John H., KEEBLE, Edna. [Canada & the United States: ambivalent allies]. [online]. *Journal of Canadian Studies; Toronto*, 1998, vol. 32, no. 4, p. 168-177 [Accessed 25.12.2018]. ISSN 00219495. Available from: <http://search.proquest.com/docview/203554374/abstract/2D7B1A73859A4CD0PQ/1>

³² Canada-US Economic Relations | The Canadian Encyclopedia [online] [Accessed 22.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

³³ KILGOUR, D., JONES, D.T. *Uneasy Neighbo(u)rs: Canada, The USA and the Dynamics of State, Industry and Culture*. [online]. [s.l.]: John Wiley and Sons, 2009, p. 79-104 [Accessed 21.12.2018] Available from: <https://books.google.ca/books?id=UJpkFA-0PY4C&lpg=PA79&pg=PA79#v=onepage&q&f=false>

reach its first trade surplus in auto and auto parts with the U.S. in 1970.³⁴ The Canadian share of the mutual auto production rose from 7.1 per cent in 1965 to 12,6 per cent in 1970, and reached 19 per cent in 1999. The conditions of the agreement were seen to be temporary by the U.S., while Canada insisted on the permanent validity of the deal. This was constantly creating friction in the relationship, and the U.S. had been trying to abolish the deal a couple times, but the agreement existed until 2001, when it was terminated due to allegations of being contrary to the rules of the World Trade Organization.³⁵

While the Auto Pact created necessary provisions for successful and peaceful bilateral trade relationship in the auto industry, in some other areas conflicts were present. One of the examples is the energy sector. As mentioned before, the United States had traditionally viewed the Canadian oil and gas to be a secure option for natural resources, however, the access to the American market had not been easy all the time. When the oil prices went up in the 70s, Canada introduced the Petroleum Administration Act, which levied export tax on oil, with a goal to keep the price below the world level by subsidizing the more costly oil imports in eastern Canada, using revenues from the tax.³⁶ In 1980, this act was supported by the acceptance of the National Energy Program, which was mainly directed at increasing the Canadian ownership of the local oil industry.³⁷ The goal of this program was to increase the domestic ownership and reach 50% by 1990, and this was supported by the agreed tax policy, which favored Canadian oil exploration companies. Not surprisingly, the United States were fighting against this policy, and by 1984 the provisions of this program were barely existent. The energy conflicts were later prevented by the creation of Canada-US free trade agreement, which prohibited using tax on oil exports, and established equal conditions for natural resources exploration in Canada for both Canadian and American companies.

In general, the 1980s were one of the key periods, when the important bilateral relationship was acquiring its current status. In the beginning of the 80s, Canada was looking at opportunities to

³⁴ KILGOUR, D., JONES, D.T. *Uneasy Neighbo(u)rs: Canada, The USA and the Dynamics of State, Industry and Culture*. [online]. [s.l.]: John Wiley and Sons, 2009, p. 79-104 [Accessed 21.12.2018] Available from: <https://books.google.ca/books?id=UJpkFA-0PY4C&lpg=PA79&pg=PA79#v=onepage&q&f=false>

³⁵ *ibid.*

³⁶ TUOHY, Carolyn. *Policy Politics Canada*. [online] [s.l.]: Temple University Press, 1992, p. 269-281 [Accessed 26.12.2018] Google-Books-ID: BLPfkCjXZmIC. ISBN 978-0-87722-870-7

³⁷ JAMES, Patrick. The Canadian National Energy Program and Its Aftermath: A Game-Theoretic Analysis. [online]. *Canadian Public Policy / Analyse de Politiques* [online]. 1990, vol. 16, no. 2, p. 174-190 [Accessed 27.12.2018]. ISSN 0317-0861. DOI: 10.2307/3550964

increase its economic growth, which was slowed down by recent recession. The relationship with the U.S. was therefore especially vital, and it was necessary to strengthen them before the American protectionism resurged again, which was the main fear of Canadians. For that reason, both parties realized that at that moment it was the time to start negotiating new trade deal, and the talks began.

1.2. NAFTA creation

In early 1980s, Canadian and American political actors realized, that the more and more interdependent relationship between these countries, the relationship, extent of which was unprecedented anywhere else in the world, would likely to share the same pattern in the future, but to make sure it would, they needed to assist in facilitating the further development by coming up with a new comprehensive bilateral free trade agreement. During that decade, trade with the United States accounted for 70 per cent of Canada's total trade. However, for the most part, Canadian exports were concentrated on resources with relatively low processing levels, as well as automotive parts.³⁸ Politicians saw the full potential of the mutual trade, and in 1980 President Reagan proposed creating a North American common market.³⁹ It was hoped that new agreement would allow the Canadian businesses to scale and become more competitive, and also attract new investors to Canada, increase interest in processing Canadian natural resources in Canada and encourage innovation and improve productivity, therefore increasing the employment and improving living standards. However, not all advocated for new free trade agreement, with some opponents arguing that the values and priorities of two countries were totally different, and fearing that further economic integration may lead to cultural and political takeover of Canada by the United States.⁴⁰

The agreement was reached at the end of 1987, and in 1988, the Canada-U.S. Free Trade Agreement (CUSFTA) was signed, marking the end of the fluctuation between free trade and

³⁸ GONZÁLEZ, G.H. Productivity Gap and Asymmetric Trade Relations: The Canada-United States of America Integration Process/Brecha en productividad y relaciones comerciales asimétricas: el proceso de integración de Canadá y Estados Unidos de Norteamérica. [online]. *Economía: Revista del Departamento de Economía, Pontificia Universidad Católica del Perú*; Lima, 2014, vol. 37, no. 73, p. 31-46 [Accessed 22.12.2018]. Available from: <http://search.proquest.com/docview/1544867157/abstract/DA634D255FA24692PQ/1>

³⁹ Canada-US Economic Relations | The Canadian Encyclopedia [online] [Accessed 22.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

⁴⁰ BOW, B., CHAPNICK, A. Teaching Canada-US relations: Three great debates. [online]. *International Journal*, 2016, vol. 71, no. 2, pp. 291-312 [Accessed 20.12.2018]. DOI: 10.1177/0020702016641710

protectionism, with both countries recognizing each other as a trading partner, which facilitates mutual trade by allowing free flow of goods and services.⁴¹ Free trade agreement came into 1989, and at that time it was the most comprehensive bilateral union, which established several fundamental provisions, contributing to the evolution of the economic relationship between Canada and the United States, where the free trade was already present in most areas. Some of the main achievements of the deal were:

- Eliminated all tariffs by 1998
- Resumed the Auto Pact of 1965, but made the rules of origin more strict
- Liberalized trade with financial services and made cross-border travel easier
- Created a bilateral panel to solve disputes arising from the agreement
- Prohibited most export and import restrictions on energy products.⁴²

While signing the CUSFTA was an important step towards the strengthening of free trade, still, it did not prevent some actions which were contrary to free trade, and had some unexpected effects. For instance, the United States were trying to restrict the softwood lumber imports, as the majority of the Canadian lumber was produced in Crown Lands, where royalty was collected, which affected the price. The U.S., however, used different price system, and to eliminate the advantage that the Canadian producers had, the United States imposed a 15 per cent tariff on Canadian softwood lumber imports, which made Canada introduce its own export tax to avoid paying American tariffs, which were later withdrawn.⁴³ CUSFTA was also expected to narrow the productivity gap between two countries, though, the gap widened instead.

Nevertheless, the CUSFTA was considered to be a quite successful step towards economic integration, and some business groups were calling for deeper integration, which would enable the countries to reach a new level of a successful relationship. And, after the negotiations among Canada, the United States and Mexico, a new trilateral agreement was signed. The North American

⁴¹ SARNA, A.j. The Impact of a Canada--US Free Trade Area. [online]. *Journal of Common Market Studies*, 1985, vol. 23, no. 4, p. 299 [Accessed 25.12.2018]. ISSN 00219886. Available from: <http://search.ebscohost.com/login.aspx?direct=true&db=bsu&AN=6274505&lang=cs&site=ehost-live>

⁴² VILLAREAL, M.A., FERGUSSON, I. The North American Free Trade Agreement (NAFTA). [online]. *Federal Publications*, 2017, p. 2 [Accessed 25.12.2018]
Available from: https://digitalcommons.ilr.cornell.edu/key_workplace/1937

⁴³ Canada--US Economic Relations | The Canadian Encyclopedia [online] [Accessed 22.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

Free Trade Agreement (NAFTA) came into effect on the first day of 1994, and replaced the CUSFTA.⁴⁴ NAFTA was a specific agreement, as it included 2 developed countries and a developing one, and creation of the deal was complicated by differences among countries, which, eventually, determined the fact that this agreement was not equally beneficial for all participants.

Among the main goals that NAFTA contained were the following ones:

- Elimination of trade barriers and facilitation of the movement of goods and services among member countries
- Encouraging healthy competition within the framework of the agreement on goods and services
- Increasing the amount of investments in Canada, the United States and Mexico
- Intellectual property rights protection
- Improving economic contradictions and disputes resolution
- Developing the prospects of future development and exploring the options to expand the free trade union.⁴⁵

While the CUSFTA indicated the termination of the National Policy, NAFTA established the framework for the development of unified way of integration. In this case, the main strategic implication for Canada can be expressed with this sentence: “Canada is heavily dependent on trade with the United States and thus increasingly vulnerable to US protectionism.”⁴⁶ By signing NAFTA, Canada protected itself from possible protectionist measures from the American side, and also guaranteed that the benefits it received from CUSFTA would not be lost, which would have been possible if the United States and Mexico signed a bilateral agreement without Canada.

⁴⁴ KILGOUR, D., JONES, D.T. *Uneasy Neighbo(u)rs: Canada, The USA and the Dynamics of State, Industry and Culture*. [online]. [s.l.]: John Wiley and Sons, 2009, p. 79-104 [Accessed 21.12.2018] Available from: <https://books.google.ca/books?id=UJpkFA-0PY4C&lpg=PA79&pg=PA79#v=onepage&q&f=false>

⁴⁵ VILLAREAL, M.A., FERGUSSON, I. The North American Free Trade Agreement (NAFTA). [online]. *Federal Publications*, 2017, p. 5 [Accessed 25.12.2018]

Available from: https://digitalcommons.ilr.cornell.edu/key_workplace/1937

⁴⁶ GONZÁLEZ, G.H. Productivity Gap and Asymmetric Trade Relations: The Canada-United States of America Integration Process/Brecha en productividad y relaciones comerciales asimétricas: el proceso de integración de Canadá y Estados Unidos de Norteamérica. [online]. *Economía: Revista del Departamento de Economía, Pontificia Universidad Católica del Perú; Lima*, 2014, vol. 37, no. 73, p. 31-46 [Accessed 22.12.2018]. Available from: <http://search.proquest.com/docview/1544867157/abstract/DA634D255FA24692PQ/1>

Still, the effects of NAFTA on the Canada-US mutual relationship were not simple. Some changes that NAFTA brought were beneficial, while other were not liberalizing at all, creating new barriers for some Canadian industries. For instance, some benefits could have been absorbed by the costs of the administration rules requiring broad record keeping, which maintenance was costly. Also, NAFTA's rules of origin became more strict in some sectors, such as textiles and apparel, and the effects of those rules could discriminate Canadian apparel manufacturers who had always used non-area imported fabrics.⁴⁷

The signing of NAFTA marked a new era of the bilateral relationship between Canada and the United States, but these relations have also been affected by a number of other events which took place during the 21st century. One of the occasions which again demonstrated the vulnerability of Canada to oscillations in the US policy was the 9/11. The terrorist attacks in 2001 led to the U.S. government establishing more stringent border control, which led to delays and trade interruptions. Canada was fearing that the American companies would not want to deal with Canadian suppliers because of the delays, and that could also stop the investments, which would definitely undermine the benefits coming from the free trade agreement. Therefore, to mitigate the US security concerns, Canada introduced new Smart Border Declaration and Action Plan.⁴⁸

Another attempt to co-operate on trade regulation was made in 2005, when the countries started the Security and Prosperity Partnership of North America, intended to ease cross-border trade and liberalize rules of origin. However, in 2009 this agreement was terminated due to limited accomplishments.⁴⁹ Later, in 2011, the United States and Canada launched the Beyond the Border Action Plan: A Shared Vision for Perimeter Security and Economic Competitiveness.⁵⁰ This plan emphasized several areas of cooperation, including cybersecurity, trade, economic growth and

⁴⁷ CADSBY, Charles Bram, WOODSIDE, Kenneth. The Effects of the North American Free Trade Agreement on the Canada-United States Trade Relationship. [online]. *Canadian Public Policy / Analyse de Politiques*. 1993, vol. 19, no. 4, p. 450-462 [Accessed 28.12.2018]. ISSN 0317-0861. DOI: 10.2307/3551389

⁴⁸ Canada-US Economic Relations | The Canadian Encyclopedia [online] [Accessed 23.12.2018]. Available from: <https://www.thecanadianencyclopedia.ca/en/article/economic-canadian-american-relations>

⁴⁹ GLUSZEK, Alicja. The Security and Prosperity Partnership and the Pitfalls of North American Regionalism. [online]. *Norteamérica* [online]. 2014, vol. 9, no. 1, p. 7-54 [Accessed 28.12.2018]. ISSN 1870-3550. DOI: 10.1016/S1870-3550(14)70112-0

⁵⁰ Beyond the Border. [online]. [Accessed 28.12.2018]. Available from: <https://www.publicsafety.gc.ca/cnt/brdr-strtg/bynd-th-brdr/index-en.aspx>

infrastructure, with a purpose of reduction the differences in regulation and eliminating trade barriers.

However, there are still debates about the importance of free trade and NAFTA specifically. While in most of the cases people realize and appreciate that free trade enables both countries to use their comparative economic advantage at the highest level, there are also fears and concerns about other possible side effects that further economic integration may cause. Some of the issues are cultural integrity, environment, health, educational policies, and national identity.⁵¹ There is a high chance that these issues will be present in the future, especially with a higher level of globalization, and free-trade debate raises concerns about possible threats to identity and independence, which are among the fundamental public values.⁵²

In general, despite some of the concerns free trade generates, it is true that the Canada-United States economic relationship has brought many advantages to both countries. Even though there are significant differences between the two countries, not only in size and power, but also in culture, there are many fundamental values that are similar, and one thing that they both have in common is understanding that Canada and the U.S. need each other, and it is important to keep their relationship strong, especially in front of rapidly happening changes that bring new challenges. The mutual economic relationship has proven to be beneficial, and liberalization of bilateral trade allows Canada and the USA to be among the biggest trade partners in the world. In the next paragraph, we will have a more detailed look at the numbers, analyzing the trends in the mutual trade.

⁵¹ NEVITTE, N. *The North American Trajectory : Cultural, Economic, and Political Ties among the United States, Canada and Mexico* [online]. Routledge, 2017, p. 1-26 [Accessed 28.12.2018]. DOI: 10.4324/9781315133539

⁵² CRAIG, Gerald M. *The United States and Canada* [online]. Reprint 2014. ed. Cambridge: Harvard University Press, 1968, p. 313-325 [Accessed 28.12.2018]. ISBN 978-0-674-18808-2. DOI: 10.4159/harvard.9780674188082

2. Mutual economic relationship

The nature of the bilateral relations between Canada and the United States has always been a subject to a variety of factors, which eventually shaped the state of current economic relationship. After having discussed the evolution of the mutual connections over the period of more than two hundred years and possessing necessary knowledge of the main trends, it is time to evaluate the situation conducting deeper analysis and gaining important insights. The goal here is to identify the mutual economic dependence and either prove right or wrong that the bilateral relations are more important for Canada than USA. This chapter will focus on the mutual economic relationship and mainly its quantitative constituents, which have been recorded over the latest years. Due to unavailability of data for the year of 2018, most of the facts and numbers will contain information coming from 2017, as well as previous years.

Even though the biggest part of this chapter will be dedicated to the analysis of macroeconomic factors, others effects, which are becoming more and more associated with the economic relationship between the countries, will also be demonstrated. First of all, we will look at the trade statistics, as they are substantial for discovering the importance of mutual relations and agreements. Specifically, the trade will be assessed both in broader terms and through its division in merchandise trade and trade with services. Also, we will address the dynamics of foreign direct investments between these countries and look at their impacts. Together, these three indicators can provide a solid foundation for the assessment of the importance of the mutual economic relations, as well as compare them to the world's other examples.

The last part of this chapter will provide insights into other effects which take place due to the existence of the bilateral relationship. For any country in the world, the challenge of finding the appropriate balance between trade liberalization, environmental improvement and social coherence has been becoming more and more actual.⁵³ Here, we will see how Canada and U.S. were able to deal with this challenge, and how the bilateral trade have affected other areas.

⁵³ Linking Trade, Environment, and Social Cohesion | NAFTA Experiences, Global Challenges | Taylor & Francis Group. [online]. , p. 1 [Accessed 18.02.2019]. Available from: <https://www-taylorfrancis-com.proxy3.library.mcgill.ca/books/9781315189185>

2.1. Merchandise trade

It is widely known that Canada and the United States are a great example of how neighboring countries can use their common status and rich history of relationships to get the maximum out of them, reaching the world's highest indicators. Not only are these countries proud to have the longest international border in the world, but their mutual relationship is also one of the most extensive and closest on the planet. For instance, the amount of bilateral trade in goods and services exceeds \$1.8 billion a day, which underscores the highest level of the economic relationship.⁵⁴ It is true, however, that the content of the trade is not distributed equally between goods and services, as merchandise still accounts for the biggest part of the trade volume. In this section we will look closer at the merchandise trade and identify the areas, which are the most important for this bilateral relationship.

First of all, let us look at the general profiles of each of the countries. This will give us a better prospective of the importance of the bilateral relationship later, when it will be assessed. The information about the total merchandise trade is shown in Table 1.

Table 1: Merchandise trade statistics, 2017 (millions of US\$)

Country	Export	Import
USA	1546273	2408476
Canada	421101	442184

Source: author, data adapted from UNCTAD

As indicated in the table above, the United States have generated substantially more international merchandise trade than Canada in the year of 2017, which also gives a great picture of how big of a player the US are on the global trade arena. To be more specific, the USA occupied the second position in the ranking of the most goods exporting countries, only surpassed by China, while Canada was placed 11th.⁵⁵ Similar situation was established with the imports, where the USA took

⁵⁴ *U.S. Relations With Canada* [online] [Accessed 18.02.2019]. Available from: <http://search.ebscohost.com/login.aspx?direct=true&db=bth&AN=128274000&lang=cs&site=ehost-live>

⁵⁵ WTO Data. [online] [Accessed 24.03.2019]. Available from: <http://data.wto.org/>

the lead with stirring \$2,4 trillion. Canada also demonstrated a similar pattern, and improved its position by one point, stepping to the 10th place in the global ranking.⁵⁶

Regarding the trade statistics by partners, there is clear dependence of Canadian economy on its relationship with the United States. Tables 2 shows the main merchandise trade partners of Canada, divided into exports and imports.

Table 2: Top 5 merchandise export and import partners of Canada, 2017

Export			Import		
Market	Trade (US\$ Mil)	Partner share (%)	Market	Trade (US\$ Mil)	Partner share (%)
USA	319,067	75.9	USA	221,967	51.3
China	18,187	4.3	China	54,661	12.6
UK	13,636	3.2	Mexico	27,352	6.3
Japan	9,118	2.2	Germany	13,826	3.2
Mexico	6,052	1.4	Japan	13,503	3.1

Source: author, data adapted from Statistics Canada

As follows from the table above, the United States are both the main export and import partner for Canada, and the dependence is strong in both directions. Canada imports more than a half of its total goods from the US, and the percentage is even higher for exports, where the USA accounts for more than three quarters of Canada's total exports.⁵⁷ The trade balance is positive for Canada, too, making it really important for this country to keep a stable relationship with its main partner. On the contrary, while the US is the leading partner for Canada in both exports and imports, the reverse relationship does not totally follow the pattern. As shown in Table 3, the division of international trade for the U.S. is more even, and, while Canada was still the main export market for the US in 2017, with 18.3 % partner share, it was only 3rd largest imports origin. Contrary to the Canada's example, the US experienced bilateral trade deficit, which continued the trend.⁵⁸ If conclusion were to be made just from the merchandise trade data, it would be logical to say that

⁵⁶ WTO Data. [online] [Accessed 24.03.2019]. Available from: <http://data.wto.org/>

⁵⁷ GOVERNMENT OF CANADA, p.C. International merchandise trade for all countries and by Principal Trading Partners. [online] [Accessed 25.03.2019]. Available from: <https://www150.statcan.gc.ca/t1/tbl1/en/cv.action?pid=1210001101>

⁵⁸ Trade Map - Bilateral trade between Canada and United States of America in 2017. [online]. [Accessed 03.10.2018]. Available from: <https://www.trademap.org/Bilateral.aspx?nvpm=1|124||842||TOTAL||2|1|1|1|1|1|1|1|1>

Canada experiences a stronger need for keeping the productive relations with the US, but we also cannot say that the mutual relationship is not important for the USA, it just differs in the extent.

Table 3: Top 5 merchandise export and import partners of USA, 2017

Export			Import		
Market	Trade (US\$ Mil)	Partner share (%)	Market	Trade (US\$ Mil)	Partner share (%)
Canada	282,243	18.3	China	526,022	21.9
Mexico	243,314	15.7	Mexico	317,207	13.2
China	129,894	8.4	Canada	305,879	12.7
Japan	67,602	4.4	Japan	139,797	5.8
UK	56,244	3.6	Germany	119,991	3.1

Source: author, data adapted from U.S. Census Bureau

Nevertheless, one can easily notice that there is some serious divergence between the statistics reported by the Canadian and United States of America's governments. The reason for the difference in numbers lies in different methods of reporting used by these two countries, that causes so called "mirror" statistics.⁵⁹ Due to this reason, the trade deficit or surplus cannot be counted properly if using the data provided above. One of the solutions for calculating an objective trade balance for each of the countries is applying the data, which can be found on the United Nation's Comtrade. Specifically, the Canadian exports to the USA in 2017 equaled roughly \$290 billion, and about \$234 billion of U.S. exports of made-in-USA goods were made in the same period.⁶⁰ That yields a \$56 billion merchandise trade surplus for Canada in the bilateral trade, and the same amount of trade deficit for the United States.

Now, after the current situation has been described, it is time to look into the evolution of the bilateral trade over a time period. For that purpose, it will be appropriate to look at the data for trade with goods, divided into two parts: exports and imports. The corresponding data for US are illustrated in the Figure 1 below. Even though we may say that participating in NAFTA had a positive impact on trade statistics between these two countries, there have been periods of time when the bilateral trade did not experienced growth, particularly if referring to the value of the trade. As the Figure 1 indicates, since the NAFTA signing, bilateral imports and exports have been

⁵⁹ OECD - Mirror statistics Definition. [online] [Accessed 25.03.2019]. Available from: <https://stats.oecd.org/glossary/detail.asp?ID=6635>

⁶⁰ Download trade data | UN Comtrade: International Trade Statistics. [online] [Accessed 24.02.2019]. Available from: <https://comtrade.un.org/data>

gradually growing for most of the time. Besides NAFTA, we can also mention another reason which affected the Canada – US trade. In 2001 the United States' largest trading partner - China - joined WTO, which gave a significant impulse for an increasing trade with this country, especially imports.

Figure 1: U.S. merchandise trade with Canada since NAFTA creation



Source: author, data adapted from U.S. Census Bureau

U.S. trade with Canada grew twice as much as the pre-NAFTA level in the first 10 years of the deal's existence, increasing from \$166.5 billion to \$362.2 billion. However, there were opposite examples, as well. Specifically, in 2001 and 2002 there was a small decrease in trade, when during the recession in 2001 the trade fell off, to some extent due to the 9/11 terrorist attack. Later, total trade with Canada increased to \$600 billion in 2008, which was a new high, but this year also started the largest fall in the value of traded goods, when the crisis played a key role in determining the economic relationship between the countries. In 2009 due to the financial crisis the economies of the the countries were hit hard, and trade decreased to \$430.9 billion. Lower Canadian exports were attributed to the difficulties in the auto industry, specifically lower demand for automotive products. Also, one of the biggest parts of the U.S. trade from Canada are crude oil imports, and, as crude oil prices dropped significantly that year, the values of imports fell, too.⁶¹ Moreover, if crude oil and petroleum products were excluded from the trade balance, the resulted deficit would

⁶¹ VILLARREAL, M.A., FERGUSON, I.F. Nafta at 20: Overview and Trade Effects*. [online]. *Current Politics and Economics of the United States, Canada and Mexico; Commack* [online]. 2014, vol. 16, no. 3, p. 16 [Accessed 18.02.2019]. Available from: <https://search.proquest.com/docview/1655115585/abstract/1A96D0394A046F0PQ/1>

be lower if compared to the overall deficit in some years, as in some years USA had a positive balance in non-energy merchandise trade.⁶² The energy prices can also be considered responsible for the uneven development of trade deficit of the U.S. with Canada. Generally, we can see the connection between decreasing prices and falling exports, which triggered slowing down of GDP growth and, as a result, imports decreased as well, based on their mutual interconnection. Also, this had an impact on Canada's balance of payments, as their current account deficit narrow down.⁶³

The latest trade drop happened in 2014 – 2016, and was also characterized by low commodity prices. While the volume of traded good did not decrease, but even rose, the lower prices were the reason why the values were falling.⁶⁴ Canada, with its sizeable energy industry and the associated investments, was severely affected by sliding oil prices. Besides commodities, the value of imports fell due to appreciation of the U.S. dollar. Trade volumes and values have been fluctuating to some point, and, even though there was a recovering growth in the last two years, the figures have not reached its former heights yet. More specifically, Canadian export of merchandise to the United States in 2017 demonstrated growth of 4.8 percent, which, nevertheless, was lower than total growth of Canadian goods exports (5.4 percent). Goods imports increased by 2.9%, but the growth, however, was slower than the overall Canadian goods import growth (4.8 percent).⁶⁵

Speaking about the changes on the American side, the direction of the modifications also had a growing trend in 2017. More into details, the US governments reported that official exports of merchandise to Canada in 2017 increased by more than \$15.5 billion if compared to the year of 2016, which was equal to a 5.8% growth.⁶⁶ Also, the exports went 13.4 percent up, if compared with the results from 2007, - certainly good news for the USA, which have been struggling with trade deficit for a long time, and having growth in exports can provide certain hope for future improvements. However, the other part affecting trade balance – imports – also demonstrated similar results in 2017. The United States of America's imports from Canada increased by \$21.5 billion, which equals a 7.8 percent growth rate counting from 2016.⁶⁷ Nevertheless, in this case the

⁶² *ibid.*

⁶³ GOVERNMENT OF CANADA, G.A.C. Canada's State of Trade: Trade and Investment Update – 2018. [online]. GAC [online] [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0

⁶⁴ *ibid.*

⁶⁵ *ibid.*

⁶⁶ Canada. [online]. [Accessed 25.02.2019]. Available from: ustr.gov/countries-regions/americas/canada

⁶⁷ *ibid.*

comparison with 2007 resulted in opposite results than in case of exports, as despite the growth in 2017 the imports were still down 5.6 percent from the year 2007. Again, for the U.S. this can mean that there has been an improvement for them in terms of their trade balance with Canada, which in reality is not true, as imports still tend to be gaining more in volume and value than exports, despite the simultaneous changes of both.

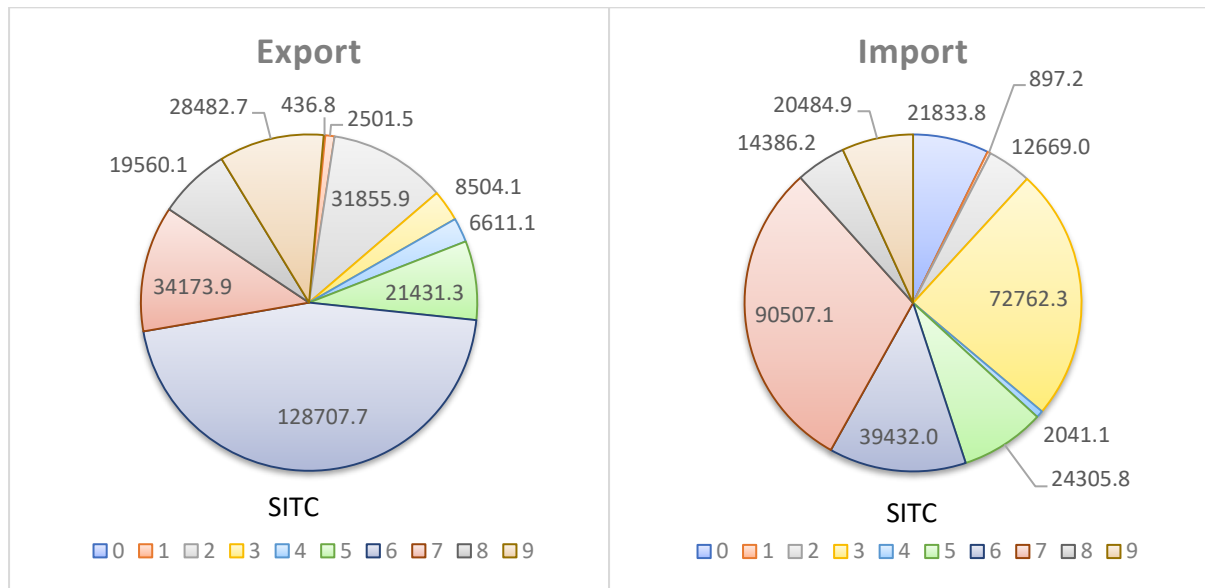
Regarding the slower growth of Canadian exports and imports to and from the United States, if compared to the overall growth of Canadian trade, this can mean that Canada has been expanding its connections so that it can be more independent from the U.S., as described in chapter one. To prove this point, we can use Canada's relations with China and EU. Compared to the slower growth of trade with the U.S., goods exports and imports with China grew by 15 and 13 %, respectively.⁶⁸ Also, the core area of imports growth were Machinery and equipment, which are also one of the most trading goods with the U.S., and this also shows that Canada diversifies the supply markets. Similarly, Canada showed high growth in imports from the EU (11%), and again, the largest categories were Machinery and also Automotive goods (one-third of which were imported from Germany). Another evidence of further expansion to EU is the implementation of CETA, and we can also expect Canada to develop relations with the fastest growing region of emerging Asia, as well as Latin America and Caribbean (imports from where grew by over 9 %).⁶⁹ Many EU members have key positions in Canada's global supply chains, and importance of Europe as a global service hub can also be vital in the future, especially with regards to the new trade agreement between them.

The next step in addressing the economic relationship between Canada and the U.S. will be considering specific industries and the composition of merchandise trade, incoming and outgoing. Located below, Figure 2 demonstrates the composition of U.S. merchandise trade with Canada under SITC classification, and one can clearly see from it that there are particular product categories, which were dominating across both imports and exports

⁶⁸ GOVERNMENT OF CANADA, Canada's State of Trade [online] [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0

⁶⁹ CETA - EU-Canada Comprehensive Economic and Trade Agreement. *Trade - European Commission* [online] [Accessed 25.03.2019]. Available from: http://ec.europa.eu/trade/policy/in-focus/ceta/index_en.htm.

Figure 2: Merchandise trade between U.S. and Canada, 2017 (US\$ mil)



Source: author, data compiled from U.S. Census Bureau

As we may see, among the most traded goods categories are Machinery and Transport Equipment, Manufactured goods and Commodities. Talking about more in-depth description of goods imports and exports, there were five products which contributed the most to Canada's imports. Among them were (HS) Vehicles, parts and accessories (\$48 billion), Machinery, mechanical appliances, parts thereof (\$31) billion, Mineral fuels and oils (\$19 billion), and Electrical machinery and equipment and Plastics, each around \$12 billion.⁷⁰ If looking at the highest share in Canada's imports from the United States, Chemical products and Plastics imports reached around 75 percent of total import share for each of the categories, while Mineral fuels and oils and Vehicles and accessories had a 64% share each. The structure of exports were similar, however, the leading product category here was Mineral fuels and oils, with \$76 billion in value, which also accounts for 91 percent of Canada's total exports of this products.⁷¹ On the contrary to the situation with Canadian exports, the United States of America's imports of these products from Canada had a substantially lower share in their total imports of respective goods. For instance, Mineral fuels and oils coming from Canada only accounted for 38 percent of total product imports, Vehicles stopped at 19 %, and Machinery and appliances only contributed to 6 percent of total imports. While it was

⁷⁰ GOVERNMENT OF CANADA, Canada's State of Trade [online] [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0d.

⁷¹ *ibid.*

common for Canada to have shares of specific product imports exceeding 90 %, the United States' highest share in total imports equals only 58 percent, for Pulp of wood or of other material.⁷² This can be used to support the idea that Canada has more to lose in case of interruption of the bilateral relations, as the consequences of losing its biggest market can be devastating for some industries.

It is also necessary to look closer at the bilateral energy trade, which has always been important for both countries. For many years, Canada has been the USA largest trading partner for energy products, and in 2017 the situation was the same. The value of imports in 2017 was reported to be \$73 billion, and exceeded the value of imports from other leading trading partners for energy, specifically Saudi Arabia, Venezuela and Mexico.⁷³ The largest part of the energy imports from Canada falls on crude oil, which accounted for 50% of total energy imports from Canada, and is followed by petroleum products and natural gas, which are mainly produced in Alberta region and shipped to the U.S.⁷⁴ Regarding the exports, Canada was the second largest export market for the U.S., only surpassed by Mexico. The value of energy exports to Canada was more than 3 times less than that of imports, reaching \$20 billion in 2017, and mainly consisted of petroleum products and crude oil. While the value of the energy trade has changed throughout the years, also because of fluctuations in key commodities prices in 2015, such as crude oil, petroleum products and natural gas, the structure of the energy trade has always been more or less the same, meaning that Canada stays a very important energy supplier for the United States.⁷⁵ Additionally, from 2016, the resource sector continues to benefit from a progressive rise in commodity prices, and the existing federal stimulus is expected to be supplemented by additional fiscal expansion in the provinces of Ontario and Quebec, creating hopes for future growth.⁷⁶ Moreover, the shift in commodity prices means that Canada's terms of trade index improve, which also allows Canada to export more, especially energy, metal ores and minerals, metals and mineral products, which accounted for the biggest part of the export increase. If not for growing energy exports, Canada's

⁷² *ibid.*

⁷³ The changing U.S. energy trade balance is still dominated by crude oil imports - Today in Energy - U.S. Energy Information Administration (EIA). [online]. [Accessed 27.02.2019]. Available from: <https://www.eia.gov/todayinenergy/detail.php?id=37253>

⁷⁴ United States: Canada is the United States' largest partner for energy trade. [online]. *Asia News Monitor; Bangkok* [online]. 2017 [Accessed 18.02.2019]. Available from: <https://search.proquest.com/docview/1875190053/abstract/81FBBBA87A57459DPQ/3>

⁷⁵ *ibid.*

⁷⁶ GOVERNMENT OF CANADA, Canada's State of Trade [online] [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0

total exports to the United States would have fallen. Higher prices accounted for about 2/3 of the increase in energy exports value, and higher volumes of exports for the rest. Similarly, the U.S. increased its exports of mainly crude oil and natural gas, and also refined oil, which was the main driver of Canada's total energy imports (15.3 %), which was the biggest increase among all exports. Considerable growth was also observed in the exports of mechanical machinery, aluminum, iron and steel, and copper. On the other hand, the strengthening of Canadian dollar and relative prices lead to decreasing exports in manufacturing industries, especially automotive and consumer goods, which slowed down the growth of bilateral trade.⁷⁷ Particularly, exports of motor vehicles and parts declined due to several reasons, among which were increased domestic consumption in Canada (4.7% growth), production losses (end of production of Buick Regal and GMC Terrain Lastly), and labor strike at General Motor's Ingersoll, which lead to production cuts of the top-selling Chevrolet Equinox. These car models are usually exported largely, but these occasions resulted in a 8% drop of total Canadian light vehicle production.⁷⁸

Another area important for both countries is agriculture, and here the importance of the bilateral trade has gained in extent especially after the signing of NAFTA. This agreement gave Canada and US an opportunity to eliminate tariffs on most agricultural products, and, as a result, receive an important preferential market access if compared to other most favored nation tariffs, which are imposed on products of most other World Trade Organization members. This also had a positive impact on the increase in output of fruit and nuts, vegetables, vegetable oils and processed foods in Canada, as well as poultry meat, beef, pork, and dairy products in the United States.⁷⁹ More generally, this increased the share of duty-free agricultural products from Canada from 33 % in 1989 to 91% in 2008.⁸⁰ Additionally, this also allowed to increase the value of total bilateral agricultural trade, which has been growing strongly since 1990. For instance, the value of Canada's agricultural exports to the U.S. increased from \$5.7 billion in 1990 to \$34.6 billion in 2016, which represented an average annual growth of about 7 %., and American exports to Canada grew from

⁷⁷ *ibid.*

⁷⁸ *ibid.*

⁷⁹ BECKMAN, J., ZAHNISER, p. The effects on intraregional agricultural trade of ending NAFTA's market access provisions. [online]. *Canadian Journal of Agricultural Economics/Revue canadienne d'agroeconomie* [online]. 2018, vol. 66, no. 4 [Accessed 18.02.2019]. DOI: 10.1111/cjag.12188

⁸⁰ CANTIN, M.-H., DUCHESNE, É. Canada-United States agricultural trade under the shadow of NAFTA: liberalization, conflicts and challenges. [online]. *Canadian Foreign Policy Journal* [online]. 2018 [Accessed 18.02.2019]. DOI: 10.1080/11926422.2018.1551234

\$5.5 to \$33.6 billion, with a similar growth rate just under 7 %.⁸¹ It is therefore understood that this economic relationship is important for both countries, as it allows them to preserve and develop strong supply management system. If not for the agreement, it would be a lot harder for the U.S. to stay competitive on the Canadian market, especially for the United States' sugar industry.⁸² On the contrary, it would be beneficial for Canadian producers of dairy, eggs and poultry to gain wider access to international markets, as Canada currently has a significant net deficit on dairy trade with the U.S., which also led to imposing tariffs on milk imports.⁸³ Meanwhile, for the United States it is important to maintain good economic relationship with Canada, as Canada is the United States' largest importer of agricultural products, which is still explained by the "productivity gap", as the Canada's labor productivity stays at 72 % of the USA productivity level.⁸⁴ Nevertheless, both countries realize the importance of the agricultural products trade, which is evidenced by the desire to improve the bilateral agricultural trade conditions.

To summarize this section devoted to the bilateral merchandise trade, it appears that the analyzed data give the necessary foundation for drawing a trend of mutual importance. The general profile of mutual merchandise trade reflects the differences between two countries, one of which is the population. The rich possessions of natural resources allows Canada to export raw materials to the U.S., and, on the contrary, import a variety of consumer goods or specialized machinery and equipment, which are used to make final products. Generally, both export and import operations, which the U.S. conducts together with Canada, do not seem to be as important for the U.S. as they are for Canada, not only because of the values, but mainly because of the substantial differences in mutual trade shares in each of the countries' total world imports and exports. While there are some product categories, which experienced some growth in bilateral trade lately, many of the products, having high values, tend to have negative changes in their trade values, and the reasons for this fluctuations can be different, as we have discussed above. While it may seem that this relationship is important only for Canada, the reality is that that Canada is still the country which imports the most merchandise from the U.S., and the second largest exporter to the U.S., which ultimately

⁸¹ *ibid.*

⁸² *ibid.*

⁸³ BUMP, P. Analysis | What U.S. trade with Canada actually looks like. [online]. *Washington Post* [online] [Accessed 18.02.2019]. Available from: <https://www.washingtonpost.com/news/politics/wp/2018/06/11/what-u-s-trade-with-canada-actually-looks-like/>

⁸⁴ NAFTA's Economic Impact. [online]. *Council on Foreign Relations* [online] [Accessed 18.02.2019]. Available from: <https://www.cfr.org/backgrounder/naftas-economic-impact>

makes Canada one of the most important trading partners for the USA. However, to judge the overall importance of Canada for the U.S. and vice versa, it is necessary to assess other areas of economic relationship as well, and we will continue with services in the next section.

2.2.Trade in services

In today's international trade, the importance of services is constantly growing. The amount and value of services traded are increasing, and their share in the global trade with good and services grows, too. Therefore, for Canada and the United States it is also important to keep track of their trade in services and make timely adjustments, which will allow them to take the best out of their bilateral relationship and improve their long-standing history of free trade development. Still, the differences between these two countries are evident, and we cannot say that Canada is as a big player on the global arena neither in merchandise trade nor services. This information is presented in Table 4.

Table 4: Trade in services statistics, 2017 (millions of US\$)

Country	Export	Import
USA	780875	538110
Canada	86876	106172

Source: author, data adapted from UNCTAD

As shown above, the United States had positive trade in services balance in 2017, which is definitely positive for a country with such a large overall deficit, however, overall trade in services cannot substantially smoothen the total deficit due to significantly smaller value. Still, the United States were the most trading country in the services area, while Canada was only on the 10th place.⁸⁵ Canada also finished the year with a deficit in services trade, but due to the respectively smaller amount of services traded, it was not that evident. Comparing these two countries, we can see that the U.S. import 5 times more services than Canada, and their exports are about 9 times as large as the Canadian ones.⁸⁶

⁸⁵ UNCTAD. UNCTADstat - General Profile: United States of America. [online]. *UNCTADstat* [online] [Accessed 24.02.2019]. Available from: <https://unctadstat.unctad.org/CountryProfile/GeneralProfile/en-GB/842/index.html>

⁸⁶ UNCTAD. UNCTADstat - General Profile: Canada. [online]. *UNCTADstat* [online] [Accessed 01.03.2019]. Available from: <https://unctadstat.unctad.org/CountryProfile/GeneralProfile/en-GB/124/index.html>

Table 5: Top 5 trade in services partners of Canada, 2016

Export			Import		
Market	Trade (US\$ Mil)	Partner share (%)	Market	Trade (US\$ Mil)	Partner share (%)
U.S.	45,143	54.9	U.S.	55,357	55.5
UK	4,998	6.1	UK	5,294	5.3
China	2,370	2.9	Hong Kong	3,136	3.1
France	2,151	2.6	France	2,416	2.4
Switzerland	1,675	2.0	Mexico	2,370	2.4

Source: author, adapted from Statistics Canada

Regarding the service trade partners for Canada, in 2016 (the data for 2017 were not available at the time of writing this part), Canada's main trading partner was, not surprisingly, the United States. The U.S. dominated the Canadian services trade both in exports and imports, with an around 55% share in each of the directions.⁸⁷ This was substantially more than the sum of other 4 biggest partners' share in services trade, which again underscores the importance of the United States as a trading partner for Canada. Nevertheless, on the contrary to the merchandise trade, here Canada imports more from the U.S. than exports, however, the difference is not even close to the one in the goods trade.

Table 6: Top 5 trade in services partners of the U.S., 2016

Export			Import		
Market	Trade (US\$ Mil)	Partner share (%)	Market	Trade (US\$ Mil)	Partner share (%)
UK	65,729	8.7	UK	51,698	10.2
China	54,157	7.2	Germany	33,395	6.6
Canada	53,957	7.2	Japan	31,004	6.1
Ireland	46,629	6.2	Canada	29,950	5.9
Japan	44,154	5.9	India	25,808	5.1

Source: author, data adapted from U.S. Census Bureau

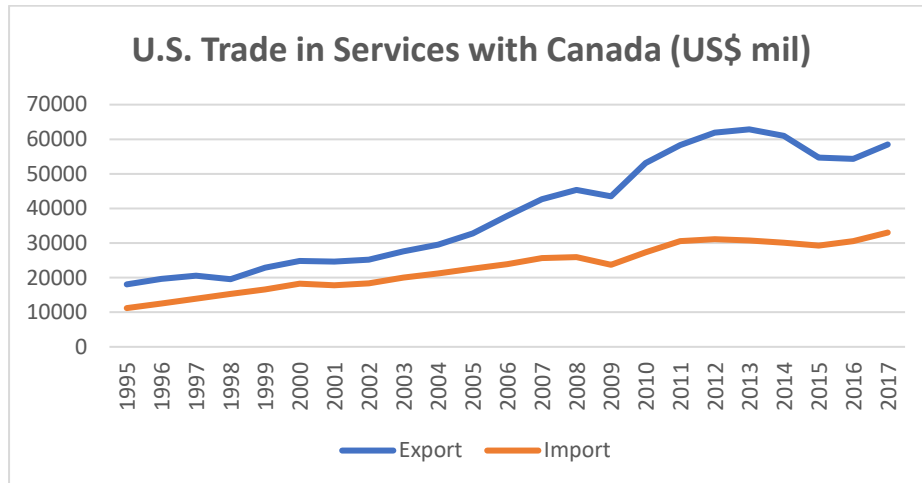
On the other side of the relationship, the importance of Canada for the USA in their trade services is not totally reciprocal. Not only Canada is only 3rd largest importing market of services from the U.S., with a share of about 7 %, but its position in the list of American service suppliers is even lower, with a lower share, as well.⁸⁸ Given the difference in the export and import of services from

⁸⁷ GOVERNMENT OF CANADA, p.C. International transactions in services, by selected countries, annual. [online] [Accessed 27.03.2019]. Available from: <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610000701>

⁸⁸ US CENSUS BUREAU, F.T.D. US Census Bureau Foreign Trade. [online] [Accessed 27.03.2019]. Available from: https://www.census.gov/foreign-trade/Press-Release/current_press_release/index.html

Canada, it is evident that there is a positive trade in services balance for the U.S., which partially mitigates the deficit in merchandise trade.

Figure 3: United States trade in services with Canada (US\$ millions)



Source: author, data adapted from U.S. BEA, Census Bureau, OECD

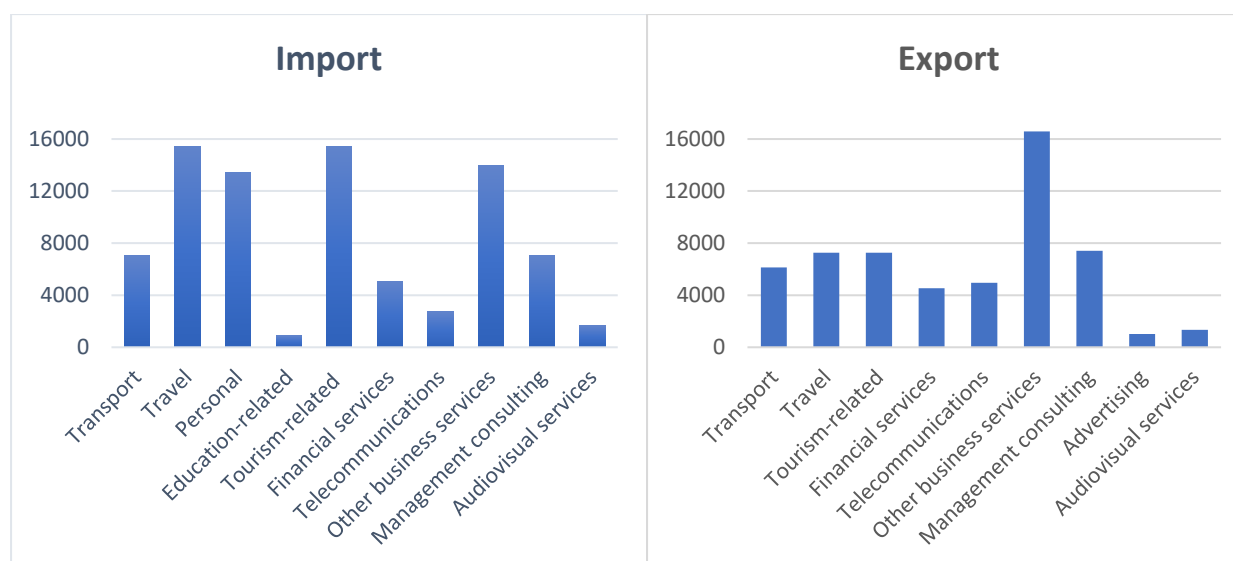
The United States' trade in services surplus, however, has been consistent throughout the year in this bilateral relationship, which proves Figure 3. Over the last five years the surplus was fluctuating in values between \$32 billion in 2013 to \$24 billion in 2016, with its moderate recovery to \$25 billion a year later.⁸⁹ The overall rising rate was interrupted by two significant events in the 2000s: the first happened at the beginning of the decade with the bursting of the “dot-com bubble”; the second was the global financial crisis. Generally, we can see how the trade in services followed the trends of merchandise trade all these years. Similarly, it fell after the crisis in 2008, as well as in 2015, which can also be explained by the fluctuations in commodities prices that transferred into the services sphere, particularly the transport category, which contributes a great deal to the global trade in services, and Canada – U.S. mutual trade is not an exception.⁹⁰ The travel services also greatly affected deficit expansion in the first decade of the new millennium, and it can be explained by the value of the Canadian dollar (a strong dollar means that it is less expensive for Canadians to travel abroad and more expensive for foreigners to travel to Canada), securing of the

⁸⁹ International Trade in Goods and Services | U.S. Bureau of Economic Analysis (BEA). [online]. [Accessed 28.02.2019]. Available from: <https://www.bea.gov/data/intl-trade-investment/international-trade-goods-and-services>

⁹⁰ U.S. Services Trade with Canada: 2011–15 | USITC. [online]. [Accessed 18.02.2019]. Available from: https://www.usitc.gov/publications/industry_econ_analysis_332/2017/canada.htm

Canada-U.S. border after the 9/11 (with a following drop in travel receipts from the US), and also general economic conditions, influencing spending. Other important services are shown on Figure 4, and more detailed information about the export and import of services between Canada and the U.S. can be found in the Appendix 1 and 2.

Figure 4: Canada's trade in services with the USA, 2016, EBOPS-2010 (US\$ million)



Source: author, data adapted from WTO, GOC and USITC

As we can see, the main share of the bilateral trade in services in both exports and imports falls on the Commercial services (WTO defines them to be equal to services minus government services), which account for \$44.8 billion in Canada's exports and more than \$55 billion in imports, which represents more than 99 % in both directions.⁹¹ Regarding the structure of imports and exports, it is fair to say that the composition of trade with services is similar, however, there is a difference in the prevailing categories for each of the directions. On the one hand, in the import of services made by Canada from the United States, the apparent leading categories (categories are classified under EBOPS 2010) are Travel, specifically Tourism-related services in travel and passenger transport, as well as Other business services and Personal services. Travel category was the one with the largest value of imports, reaching \$15.5 billion, and exceeding the Personal services category by more than \$2 billion.⁹² Travel services were also among the key drivers of Canada's deficit, as

⁹¹ Commercial services trade by sector and partner, WTO Data [online] [Accessed 24.03.2019]. Available from: <http://data.wto.org/>

⁹² *ibid.*

Canadians travelling in the USA spent twice more than what Americans travelling in Canada did, and the travel deficit with the U.S. dropped the latest trend of decreasing and grew by \$1 billion in 2017.⁹³ Among the Other business services, the biggest part was traded for Professional and management consulting services, which had \$7.6 billion in value, and was \$550 million more than the Transport group of services, where the most traded type of transport was air transport, with just over \$3.5 billion. Also, it is worth mentioning the Financial services, which accounted for almost 10% of the total import of services, with a value a bit over \$5 billion.⁹⁴ Moreover, another important services category was the Intellectual property (almost \$7 billion in value), particularly Audiovisual and related services (\$1.7 billion). The overall value of Canada's import of services from the U.S., or the United States' exports rose by around 243 % from 1993 (pre-NAFTA).

The situation with export of commercial services by Canada to the USA has some nuances in comparison the the imports. Specifically, here the most traded services were the Other business services, followed by Travel and Transport category. Inside the Other business services, the biggest part was attributed to the Professional and management consulting services (\$7.4 billion) and Technical, trade related and other business services (\$6.5 billion).⁹⁵ Inside the Travel group, the main and only constituent were Tourism-related services in travel and passenger transport, with over \$7 billion in value, which was more than \$1 billion higher than the value of Transport services exported, where the leading sub-group were Other models of transport and Air transport.⁹⁶ Even though growth in travel exports was slower than in 2016, it was still the major source of growth in services exports and was probably impacted by the relatively low value of the Canadian dollar.⁹⁷ Also, we should not forget about Telecommunications, computer, and information services, as well as Financial services, which resulted in the value of \$4.95 billion and \$4.5 billion, respectively.⁹⁸

⁹³ GOVERNMENT OF CANADA, Canada's State of Trade [online] [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0

⁹⁴ *ibid.*

⁹⁵ Commercial services trade by sector and partner, WTO Data [online] [Accessed 24.03.2019]. Available from: <http://data.wto.org/>

⁹⁶ Recent Trends in U.S. Services Trade: 2018 Annual Report. [online] [Accessed 01.03.2019] Available from: <https://www.usitc.gov/publications/332/pub4789.pdf>

⁹⁷ GOVERNMENT OF CANADA, Canada's State of Trade [online] [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0

⁹⁸ *ibid.*

Generally, the imports of services by the United States from Canada were up almost 263 % compared to the level in 1993, before NAFTA.

To close the topic of bilateral trade with services, we should underscore that, despite the fluctuation in the amount of traded services in the recent years, the mutual trade still has a tendency to grow, especially if we look how it has developed since the NAFTA creation. Given the geographic proximity of the countries, it is logical that the most important and traded categories of services are Transport and Travel, which continue to grow between the two countries, but are still dependent on some other factors, such as instability of commodity prices. Besides these groups, other categories which have a substantial share of the mutual trade in services are Intellectual property services, Financial services and Management and business consulting services, which have also followed a trend of stable growth. Again, similar to the situation with merchandise trade, it seems that the importance of this economic partnership for each of the countries is different. For Canada, the United States are both the leading export and import market, while the U.S., on the other hand, cannot say that Canada is their biggest trading partner, if only mentioning services. Nevertheless, the amount of trade is still quite significant, and its level of stability and growth throughout the mutual history of this relationship is another evidence of how important the bilateral relationship is for each of the countries.

2.3.Foreign direct investments

Having discussed trade in goods and services, we can now move onto the next significant indicator of this economic relationship, which can also give us an insight into how important these countries are for each other as partners. This part will be dedicated to foreign direct investments (FDI), which represent a long-lasting interest in control of a foreign affiliate or enterprise by a resident of another country, and can be reflected as either inflow or outflow of capital to or from a specific country.⁹⁹ Canada and the United States have been trading partners for a long time, and this relationship has also been accompanied by belief in the mutual relations, which resulted in significant amount of investments between these countries. However, the situation which built up on the global investment arena in 2017 affected the U.S. – Canada relationship as well. Specifically, in 2017 the

⁹⁹ UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT. *World Investment Report 2018: Investment and New Industrial Policies* [online]. UN, 2018 [Accessed 24.03.2019]. DOI: 10.18356/ebb78749-en

world FDI inflows fell by 23 %, and fell back to the level of 2013.¹⁰⁰ This trend was also evident in the North American inflows, which decreased by 33.2 %, and, to some extent, were caused by the falling cross-border mergers and acquisitions transactions between Canada and the U.S.¹⁰¹ Nevertheless, despite this decrease, the United States still were the leading receiver and provider of FDI in 2017. The values of FDI for both countries are shown in Table 7.

Table 7: FDI statistics, 2017 (US\$ million)

Country	Outward	Inward
United States of America	342269	275381
Canada	76988	24244

Source: author, data adapted from UNCTAD

Even though the USA were the leading country in FDI, they witnessed the decrease in inflows if compared to 2016, when they received \$457 billion, however, the outflow of FDI increased. Canada, on the other hand, received and provided significantly less FDI, and was on the 7th place in the global ranking of outward FDI, while in the inward FDI ranking Canada was at the end of top 20 countries.¹⁰² Regarding the mutual exchange of directed investments in 2017, represented in flow, the effects of trend, which established in the world, were not particularly similar to the situation on the global market. The results for 2017 are shown in Table 9 below.

Table 8: Canada's direct investments, 2017 (US\$ million)

Direction	Outflow	Inflow
United States of America	61590	17427
Growth	0.12	-0.144

Source: author, data adapted from Global Affairs Canada

¹⁰⁰ *ibid.*

¹⁰¹ GOVERNMENT OF CANADA, G.A.C. Canada's State of Trade: Trade and Investment Update – 2018. *GAC* [online], p. 30 [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0

¹⁰² UNCTADstat - Table view - Foreign direct investment: Inward and outward flows and stock, annual. [online]. [Accessed 02.03.2019]. Available from: <https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx>

As we may see from the table above, FDI inflows from the United States into Canada decreased by 14.4 percent, reaching the value of \$17.4 billion.¹⁰³ However, this decline was not as sharp as the fall of direct investment from the rest of the world, where the inflow from those countries declined by 63 %. Overall, the inflow of FDI into Canada dropped by 36.4 %, with a value of \$31.5 billion. The falling inflow of investment from the United States was mainly attributed to a reversal in net mergers and acquisitions (M&A) activity from the investors, and, as a result, M&A investment became divestment. Even though reinvested earnings grew by 101.7 %, other flows fell from almost \$13 billion to just over \$1 billion.¹⁰⁴ Despite the decrease of FDI inflow, the United States were still the leading investor in Canada, with a position of \$392.1 billion in 2017 (stock), as shown in Table 10 below. This also equals a 48% share in Canada's total FDI stock by investing countries.¹⁰⁵ Moreover, Canada was only 5th largest destination of the U.S. direct investments abroad, surpassed by the Netherlands, the UK, Luxembourg and Ireland.¹⁰⁶ Among the main destinations of the U.S. direct investments into Canada were manufacturing, finance and insurance, and non-bank holding companies, trade and transportation, management of companies, while mining and oil and gas extraction was the only category with negative investment.¹⁰⁷

Table 9: FDI stock, 2017 (US\$ billion)

U.S. direct investment stock in Canada	391.2
Canadian direct investment stock in U.S	453.1

Source: author, data adapted from USTR

On the other side of the investment exchange, the outflow of Canadian direct investment in the U.S. grew by 12 percent in 2017, reaching \$61.6 billion.¹⁰⁸ Again, similar to the situation with the inflows, the reason for partial increase in the outflow were rising M&A and reinvested earnings,

¹⁰³ GOVERNMENT OF CANADA, Canada's State of Trade [online] [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0

¹⁰⁴ *ibid.*

¹⁰⁵ *ibid.*

¹⁰⁶ Direct Investment by Country and Industry, 2017 | U.S. Bureau of Economic Analysis (BEA). [online]. [Accessed 03.03.2019]. Available from: <https://www.bea.gov/news/2018/direct-investment-country-and-industry-2017>

¹⁰⁷ Canada [online] [Accessed 25.02.2019]. Available from: ustr.gov/countries-regions/americas/canada

¹⁰⁸ GOVERNMENT OF CANADA, Canada's State of Trade [online] [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0

however, other flows to the United States' affiliates were on a falling trend. Interestingly, Canada's M&A outflows declined by 54.5 % to the rest of the world, but reinvested earnings grew by about 33 percent.¹⁰⁹ Regarding the Canadian direct investment stock into the United States, it was roughly at \$453 billion in 2017, or 19 % higher than in 2016.¹¹⁰ The leading categories of affiliates with the largest investments were manufacturing, finance and insurance, and also wholesale trade, and we can see that the structure is quite similar to the reverse investment direction. Another reason for Canada's growth in direct investment stock in the USA was the appreciation of the Canadian dollar against major currencies.¹¹¹ Nevertheless, Canada was not the country with the largest direct investment position in the U.S. The leading investing country in 2017 was the United Kingdom, while Canada was only third, also surpassed by Japan.¹¹² However, Canada was the leading investor in flow of capital, with a 45% share in 2017, which is almost at the same level as it was in 2007 (43 %).¹¹³

Indeed, the results of 2017 somehow represent the general trend of the development of the foreign direct investment between these two countries. Since the signing of NAFTA, the U.S. stock of FDI into Canada grew from \$69.9 billion in 1993, to \$351 billion in 2012, and \$391 billion in 2017.¹¹⁴ Canada, while not being the largest investor in the U.S., still proves that the United States is the leading destination for Canadian FDI, with a stock of \$453 billion in 2017, which grew significantly over the period of 25 years, starting from \$26.6 billion in 1993 and later increasing to \$225 billion in 2012. Despite prevailing growth, there have been years when the FDIs deviated from that trend, due to economic and other events, such as commodities prices changes and attacks, and we can also expect that the countries will continue to invest more in developing countries. But generally, we can see that both countries consider each other to be an important partner, and the

¹⁰⁹ *ibid.*

¹¹⁰ Canada [online] [Accessed 25.02.2019]. Available from: ustr.gov/countries-regions/americas/canada

¹¹¹ GOVERNMENT OF CANADA, Canada's State of Trade [online] [Accessed 02.03.2019]. Available from: https://www.international.gc.ca/gac-amc/publications/economist-economiste/state_of_trade-commerce_international-2018.aspx?lang=eng#6.0

¹¹² Direct Investment by Country and Industry, 2017 | U.S. Bureau of Economic Analysis (BEA) [online] [Accessed 03.03.2019]. Available from: <https://www.bea.gov/news/2018/direct-investment-country-and-industry-2017>

¹¹³ *ibid.*

¹¹⁴ VILLARREAL, M.A., FERGUSSON, I.F. Nafta at 20: Overview and Trade Effects*. *Current Politics and Economics of the United States, Canada and Mexico; Commack* [online]. 2014, vol. 16, no. 3, p. 26 [Accessed 18.02.2019]. Available from: <https://search.proquest.com/docview/1655115585/abstract/1A96D0394A046F0PQ/1>

growth in investments demonstrates that there is a shared vision of mutual investments as a mean supporting the economy and creating new jobs and technologies resulting from the investments.

2.4. Other effects

Although the macroeconomic aspects of the bilateral relationship are the main focus of this chapter, it is still necessary to mention other effects, which influence the development of relationship between Canada and the USA, and which will probably determine how these relations will change in the future. Among the most important areas of cooperation are labor regulations and immigration, environmental impacts and intellectual property rights (IPR). It is worth mentioning that despite having significant importance for both Canada and the United States, these areas of cooperation were not included in the main part of NAFTA.¹¹⁵ However, we should also state that these particular issues were considered by Canada and the U.S. mainly because of their mutual cooperation with Mexico inside NAFTA, with fears of illegal migration, and also possible environmental damage due to availability of low-cost production opportunities and also absence of environmental regulations. In order to eliminate possible harm, two side agreements of labor rights and environment protection were signed.¹¹⁶ The signature of NAFTA allowed its participants to recognize the importance of environmental vulnerabilities, which may arise, and prepared them for mutual cooperation under the trade-environment regime that would benefit all participants.¹¹⁷

Regarding the labor market specifically in the Canada – U.S. relations, the main area, where the mutual free trade agreement led to some changes, is the composition of employment. Tariff cuts, applied in these countries, affected the paid vs self-employment division, as well as the structure in terms of sectors. Though the free trade agreement and regional tariffs do not lead to the traditional changes on the labor market, such as employment and salaries, the agreement affects this area in an indirect way, bring it to the regional parity, and making the self-employment prevail.¹¹⁸ However, the share of self-employed people depends on the economic cycles, and

¹¹⁵ GAMSO, J., GROSSE, R.E. NAFTA 2.0 What Should Be Next? [online]. *SSRN Electronic Journal* [online]. 2017 [Accessed 18.02.2019]. DOI: 10.2139/ssrn.2967014

¹¹⁶ *ibid.*

¹¹⁷ Linking Trade, Environment, and Social Cohesion | NAFTA Experiences, Global Challenges. *Taylor & Francis* [online], p. 76 [Accessed 03.03.2019]. Available from: <http://www.taylorfrancis.com/books/e/9781351745369>

¹¹⁸ CHAN, J. *Tariffs and the Composition of Employment: Evidence from the Canada-U.S. Free Trade Agreement* [online], p. 21 [Accessed 03.10.2018]. Available from: <https://papers.ssrn.com/abstract=3200170>

therefore can fluctuate following that very cycle. Nevertheless, it is possible to say that free trade agreements can motivate people to change their employment, in this example, lower Canadian tariffs can mean higher competition on the local market, and might persuade people to enter self-employment, while lower American tariffs, on the other hand, can signify better economic conditions and the desire of people to leave their self-employment and find a paid job. Additionally, even though tariff cuts in specific industries were implemented based on a principle of welfare maximization, we should recognize the fact that these tariffs are usually a matter of lobbying by interested groups in both countries, which is another reason why the composition of labor market is different in some industries.¹¹⁹ Also, when assessing the impact the mutual free trade agreements had on both countries regarding the income equality, it was said that the agreement benefited Canada, especially because of its relatively more elastic supply and the ability to react quicker to the increased demand. Moreover, increasing capital share of the USA in the production allows them to come closer to Canada, but still, bigger production capacity of the U.S. companies was announced to benefit Canada, too.¹²⁰

Lastly, speaking about IPR, even though NAFTA did not include provision on IPR in its main part, there was a side agreement, which regulated this area, and that allowed NAFTA to be the first agreement, which side agreement contained information about IPR.¹²¹ Even though it was written before the widespread use of Internet, it provided protection for American and Canadian firms, which had some technological information and know-how, and served as evidence of the interest in the long-term development of mutual relationship in this dynamic sphere, with regulations being updated later on. New technologies are invented all the time, and it is important to update the provisions regularly to keep the owner of proprietary rights safe. However, this also refers to other concerns of mutual relations, and in the next chapter we will try to find out how to ensure successful future bilateral cooperation.

¹¹⁹ STOYANOV, A. Regional Trade Agreements and Cross-Border Lobbying: Empirical Evidence from the Canada-US Free Trade Agreement Negotiations. *Review of International Economics* [online]. 2016, vol. 24, no. 1, p. 21 [Accessed 02.10.2018]. DOI: 10.1111/%28ISSN%291467-9396/issues

¹²⁰ HONG, G. Trade and Global Income Inequality with Frictional Labor Markets: A Lesson from the Canada-US Free Trade Agreement. *International Economic Journal* [online]. 2015, vol. 29, no. 2, p. 19 [Accessed 02.10.2018]. Available from: <http://search.ebscohost.com/login.aspx?direct=true&db=eoh&AN=1519997&lang=cs&site=ehost-live>

¹²¹ VILLAREAL, M.A., FERGUSSON, I. The North American Free Trade Agreement (NAFTA). *Federal Publications* [online]. 2017, p. 28. Available from: https://digitalcommons.ilr.cornell.edu/key_workplace/1937

3. Current problems and perspectives

Canada – U.S. bilateral relations are widely known to be one of the biggest examples of successful economic relationships between two countries. In the first two chapters, we have described the history of their mutual relationship and analyzed the recent trends in bilateral trade, investments, as well as some other aspects. The results show that there is definitely dependence of one country on the other, which also means that the relationship is important for both countries, even though it may differ in the extent. Nevertheless, despite the positive trends in the development of this mutual relationship, these countries have encountered some problems and challenges in their attempts to further improve the economic relations. To understand what drives the changes in the bilateral relations and understand the current conditions, we will look at the recent events and established situation, particularly at how the President Trump affected the NAFTA renegotiations, what are the specifics of new agreement between Canada, U.S. and Mexico, and what are possible future scenarios.

The first part of this chapter will provide introduction to the topic of NAFTA renegotiation process, and explain how the process was initiated and what were the reasons for that. In this case, the information will be also presented from the point of view of President Trump, who was the key role behind initiating the negotiations, and who also called NAFTA “the worst trade deal in the history of the country”.¹²² As of today, we all know that his attempts were successful, and the United States, Mexico and Canada reached a new agreement in November 2018, meaning that there will be new conditions of mutual trade, the impacts of which on Canada and the United States will be different.¹²³ We will try to understand what changed and if the new changes will affect the future development of the relations between these two countries. In the end, we will try to prognose future scenarios and made suggestions on possible improvements of the bilateral relationship between Canada and the United States. If the suggested changes and improvements are made, they can contribute to strengthening of the relationship and further realization of the mutual importance.

¹²² PARTINGTON, R. Nafta: what is it and why is Trump trying to renegotiate? [online]. *The Guardian* [online]. 2018 [Accessed 06.03.2019]. Available from: <https://www.theguardian.com/us-news/2018/aug/30/nafta-what-is-it-why-is-trump-trying-to-renegotiate>

¹²³ United States-Mexico-Canada Agreement. [online]. [Accessed 06.03.2019]. Available from: [/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement](#)

3.1. President Trump's policies and NAFTA renegotiation

For any trade agreement in the world it is quite common to encounter different opinions coming from people, both negative and positive. And the case of NAFTA, the agreement between Canada, U.S. and Mexico, was not an exception. Canada and the United States expressed their concerns about the functioning of NAFTA and the mutual relationships multiple times, but the radical actions had not been taken until the U.S. elected Mr. Trump as their new president. The main reasons and motives behind the renegotiation of NAFTA had been expressed before by all three participants of the agreement. However, the United States had always been the member who had the highest degree of dissatisfaction with the agreement, particularly because of the negative impact NAFTA had had on the loss of jobs in the traditional heavy manufacturing sectors in some states, such as Michigan.¹²⁴ Moreover, the Americans were blaming NAFTA for preventing the growth of wages in the sectors that remained. President Trump, who was not satisfied with the conditions of NAFTA, decided to start the renegotiation process, and in May 2017 his administration sent renegotiation notice to the Congress, marking the beginning of the complicated and long-lasting process.¹²⁵ This action clearly showed President Trump's intentions to change what he had called before "the worst trade deal in the history of the country", and continued the actions which he had taken before, particularly imposing aggressive tariffs on Canadian and Mexican products in order to stimulate the renegotiation process.¹²⁶

However, we should stress that President Trump tried to affect the agreement in many different ways, since he took on his new role. Creating better conditions for workers and saving jobs were among his main pledges during his presidential campaign, and, once he was elected, he started to try to fulfill those promises. He was constantly putting the pressure on the other two members of the pact, mainly complaining about the trade imbalance with Canada, and emphasizing that the United States imported more goods and services than exported, which he was equating to the U.S. being treated unfairly. Playing from the position of power, he also threatened to abandon the agreement, which eventually worked and Canada and Mexico agreed to renegotiating the

¹²⁴ PARTINGTON, Nafta [online] [Accessed 06.03.2019]. Available from: <https://www.theguardian.com/us-news/2018/aug/30/nafta-what-is-it-why-is-trump-trying-to-renegotiate>

¹²⁵ DAVIS, J.H. Trump Sends Nafta Renegotiation Notice to Congress. *The New York Times* [online]. 2018 [Accessed 08.03.2019]. Available from: <https://www.nytimes.com/2017/05/18/us/politics/nafta-renegotiation-trump.html>

¹²⁶ PARTINGTON, Nafta [online] [Accessed 06.03.2019]. Available from: <https://www.theguardian.com/us-news/2018/aug/30/nafta-what-is-it-why-is-trump-trying-to-renegotiate>

agreement.¹²⁷ What is interesting, the renegotiation was not supported equally by all the interested parties. For instance, Canada's prime minister, Justin Trudeau, was repeating that he welcomed the opportunity to change NAFTA and make it more modern, while the Republicans in Congress expressed their preoccupations that the new changes might break the well-working supply chain, which would worsen their economic results.¹²⁸

Another area of the bilateral relations between Canada and the U.S., affected by the Trump's policies, are the cross-border relations. The ease of crossing the borders and absence of barriers provide positive conditions for trade development, but with the election of Trump crossing the borders has been more and more uncertain, even for the groups that rarely had any problems before. It is extremely important for the representatives of both countries to realize how important the mutual relationship is, and to look at the changes in the policies from different perspective, including the long-standing bilateral history. Enabling and preserving easy border-crossing will allow both businesses in both current to keep current level of economic relationship, some of which depend significantly on well-established supply chains, and also facilitate future improvements in the mutual trade.¹²⁹

As mentioned before, President Trump's favorite tactics during the process of negotiations were threatening the U.S. counterparts with imposing the tariffs on some of the sectors of economy. It is quite understandable why both countries found it difficult to sign a new deal at that time. The inability of Trump to make concessions and putting the U.S. in the central position at all times prevented the negotiations from being equal and friendly to other partners, and significantly slowed down the process. One of the main items on the discussion list of the Trump's Administration was reaching exemption from Canada's protectionist policies, which supported Canada's dairy producers, and was realized in form of heavy import taxes on milk and cheese.¹³⁰ When Canada showed that it was not willing to completely lift those measures, Trump decided to impose tariffs

¹²⁷ DAVIS, Trump Sends Nafta Renegotiation Notice to Congress [online] [Accessed 08.03.2019]. Available from: <https://www.nytimes.com/2017/05/18/us/politics/nafta-renegotiation-trump.html>

¹²⁸ *ibid.*

¹²⁹ ANDREWS, J. Introduction—Fantasies of Nation: Canada-US Relations in the Era of Trump. *Canadian Review of American Studies* [online]. 2018 [Accessed 02.10.2018]. DOI: 10.3138/cras.48.s1.2017.007en

¹³⁰ CECCO, L. Trade talks stuck in neutral as Trump "very unhappy" with Canadian negotiator. *The Guardian* [online]. 2018 [Accessed 08.03.2019]. Available from: <https://www.theguardian.com/us-news/2018/sep/29/nafta-latest-us-canada-trade-talks-deadline>

on Canadian steel and iron, from which Canada had been exempt before.¹³¹ However, while this action may have stimulated Canada to reconsider its policies, at the same time it prevented the signing of the agreement, as it was clear that Canada would not sign a deal which would not have provisions on conflict resolution, particularly from punitive tariffs imposed by the U.S.¹³² This serves as an example that President Trump's inclination to conduct negotiations from the position of power often prevents participating countries from reaching an agreement quickly, but also allows the United States somehow get better deals if compared to the counterparts.

To summarize, the NAFTA renegotiation process was affected significantly by uncertainty about the United States' tax and trade policies, future bilateral and multilateral relations, possible risks and threats to the macroeconomic stability of the global economy, and the way the President Trump's Administration reacted to the iterations in the negotiations.¹³³ Even though the main part of the renegotiation was dedicated to the U.S. – Mexico relations, and Canada – U.S. relationship was only intended to go through modest changes or tweaks, the demands of two countries still had to be met. The process of negotiations took longer than expected, which is understandable that neither of the participants wanted to concede their interests, which may have disrupted the stability in some of the key sectors of the economies. Nevertheless, despite complicated and long-lasting renegotiation process, the concessions were made and both countries came to a compromise, which resulted in agreeing to a new deal together with Mexico, a deal which is intended to replace NAFTA. In the next part of this chapter we will look closely at some of the major changes and key provisions of the new trade deal.

3.2. The United States-Mexico-Canada Agreement

NAFTA renegotiation was a complicated process which lasted over two years, but, despite long negotiating and missing set deadlines, NAFTA members agreed to sign a new deal. Initially, the United States agreed a new bilateral deal with Mexico on the update terms of NAFTA agreement, but Canada was not part of that deal until the last day of September 2018, when all three countries

¹³¹ CECCO, Trade talks stuck in neutral as Trump "very unhappy" with Canadian negotiator [online] [Accessed 08.03.2019]. Available from: <https://www.theguardian.com/us-news/2018/sep/29/nafta-latest-us-canada-trade-talks-deadline>

¹³² *ibid.*

¹³³ CIURIAK, D. *Renegotiating NAFTA: Implications for Canada of Possible Trump Administration Policies* [online], p. 9 [Accessed 03.10.2018]. Available from: <https://papers.ssrn.com/abstract=2911390>

were finally satisfied with the provision of a new deal, which resulted in signing and creating a new agreement called the United States-Mexico-Canada Agreement, or USMCA.¹³⁴ As stated on the website of the United States Trade Representative, this deal is “a mutually beneficial win for North American workers, farmers, ranchers, and businesses”.¹³⁵ The main goal of this agreement is building more balanced, reciprocal trade, which will support and create new jobs, as well as increase high-paying jobs in the whole North America.¹³⁶ However, despite being signed in November by the highest representatives of all three participants, the deal still needs to be ratified by the governments of all three countries. This particular requirement can delay the deal, especially considering the fact that the Congress of the United States has not started the process of approving the agreement yet, and the process itself can be complicated as the Democrats in the Congress do not fully agree with all the provisions of the deal, especially labor and environmental standards.¹³⁷

The new agreement includes major modifications in several key areas of mutual trade relations. Among them are country of origin rules, labor provisions, access to the Canada’s dairy market by American producers, intellectual property rights and digital trade, dispute resolution, as well as “Sunset” clause, which means that the deal will expire after a set period of time (16 years in this case), and also includes deal reviews every five years.¹³⁸ Now we will look closer at each of the mentioned changes.

Regarding the rules of origin, NAFTA provisions included a requirement of 62.5 % of vehicle’s content to be produced in one of the member-countries to qualify for zero tariffs. The new deals modifies this requirement and raises the percentage to 75 percent, which can have different impacts on the economies of the countries. This rule is meant to benefit the United States in a way that Canada and Mexico will have to limit the import of parts from other countries like Germany, Japan,

¹³⁴ PORTER, C. For Canada, a Sigh of Relief More Than a Celebration in New Nafta Deal. *The New York Times* [online]. 2018 [Accessed 07.03.2019]. Available from: <https://www.nytimes.com/2018/10/01/world/canada/trudeau-nafta-canada.html>

¹³⁵ United States-Mexico-Canada Agreement [online] [Accessed 06.03.2019]. Available from: [/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement](https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement)

¹³⁶ Agreement between the United States of America, the United Mexican States, and Canada Text. [online]. [Accessed 10.03.2019]. Available from: [/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between](https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between)

¹³⁷ POLITI, J. US Democrats seek changes to revamped Nafta deal. *Financial Times* [online] [Accessed 10.03.2019]. Available from: <https://www.ft.com/content/6f1b275a-1b43-11e9-9e64-d150b3105d21>

¹³⁸ REUTERS. U.S. pushes for “sunset clause” to re-examine NAFTA every five years - BNN Bloomberg. *BNN* [online] [Accessed 10.03.2019]. Available from: <https://www.bnnbloomberg.ca/u-s-pushes-for-sunset-clause-to-re-examine-nafta-every-five-years-1.883334>

South Korea or China, and eventually together with other factors contribute to moving the assembling factories and jobs back to the U.S.¹³⁹

The labor provisions were also changed, particularly in the car manufacturing area. The new rule says that at least 40 % of automobile parts have to be manufactured by workers who earn at least \$16/hour by 2023.¹⁴⁰ This “high-wage” factory rule will significantly affect Mexico, where the average salary for production workers is around three times lower. This can be interpreted as an attempt of the United States to persuade automakers to switch suppliers of parts from Mexico to Canada or the U.S., supporting and creating more jobs.¹⁴¹ However, this can also be a negative consequence, especially for American consumers, for whom the price of cars will increase, which can lead to a decrease in sales, and following reactions of automakers in form of shifting the production to low-cost countries abroad, e.g. China.

The next change was especially important for President Trump in his attempts to modify bilateral relations with Canada, and refers to access to the dairy market, which was also the most discussed point of the negotiations, preventing them from meeting the deadlines. What Trump was concerned about is the Canada’s protection of its dairy markets, particularly limits on imports from the U.S., as well as government protection, which benefits Canadian producers and makes them more competitive on the international markets than the American ones. The new deal includes Canada’s agreement to give the United States’ dairy farmers access to 3.5 percent of Canada’s annual domestic dairy market, which is worth about \$16 billion.¹⁴² Moreover, the new modifications mean wins for the U.S. in both areas, as Canada agreed to not only provide access to its dairy market, including fluid milk, butter, cheese and other markets, but also to eliminate its government program which supported Canadian producers on domestic and international markets.¹⁴³

¹³⁹ TANKERSLEY, J. Trump Just Ripped Up Nafta. Here’s What’s in the New Deal. *The New York Times* [online]. 2018 [Accessed 07.03.2019]. Available from: <https://www.nytimes.com/2018/10/01/business/trump-nafta-usmca-differences.html>

¹⁴⁰ REUTERS. Trump heralds “wonderful new trade deal” to replace Nafta after Canada talks. *The Guardian* [online]. 2018 [Accessed 02.10.2018]. Available from: <https://www.theguardian.com/us-news/2018/sep/30/nafta-talks-trump-canada-mexico-sunday-deadline>

¹⁴¹ *ibid.*

¹⁴² *Ibid.*

¹⁴³ TANKERSLEY, J. Trump Just Ripped Up Nafta. Here’s What’s in the New Deal. [online] [Accessed 07.03.2019]. Available from: <https://www.nytimes.com/2018/10/01/business/trump-nafta-usmca-differences.html>

The intellectual property and digital trade were also modified in the new agreement. Here, some of the changes are extending the copyright terms from 50 to 70 years beyond the authors life, extending the period of protection of pharmaceutical drugs from competition, as well as new considerations of digital trade, which includes prohibiting imposing duties on music and e-books, and also protecting internet companies from the liabilities that may arise due to the content that their users produce.¹⁴⁴ Regarding the provision on drugs, it will benefit American pharmaceutical companies and allow them to be protected longer from their similar competitors, which will also likely increase the profits of those companies on the foreign markets, particularly in Canada.

The last modification was especially important for Canada during the negotiation process, and is related to trade dispute settlement mechanism, which would protect Canada from the U.S. tariffs, so favored by President Trump. Even though the United States wanted to eliminate this mechanism, it will still be a part of the new deal, and will protect Canada's lumber and other industries from the U.S. anti-dumping tariffs.¹⁴⁵ Canada and Mexico also wanted to protect themselves from import tariffs on steel and iron, but the tariffs are still in place, which cannot make these countries fully satisfied with a new deal. However, Trump will not be able use auto tariffs as he used to do, as Canada and Mexico protected themselves in a side agreement, which grants them exemption from American tariffs on up to 2.6 million imported passenger vehicles in case if Trump decided to impose 25% global autos tariffs under national security reasoning.¹⁴⁶ This provision allows Canada to increase its automotive exports, which will be a safeguard for the local plants.

In the end, let us summarize the key conclusions and impact for two countries from the modernized and updated free trade agreement. Regarding the United States, it looks like for them the new agreement was a victory on almost all fronts. Major changes in NAFTA agreement will allow the U.S. to create new jobs and assure salaries growth in the manufacturing sectors through the change of rules of origin. American farmers will benefit from the extended access to the Canadian dairy market, which will strengthen the food and agricultural trade in the whole North America. New provisions on intellectual property and digital trade will protect American companies from unfair

¹⁴⁴ *ibid.*

¹⁴⁵ REUTERS, Trump heralds "wonderful new trade deal" to replace Nafta after Canada talks [online] [Accessed 03.10.2018]. Available from: <https://www.theguardian.com/us-news/2018/sep/30/nafta-talks-trump-canada-mexico-sunday-deadline>

¹⁴⁶ *ibid.*

competition, and contribute to the development and protection of small and medium-sized enterprises. For Canada, the success of the new agreement is not that obvious. The agreement and negotiation process was an evidence of Canada's strong standing and desire to make concessions only if they will benefit the Canadian economy.¹⁴⁷ Canada managed to preserve a trade dispute settlement mechanism, which will protect it from future import tariffs imposed by the U.S. However, this achievement came at a cost, and Canada had to make a number of concession in favor of the United States. First of all, Canada did not protect itself from the tariffs on steel and aluminum, even though it was one of the main discussion points. Moreover, the country opened its dairy market to the competition, and agreed to a quota on automotive export to the U.S. While Canadian officials were saying that this agreement was a success, it is still clear that the deal was not what Canada was hoping for, and it will only have a modest effect on the economy, neither bolstering the growth or hurting it.¹⁴⁸ Nevertheless, the USMCA shows that both countries see the future in their mutual relationship, and it continues to stay important for both of them. In the next section, we will try to prognose the future relations and suggest improvements.

3.3.Future scenarios

Even though Canada and the United States agreed on a new trade deal, the agreement is only signed for a limited period of time, which leaves us space for suggestions and predictions of how the future bilateral relationship will look like during and after the validity of the deal. To ensure strong economic relations and their further development, it will be necessary to support the economic subject at all times and implement modifications, which will allow countries to adapt to new bilateral and global changes and successfully tackle challenges. More specifically, Canada and the USA should make sure that they use the mandatory review meetings every five years to keep track of and modernize provisions in the following areas: automotive sector, services, e-commerce, data flows and data localization, intellectual property rights and digital trade, state-owned enterprises, investments and dispute settlements, labor and environment protection, energy provisions, customs and trade facilitation, and, lastly, sanitary and phytosanitary standards.¹⁴⁹ All these areas are

¹⁴⁷ FREELAND, C. A win for Team Canada; The United States Mexico Canada Agreement is the result of Canada standing strong. *The London Free Press*; London [online]. 2018 [Accessed 18.02.2019]. Available from: <https://search.proquest.com/docview/2126121123/citation/ED3EEF895F8946B3PQ/74>

¹⁴⁸ *ibid.*

¹⁴⁹ VILLAREAL, FERGUSSON, The North American Free Trade Agreement (NAFTA) [online] . p.38, 2017 [Accessed 09.03.2019]. Available from: https://digitalcommons.ilr.cornell.edu/key_workplace/1937

particularly important for the mutual economic relationship, and updating them periodically will help protect both countries from possible threats. Also, the necessity to modernize these provisions comes from the current dissatisfaction of the USMCA members regarding some of the topics. Particularly, as we mentioned before, the Democrats in the U.S. Congress do not completely approve of the provisions on labor and environmental standards, and Canada's officials would strive to further improve the dispute settlement mechanism, which will protect Canada from the U.S. tariffs on steel and aluminum. The environmental standards are also of particular importance, as concerns about the future state of environment constantly grow nowadays. Here, it is important to make sure that both countries address the issues and threats like environmental crimes, such as endangered species trade, illegal fishing, etc. Moreover, the countries should develop broad public policymaking participation, which will make the process more transparent and attract more investments and trade.¹⁵⁰ Regarding the e-commerce and digital trade, cross-border and free digital trade can be contentious due to different privacy standards in various countries. Therefore, it is important to update corresponding provisions and react properly to the global trends. To ensure development in this area, countries should improve protection of proprietary technologies and strengthen intellectual property protection, particularly against online piracy.¹⁵¹ While it is important to protect the privacy of companies and consumers, the governments of both countries should also preserve an open digital market, and permitting cross-border data flows and providing access to foreign suppliers of such products and services, as well as treating them without discrimination.

While it is not clear what the mutual relationship will look like in the long-term, it is possible to say that the progress in the relations will be affected by different factors, which will eventually underline the economic and demographic differences between two countries. One of such factors are demographic changes, which can also shape the future bilateral relations. Specifically, Canada-US relationship can be affected by a demographic transition in the long-term, and those factors can intersect with trade interest, dictating the direction in what the bilateral economic relationship will move.¹⁵² With the aging population and lower fertility rates, if compared to the United States,

¹⁵⁰ VILLAREAL, FERGUSON, The North American Free Trade Agreement (NAFTA) [online]. 2017, p.38 [Accessed 09.03.2019]. Available from: https://digitalcommons.ilr.cornell.edu/key_workplace/1937

¹⁵¹ BERGSTEN, C.F., BOLLE, M. de. *A Path Forward for NAFTA*. [online] [s.l.]: Peterson Institute for International Economics, 2017, p.78. [Accessed 10.03.2019]. ISBN: 978-0-88132-730-4. Google-Books-ID: EDsuDwAAQBAJ

¹⁵² LILLY, M.B. How Demographic Transition Can Help Predict Canada-US Trade Relations in 25 Years. *International Journal of Canadian Studies*, p.3 [online]. 2018 [Accessed 10.03.2019]. DOI: 10.3138/ijcs.55.07

where the aging of population will also be a problem but due to higher fertility the situation will not be critical, Canada will need to continue to take sufficient measures to attract highly-skilled professionals, who will help smoothen the skills deficit, which has been present in Canada for many years.¹⁵³ These measures will allow Canada to support and improve its overall economic performance, and respond to the global challenges. Also, the aging population can also mean that both countries will continue to expand their trade in services rather than goods, transitioning further towards service-oriented economies and creating more jobs in this sphere.

The future of Canada-U.S. relationship for the next 16 years has been determined recently, but after that the countries can either abandon the agreement or strike a new deal. However, it is quite obvious that withdrawing from the agreement will bring problems such as unemployment rise, growing consumer price, immigration issues, etc. Even though the impact of the FTA on the economy is modest, it is still better than the relationship under WTO provisions. If the countries abandon USMCA, there will be more barriers to mutual trade, which will result in decrease in bilateral trade and lower efficiency gains.¹⁵⁴ Thus, a future renegotiated agreement is more economically beneficial for Canada or United States than signing a separate bilateral agreement with other two members of the USMCA or returning back to the WTO regime. Despite the fact that further trade liberalization can hurt producers in some sectors of the economy, such as Canadian farmers, such liberalization can be advantageous in the long-term. Further modifications in the bilateral trade, such as removing barriers coming from the different regulations and customs procedures, can improve the mutual trade conditions.¹⁵⁵ Nevertheless, all these positive effects can only result from future successful negotiations, which will make accent on solving the most sound issues and adapting to changes on the global market. From Canada's point of view, this will be particularly important, as, due to its higher dependence on the United States, unsuccessful negotiations, resulting in either discriminating conditions or even ending the agreement, can lead to the disruption in the economy and other additional consequences. United States, on the other hand, will also loose something, however, the impact on their economy will not be as substantial.

¹⁵³ LILLY, How Demographic Transition Can Help Predict Canada-US Trade Relations in 25 Years. p.4 [online] [Accessed 02.10.2018]. DOI: 10.3138/ijcs.55.07

¹⁵⁴ The Fate of NAFTA: Possible Scenarios and their Implications for Canada. *Fraser Institute* [online] [Accessed 10.03.2019]. Available from: <http://bit.ly/2ftMB4D>

¹⁵⁵ The Fate of NAFTA: Possible Scenarios and their Implications for Canada. *Fraser Institute* [online] [Accessed 10.03.2019]. Available from: <http://bit.ly/2ftMB4D>

Conclusion

The bilateral economic relationship between Canada and the United States is widely-known to be one of the greatest examples of how two countries with contingent borders can use it to their advantage. Their long-lasting relationship has proved to be of a great importance to each of the countries, however, in this paper we analyzed their mutual relations and came to the conclusion that the extent of this perception is different for Canada and the U.S. Below, we will summarize some of the key findings.

Canada-US first free trade agreement talks date back to the 18th century, proving that this relationship has gone through a long process of development and modifications. During their mutual history, the importance of this partnership has experienced fluctuations, but, generally, the officials of both countries have always known that it is necessary to keep good relations with each other. Specifically, in early 1980s, Canadian and American political actors realized, that the more and more interdependent relationship between these countries, the relationship, extent of which was unprecedented anywhere else in the world, would likely to share the same pattern in the future, but to make sure it would, they needed to assist in facilitating the further development by coming up with a new comprehensive deal. As a result of such thinking, two countries first signed a bilateral free trade agreement, and then adopted a new free trade agreement together with Mexico, which, despite some of the concerns free trade generates, has brought many advantages to both countries. Even though there are significant differences between the two countries, there are also many fundamental values that are similar, and one thing that they both have in common is understanding that Canada and the U.S. need each other, and it is important to keep their relationship strong, especially in front of rapidly happening changes that bring new challenges. The mutual economic relationship has proven to be beneficial, and liberalization of bilateral trade allows Canada and the USA to be among the biggest trade partners in the world.

The fact that Canada-US bilateral trade is the second largest in the world also gives us a perspective of the importance of such a relationship. The general profile of mutual merchandise trade reflects the differences between two countries, one of which is the population. The rich possessions of natural resources allows Canada to export raw materials to the U.S., and, on the contrary, import a variety of consumer goods or specialized machinery and equipment, which are used to make

finished products. Moreover, the two countries are also strategic partners in agriculture trade, which is also one of the most discussed topics during the free trade agreement negotiations. Generally, both export and import operations, which the U.S. conducts together with Canada, do not seem to be as important for the U.S. as they are for Canada, not only because of the values, but mainly because of the substantial differences in mutual trade shares in each of the countries' total world imports and exports (75 % in export and 51 % in import for Canada, versus 18 % and 12 %, respectively, for the United States). However, while it may seem that this relationship is important only for Canada, the reality is that Canada is still the country which imports the most merchandise from the U.S., and the second largest exporter to the U.S., which ultimately makes Canada one of the most important trading partners for the USA.

Regarding the bilateral trade with services, we should underscore that, despite the fluctuation in the amount of traded services in the recent years, the mutual trade still has a tendency to grow, especially if we look at how it has developed since the NAFTA creation. Given the geographic proximity of the countries, it is logical that the most important and traded categories of services are Transport and Travel, which continue to grow between the two countries, but are still dependent on some other factors, such as fluctuations in merchandise trade. Besides that, a substantial share of the mutual trade in services belongs to Intellectual property services and Financial services. The importance of global trade in services is also apparent in this case, as most of the categories in bilateral trade in services have followed a trend of stable growth. Again, similar to the merchandise trade, the extent of the importance differs. For Canada, the United States are both the leading export and import market, while the U.S., on the other hand, cannot say that Canada is their biggest trading partner, if only mentioning services. Specifically, the USA have a 55% share in Canada's global imports and exports of services, while Canada only accounts for 7 % of exports of services to the U.S. and 6 % of imports.

FDI between Canada and the U.S. also show the importance of bilateral economic relationship. Indeed, the results of 2017 somehow represent the general trend of the development of the foreign direct investment between these two countries. Since the signing of NAFTA, the U.S. stock of FDI into Canada grew from \$69.9 billion in 1993, to \$351 billion in 2012, and \$391 billion in 2017. Canada, while not being the largest investor in the U.S., still proves that the United States is the leading destination for Canadian FDI, with a stock of \$453 billion in 2017, which grew

significantly over the period of 25 years, starting from \$26.6 billion in 1993 and later increasing to \$225 billion in 2012.

Nevertheless, despite having positive impact on the bilateral relationship, the free trade agreements between the countries also cause some side effects, which can lead to creation of issues, solving which is especially important for future success of the partnership. Some of such issues caused dissatisfaction of President Trump with the agreement, particularly the negative impact of NAFTA on the loss of jobs in the traditional sectors in some states, which was also among the reasons why he called for renegotiation. President Trump's favorite tactics during the process of negotiations were threatening the U.S. counterparts with imposing the tariffs on some of the sectors of economy, which also contributed to the delays in the negotiations process. Eventually, the negotiators managed to agree on a new deal, USMCA, but it still needs to be ratified by the governments of all three countries. The main changes in the new deal are country of origin rules (75 % of vehicles' domestic production requirement), labor provisions (\$16/hour minimum wage for production workers by 2023), access to the Canada's dairy market by American producers (3.5% share of the \$16 billion annual market), intellectual property rights and digital trade, as well as dispute resolution mechanism, protecting Canada from the U.S. tariffs.

In short, conducted research confirms that the bilateral economic relationship, while being important for both countries, differs in extent. Canada, due to being a smaller partner both economically and demographically, shows a greater dependence on a stable relationship with the U.S. than vice versa. Despite the modest impact which the FTA has had on the economies, it is still better than operating under WTO conditions. Therefore, it is unlikely that the countries will abandon the deal, and they should instead focus on a shared long-term vision of mutual relations and further negotiate the topics of automotive sector, services, intellectual property rights and digital trade, investments and dispute settlements, labor and environment protection, energy and agriculture sectors, etc. From Canada's point of view, this will be particularly important, as, due to its higher dependence on the United States, unsuccessful negotiations, resulting in either discriminating conditions or even ending the agreement, can lead to the disruption in the economy and other additional consequences. Such consequences are not covered in this paper, however, the author realizes that this is an interesting topic, and suggests elaborating on it in a separate paper.

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Appendices

Table A: Commercial services imports by Canada from the U.S. (US\$ million)

Product/Sector	2016
BOP6 - S - Memo item: Total services	55357.00
BOP6 - SOX - Commercial services	55040.00
BOP6 - SPX1 - Memo item: Other services	32396.00
BOP6 - SOX1 - Other commercial services	32079.00
BOP6 - SD - Travel	15457.00
BOP6 - SDZ - Tourism-related services in travel and passenger transport	15457.00
BOP6 - SJ - Other business services	13995.00
BOP6 - SDB - Personal	13449.00
BOP6 - SDB3 - Other (Personal)	12075.00
BOP6 - SJ2 - Professional and management consulting services	7606.00
BOP6 - SC - Transport	7050.00
BOP6 - SJ21 - Legal, accounting, management consulting, and public relations services	7049.00
BOP6 - SH - Charges for the use of intellectual property n.i.e.	6893.00
BOP6 - SJ3 - Technical, trade-related, and other business services	5593.00
BOP6 - SG - Financial services	5072.00
BOP6 - SC2 - Air transport	3662.00
BOP6 - SJ31 - Architectural, engineering, scientific, and other technical services	2865.00
BOP6 - SI - Telecommunications, computer, and information services	2734.00
BOP6 - SC3 - Other modes of transport	2162.00
BOP6 - SDA - Business	2007.00
BOP6 - SK - Personal, cultural, and recreational services	1843.00
BOP6 - SK1 - Audiovisual and related services	1704.00
BOP6 - SJ35 - Other business services n.i.e.	1697.00
BOP6 - SF - Insurance and pension services	1262.00
BOP6 - SDB2 - Education-related	935.00
BOP6 - SJ1 - Research and development services	796.00
BOP6 - SC4 - Postal and courier services	715.00
BOP6 - SI1 - Telecommunications services	656.00
BOP6 - SJ22 - Advertising, market research, and public opinion polling services	557.00
BOP6 - SJ33 - Operating leasing services	543.00
BOP6 - SC1 - Sea transport	510.00
BOP6 - SJ34 - Trade-related services	488.00
BOP6 - SPX4 - Goods-related services	454.00
BOP6 - SB - Maintenance and repair services n.i.e.	454.00
BOP6 - SDB1 - Health-related	440.00
BOP6 - SL - Memo item: Government goods and services n.i.e.	317.00
BOP6 - SE - Construction	279.00
BOP6 - SK2 - Other personal, cultural, and recreational services	139.00

Source: Statistics on trade in commercial services, WTO. [online] Available from: data.wto.org

Table B: Commercial services exports from Canada to the U.S. (U.S. million)

Product/Sector	2016
BOP6 - S - Memo item: Total services	45143
BOP6 - SOX - Commercial services	44835
BOP6 - SPX1 - Memo item: Other services	30706
BOP6 - SOX1 - Other commercial services	30398
BOP6 - SJ - Other business services	16588
BOP6 - SJ2 - Professional and management consulting services	7424
BOP6 - SD - Travel	7254
BOP6 - SDZ - Tourism-related services in travel and passenger transport	7254
BOP6 - SJ3 - Technical, trade-related, and other business services	6563
BOP6 - SJ21 - Legal, accounting, management consulting, and public relations services	6400
BOP6 - SC - Transport	6137
BOP6 - SDB - Personal	5915
BOP6 - SDB3 - Other (Personal)	5570
BOP6 - SI - Telecommunications, computer, and information services	4959
BOP6 - SG - Financial services	4539
BOP6 - SC3 - Other modes of transport	3146
BOP6 - SJ31 - Architectural, engineering, scientific, and other technical services	2795
BOP6 - SJ1 - Research and development services	2601
BOP6 - SH - Charges for the use of intellectual property n.i.e.	2327
BOP6 - SJ35 - Other business services n.i.e.	2246
BOP6 - SC2 - Air transport	1530
BOP6 - SK - Personal, cultural, and recreational services	1412
BOP6 - SK1 - Audiovisual and related services	1350
BOP6 - SDA - Business	1339
BOP6 - SJ34 - Trade-related services	1096
BOP6 - SPX4 - Goods-related services	1046
BOP6 - SB - Maintenance and repair services n.i.e.	1046
BOP6 - SJ22 - Advertising, market research, and public opinion polling services	1024
BOP6 - SC4 - Postal and courier services	988
BOP6 - SI1 - Telecommunications services	847
BOP6 - SC1 - Sea transport	473
BOP6 - SJ33 - Operating leasing services	426
BOP6 - SF - Insurance and pension services	314
BOP6 - SL - Memo item: Government goods and services n.i.e.	308
BOP6 - SDB2 - Education-related	260
BOP6 - SE - Construction	259
BOP6 - SDB1 - Health-related	85
BOP6 - SK2 - Other personal, cultural, and recreational services	62

Source: Statistics on trade in commercial services, WTO. [online] Available from: data.wto.org