COMMENTS BY THE

GOVERNMENT OF CANADA

TO THE INTERNATIONAL TRADE ADMINISTRATION

U.S. DEPARTMENT OF COMMERCE

and

THE OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

REQUEST FOR COMMENT:

PUBLIC COMMENTS AND HEARING REGARDING ADMINISTRATION REPORT ON SIGNIFICANT TRADE DEFICITS

U.S. FEDERAL REGISTER 82FR18110

April 17, 2017

Submitted by:

The Canadian Embassy

Washington, D.C.

May 10, 2017

The Government of Canada would like to provide the following comments on the Department of Commerce ("the Department") and the Office of the United States Trade Representative ("the Office") notice of public hearing and request for comments on the preparation of an Omnibus Report on Significant Trade Deficits, further to the notice published in the Federal Register volume 82, No. 72 of April 17, 2017 ("the notice").

Canada appreciates the opportunity to contribute to a fact-based analysis of the United States' trade relationship with Canada. The February 13, 2017 joint statement from President Trump and Prime Minister Trudeau affirmed the profound shared economic interests of our two countries and committed to further deepening the relationship. Canada-U.S. trade is longstanding, balanced, and supports millions of jobs in both countries. Our integrated economies provide a basis for advancing prosperity for all Canadians and Americans.

Canada also recognizes the United States' interest in ensuring that its trade relationships strengthen national security. The U.S.-Canada bilateral defense and trade relationship, an outgrowth of our longstanding and close defense alliance, has evolved into a joint defense industrial base characterized by unparalleled cooperation between our respective militaries and defense industries.

Given the extent of U.S.-Canada bilateral trade, it is inevitable that irritants will arise. Canada and the United States have recognized this fact and, historically, have chosen to settle such disagreements through established bilateral and multilateral dispute resolution mechanisms. There is no evidence that the policies and practices listed in the notice as possible causes of the U.S. trade deficit have a significant bearing on the U.S. –Canada trade balance. Moreover, the Government of Canada questions two core assumptions of this assessment: that trade barriers are the fundamental drivers of trade imbalances and that trade restrictions are an effective way to address such deficits. In Canada's view, there is no direct link between trade agreements and the Canada-U.S. trade balance. What is most important is that since the North American Free Trade Agreement came into force, total merchandise trade between Canada and the United States more than doubled, and U.S. merchandise exports to Canada grew at an annualized rate of over 4.3 percent between 1993 and 2016.

Canada submits the following information related to assessments called for in Executive Order 13786 of March 31, 2017 (Note that all figures are expressed in U.S. dollars, unless otherwise noted):

1. **Trade with Canada is in balance.**

The U.S. posted a trade account surplus of $8.1 billion with Canada in 2016, according to Bureau of Economic Analysis (BEA) data.[1] This was an increase of almost $2.0 billion over the U.S. surplus registered in 2015 ($6.1 billion). The U.S. trade surplus represents 1.3 percent of overall Canada-U.S. goods and services trade, which does not represent a "significant" trade imbalance, given the size of the relationship ($635.1 billion in 2016).

Canada is the leading foreign destination for U.S. exports of goods and services – the single largest foreign customer of U.S. exports and the second-largest foreign destination for services. At the state level, Canada is the leading merchandise export destination for 32 U.S. states, and in total, among the top five destinations for merchandise exports for all 50 U.S. states.

This trading relationship is not simply about trade in finished goods. Our trade is characterized by a high level of integrated production, with companies on both sides of the border using inputs from the other. Approximately, 17.5 percent of the value of Canadian exports of goods and services to the U.S. contain content that was imported from the U.S. This value chain integration is even more concentrated in manufacturing, where more than one-quarter of the value (26.2 percent) of U.S. imports of manufactured products from Canada are inputs originating from the U.S.[2] Finally, the U.S. relies on imports of Canadian raw materials and intermediate goods that ensure the competitiveness of U.S. manufactured products.[3]

Given that the U.S is the world's largest exporter of services (with services being the most important and fastest-growing area of the U.S. economy, responsible for 83.8 percent of U.S. total private employment in 2016),[4] any assessment of the U.S.-Canada trade balance would be incomplete if services trade were excluded. In 2016, the U.S. posted a $24.6 billion-services trade surplus with Canada based on total value of services trade of $83.7 billion,[5] a surplus that has been maintained on average for the past 10 years (2006-2015).

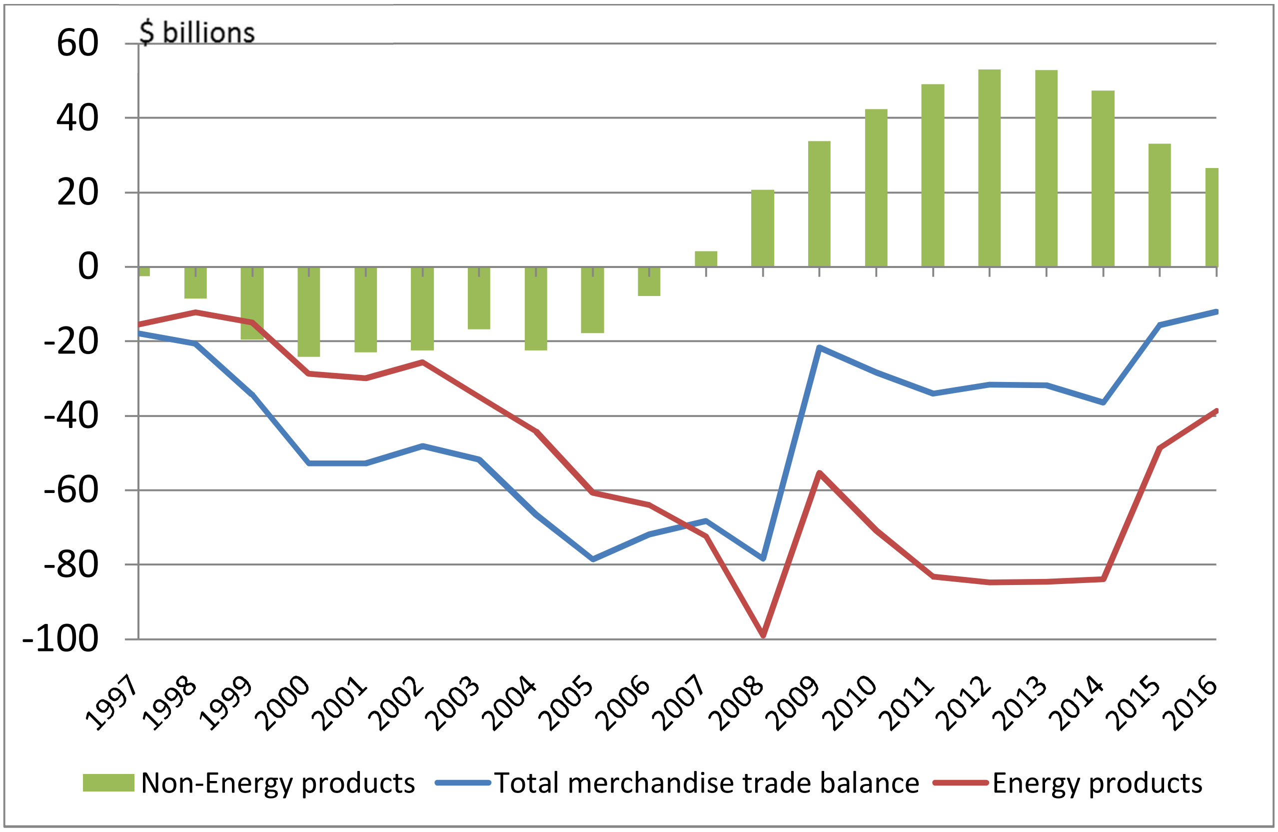
2. **Excluding energy, the United States runs an overall merchandise trade surplus with Canada**.

In terms of goods trade, which is the focus of the notice, U.S.-Canada merchandise trade was valued at $544 billion in 2016 (on a customs basis). The U.S. registered a $12.1 billion merchandise trade deficit with Canada, which amounted to only 2.2 percent

[1] U.S. Department of Commerce, Bureau of Economic Analysis.
[2] Statistics Canada.
[3] Approximately 45 percent of U.S. goods imports from Canada are raw materials and intermediate goods which are used to produce goods in the United States. Source: World Integrated Trade Solution.
[4] U.S. Bureau of Labor Statistics, Employment, Hours and Earnings from the Current Employment Statistics survey (National), series CES0800000001 as a share of series CES0500000001 (accessed May 05, 2017).
[5] United States Census Bureau: https://www.census.gov/foreign-trade/Press-Release/current_press_release/exh20b.pdf

of total merchandise trade between the two countries. In recent years, energy products have been the primary reason for U.S. merchandise trade deficits with Canada, which is a function of the world price of energy. If energy is excluded from the trade balance, the United States has enjoyed merchandise trade surpluses with Canada in non-energy products for the past 10 years (Table 1).

Table 1: United States merchandise trade balance with Canada, by selected commodity groups, 1997-2016



3. **Canada is a secure and reliable energy supplier to the United States.**

The U.S. does not produce sufficient quantities of energy to meet its domestic demand. As a consequence, this shortfall must be met by imports.[6] The U.S. trade deficit in energy products is therefore mostly structural.

Canada provides a secure and reliable supply of energy products to meet U.S. domestic demand – for crude oil, Canada provides about 39 percent of U.S. import demand over the 2014-2016 period (by volume). Energy-related products (HS code 27) accounted for 19 percent of the value of total U.S. merchandise imports from Canada in 2016. Three

[6] According to the *BP Statistical Review of World Energy 2016*, U.S. oil consumption has exceeded U.S. oil production in every year dating back to 1965. The shortfall amounted to about 2.4 million barrels in 2015.

commodities account for the bulk of the U.S. trade deficit with Canada in energy: crude oil ($31.6 billion), natural gas ($4.5 billion), and electricity ($2.0 billion).

However, our energy relationship is much more than simply Canadian exports. Our two countries share an integrated network of energy systems and infrastructure (pipelines and transmission lines) that not only supports robust two-way energy trade ($69.7 billion 2016; $113.7 billion annual average over the past five years) but also contributes to energy supply resilience. In addition to over 70 oil and gas and pipelines, there are over 30 cross-border electricity transmission lines and a strong and thriving collaboration on renewable energy and clean technology, all of which advances U.S. energy security. Energy imports from Canada power U.S. economic growth and support job creation in the energy sector and beyond (including providing electricity to power computers and feedstocks for U.S. manufacturing in chemicals, plastics and synthetic materials.) Canada is also the largest export market for U.S. crude, which supplies 56 percent of Canadian import demand by volume, contributing significantly to U.S. jobs and growth.

4. **Trade with Canada strengthens U.S. production capacity and manufacturing.**

Canada is the largest export market for U.S. manufacturing exports; the U.S. posted a trade surplus with Canada of $34.2 billion in manufactured goods in 2016.[7] Our integrated value chains enable Canadian and American companies to specialize in complementary products that boost competitiveness in their home markets as well as abroad.

The integration of Canada-U.S. value chains affects all aspects of the production process, from raw material inputs to finished products.

Minerals and metals: The United States cannot meet its minerals and metals demand required for industrial, manufacturing and national security needs.[8] Canada remains the United States' most reliable and secure supplier of almost 40 nonfuel mineral commodities. Bilateral trade in mineral commodities reached $65.3 billion in 2016. By value, Canada supplies more of stage 1 and stage 2 products (ores, alloys – raw materials) to meet U.S. needs, while stage 3 and stage 4 (semi- and fully fabricated mineral products) trade is fairly balanced. Canada is also the supplier of 16 materials categorized by the U.S. Government as "potentially critical" to the economy, largely to enable the high tech industry.[9] In 2015, Canada exported nearly $626 million of these materials to the United States. Top exports included vanadium ($197 million), platinum group metals ($163 million), and cobalt ($73 million).[10]

[7]Bureau of Economic Analysis data. Excludes energy, mining, and agricultural commodities.
[8]The U.S. Department of the Interior – U.S. Geological Survey *Mineral Commodity Summaries 2017* lists 20 mineral commodities on which the U.S. has 100 percent net import reliance. Of this list, Canada was a major import source of five.
[9] *Critical minerals*: *U.S. National Science & Technology Council Report to the White House*, March 2016. Minerals include: Antimony, bismuth, cobalt, ferromolybdenum, germanium, iridium, magnesite, mercury, mica, monazite, rare earths (La-Lu), rhodium, ruthenium, silicomanganese, tungsten, vanadium.
[10] Trade Retrieval Aggregate Statistics database, using CAD/USD exchange rate averages for 2015 and 2016.

Aluminum: Canada and the U.S. have an integrated aluminum market, valued at approximately $9.7 billion (HS codes 76 and 26.06). Canada supplies a significant portion of unwrought aluminum and aluminum plates and sheets used in U.S. manufacturing processes while the U.S. enjoys a $301 million trade surplus with Canada in value-added aluminum manufactured products (HS code 76.04-76.16). Trade flows in the aluminum sector are broadly representative of other commodities, where Canadian exports of raw materials are incorporated into manufactured goods in the United States.

Iron and steel: Canada and the U.S. have an integrated, complementary trade in iron and steel products. The U.S. sells more iron and steel to Canada than it buys—more than $2.1 billion in articles of iron and steel (HS code 73) and $0.1 billion in iron and steel (HS code 72) in 2016. Canada is the number one destination for U.S. steel exports for both iron and steel and articles of iron and steel. The balance of trade clearly favors the U.S.

Furthermore, American and Canadian steel producers are an integral part of each other's supply chains for steel products, especially in sectors such as automotive, construction and energy. For example, in North American auto supply chains, a steel coil produced in the U.S. can be transformed several times in cross border shipments with Canada, starting from raw steel, to polished sheet, to form stamping, to chrome plating, to assembly and finally to the sales market.

Machinery and equipment: U.S. machinery (HS code 84), which is highly integrated within North American automotive supply chains, reported a $20.8 billion surplus with Canada in 2016, while U.S. machinery exports to Canada totalled $40 billion in 2016. The U.S. also maintained a $16.6 billion trade surplus in electronics and electrical machinery and equipment (HS code 85), a $5.0 billion surplus in scientific and precision instruments (HS code 90), and a $1.9-billion surplus in plastics (HS code 39). These products have important applications across a range of manufacturing industries in the U.S.

Information and Communications Technology: The Information and Communications Technology sectors in the United States and Canada are highly integrated in terms of trade, foreign direct investment and labor markets. The United States posted a trade surplus with Canada of approximately $15 billion in information and communications technology goods (includes computers and peripheral equipment) on total goods trade of $24.6 billion in this sector.

Integrated automotive sector: The North American automotive industry is perhaps the strongest example of an industry where economic integration has permitted specialization and the evolution of complementary supply chains that contribute to overall competitiveness. While the U.S. posts surpluses in most automotive sub-sectors, Canadian exports of certain types of passenger vehicles (that contain U.S.-made parts) explain the overall U.S. deficit of $9.8 billion on total trade of $106 billion in this sector (HS code 87) in 2016. Dating to the Canada—United States Automotive Products

Agreement (Auto Pact) in 1965, automotive supply chains have worked seamlessly across the border, with parts flowing back and forth in support of assembly operations in both countries that work on a "just in time" basis.

Aerospace: The majority of Canadian aerospace trade with the United States is supply chain related and highly complementary. Over the past number of years, overall trade balances (HS code 88) have fluctuated between small surpluses and small deficits. In 2016, the U.S. posted a $1.3 billion surplus on total trade of $13.5 billion. Any new barriers to trade could cause supply chain disruptions and negatively impact competitiveness on both sides of the border.

Invariably, there are other sectors where Canada enjoys a trade surplus. Sectoral trade balances are not a realistic outcome in an extensive, comprehensive trade relationship such as that enjoyed between Canada and the U.S.

5. Trade with Canada strengthens the U.S. defense industrial base.

The U.S. and Canada have built a unique defense industrial cooperation framework over a 75-year period, and now share the most integrated defense industrial base in the world. As a reflection of the strength of our defense alliance, the U.S. Government considers Canada to be a part of the National Technology and Industrial Base (NTIB) for U.S. national security purposes.[11]

As a consequence, the U.S. Department of Defense includes Canadian persons and organizations in its defense industrial base analysis, programs, policies and planning. For example, the Secretary of Defense is required to develop a national security strategy for the NTIB which includes analysis of the risks and challenges to the supply chain and the ability of the NTIB to meet certain national security objectives. Canada's inclusion in the NTIB is recognition of the fact that Canada is a trusted ally that helps achieve U.S. national security objectives.

Reflecting the close defense relationship, the Canadian government purchases significant defense goods and services from the U.S. ($1.44 billion annual average).[12] Our defense industry is highly integrated; defense exports to the United States are mostly from Canadian subsidiaries of U.S. companies (representing five of Canada's largest 11 defense companies and accounting for 57 percent of Canadian defense exports). Sourcing patterns are particularly notable: Canadian subsidiaries of U.S. firms purchase 48 percent of their inputs from U.S. suppliers, which contributes to the creation of high-quality jobs in the United States.[13]

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[11] In the 1993 *National Defense Authorization Act*, Congress modified the definition of the "National Technology and Industrial Base (NTIB)" to include Canada. The NTIB is defined as "the persons and organizations that are engaged in research, development, production, integration, services, or information technology activities conducted within the United States and Canada" [10 USC § 2500(1)].
[12] Government of Canada data converted to USD using CAD/USD exchange rate averages for 2014-2016.
[13] *State of Canada's Defence Industry, 2014*, Innovation, Science and Economic Development Canada and CADSI.

6. **Trade with Canada supports U.S. employment and export capacity.**

Trade and investment with Canada is an important generator of employment in the United States. A study published in 2014 found that U.S. - Canada trade:

- supported 8.3 million jobs in the U.S. in 2013, (representing more than 4.5 per cent of U.S. jobs);
- had a positive effect on employment in every state and the District of Columbia, and in every Congressional district;
- had a net positive effect on U.S. GDP of 6.5 percent resulting from a positive effect on output in 437 industries; and
- supported directly and indirectly 24 percent of U.S. exports[14].

Support for U.S. exports (24 percent) was more than Canada's direct share (18 percent) in U.S. exports because, for many industries, exports to Canada help produce the economies of scale in exporting that are necessary to sustain U.S. competitiveness in other export markets. Furthermore, Canadian direct investment in the United States directly supports an additional 649,300 employees in the U.S., including almost 246,000 in U.S. manufacturing.[15]

7. **Canada and the United States cooperate to reduce impediments to trade.**

The Canada-United States Free Trade Agreement, and then the North American Free Trade Agreement, have lowered tariffs, established predictable rules, reduced technical barriers to trade, and created mechanisms for the resolution of disputes. Building on this framework, our two countries cooperate on an ongoing basis to minimize unnecessary regulatory differences and lower administrative burdens on our businesses. Under the Regulatory Cooperation Council, Canada and the United States have cooperated formally since 2011 to foster alignment of independent regulatory systems and remove unnecessary and duplicative requirements and costs, with the objective of enhancing joint economic competitiveness while maintaining high standards when it comes to health, safety and the environment.

Canada-U.S. regulatory cooperation benefits U.S. and Canadian businesses alike by eliminating duplication and lowering costs. It is well supported by stakeholders on both sides of the border. The February 13, 2017 leaders' joint statement included a strong expression of support for continued bilateral regulatory cooperation and provides a solid basis for regulators in both countries to continue the work begun under the Regulatory Cooperation Council. Canada welcomes the inclusion of international regulatory cooperation among activities considered as potential deregulatory actions and sources of cost savings pursuant to Executive Order 13771 on Reducing Regulation and Controlling Regulatory Costs.

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[14] Peter B. Dixon and Maureen T. Rimmer, *The Dependence of U.S. Employment On Canada, 2013*, Centre of Policy Studies, Victoria University, December 3, 2014.
[15] 2014 data. U.S. BEA, Data on Multinational Enterprises, FDI in the U.S., All U.S. Affiliates, accessed May 10, 2017.

Canada and the U.S. also have longstanding, entrenched cooperation to facilitate the smooth cross-border movement of legitimate people and goods, while ensuring border integrity and security. The leaders' joint statement committed to building a "21st century border" though ongoing cooperation on a range of initiatives, including establishing preclearance for cargo and accelerating the expansion of preclearance for travellers. We work closely together on joint trusted traveller programs and trusted trader programs, which benefit both business and customs agencies.

8. **An assessment of trade barriers should be a two-way street.**

The notice also seeks comments on various local content requirements of trading partners that have affected opportunities for increased U.S. exports, profitability, and employment. However, examining localization requirements of trading partners while ignoring such measures imposed by the United States (for example, "Buy America" procurement restrictions) would result in an inaccurate assessment of the extent to which local content restrictions adversely impact firm participation, competition, costs, and employment. A recent study found that eliminating Buy America and Buy American provisions would increase U.S. jobs by 306,000 and would increase U.S. GDP by $22 billion. Export-oriented manufacturing sectors, such as high-tech and machinery industries would be most likely to see increased employment and exports.[16]

[16] Peter B. Dixon, Maureen T. Rimmer and Robert G. Waschik, *Macro, Industry and Regional Effects of Buy America(n) Programs: USAGE Simulations*, Centre of Policy Studies, Victoria University, April 2017.