Lessons from free trade in Canada

As negotiations between the US and SACU on a free trade agreement continue this year, it is important to review the experiences of other countries. ***Pierre Laliberte*** *presents a critical perspective of Canada's experience with free trade and the lessons learnt.*

January 2004 has marked two anniversaries in Canada: the 15th year of the passage of the Canada-US Free Trade Agreement (CUFTA) as well as the 10th year of the North American Free Trade Agreement (NAFTA), an agreement that both deepened CUFTA and extended it to Mexico.

The passage of the CUFTA in the late 1980s was marked by a large public debate in Canada. In fact, it became the central theme of the 1988 federal election that saw parties opposed to free trade with the US get a majority of the vote. However, free trade came to pass as the Conservative Party won a majority of the seats in parliament.

The central economic case for entering into a Free Trade Agreement

(FTA) with the US centred on Canada's longstanding productivity gap with the US. It was argued that increased specialisation and exposure to a more dynamic economy would boost Canada's productivity. CUFTA advocates were keen on repeating that Canadian industry would not only get a privileged access to the US market (already by far Canada's largest trade partner), but would also provide a needed safeguard against US protectionism.

Opponents of the CUFTA, including trade unions, did not take issue with the fact that Canadian industry did indeed suffer from an overall lower productivity performance -- a reflection of an over-reliance on resources and a weak capital goods sector. They argued however that what Canada needed to remedy this situation were policies to build a comparative advantage, not an increased reliance on the free market. They saw the constraints built into the FTA as actually foreclosing the use of some key industrial policy levers in the future.

Moreover, there were fears that CUFTA would lead to a downward move towards US levels when it came to wages or social standards. Canada has indeed a different social model from the US: greater unionisation levels, a more generous system of transfers, as well as a greater level of public provision of services such as health, education, etc. These more egalitarian social features have provided for better social outcomes in the areas of health, education, crime and poverty.

It was feared that the FTA would increase the bargaining power of large corporations and the business sector more generally to blackmail workers to accept lower wages and working conditions, and communities to provide more concessions to keep jobs local.

Finally, foes of the CUFTA pointed out that Canada had utterly failed in its negotiations with the US to secure genuine protection against US protectionism. Indeed, based on this very fact, Canada's chief negotiator recommended that the Canadian government not sign the agreement. As it turns out, Canada 'gained' an agreement that essentially commits both parties to respecting their own laws concerning dumping and countervails. Given the fact that US trade laws are notoriously self-serving and open-ended when it comes to trade measures, this 'gain' essentially meant that an independent arbitration panel would now decide whether national laws had indeed been respected.

Despite a vigorous grassroots campaign, CUFTA came to pass in 1989. The extension of CUFTA into NAFTA in 1994 did not generate as much organising in Canada. However, some new important features were added to the package, which have now become the standard fare of 'trade' agreements, most notably the inclusion of language around intellectual property as well as stronger protection for foreign investors (including the notorious investor-state arbitration process).

Canada has already lost a couple of cases under the investment provisions of the NAFTA. In both cases, it was seeking to enforce regulations related to environment and health, but was forced to compensate foreign investors.

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Canada's economic performance

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CUFTA and NAFTA boosters have made much of the fact that Canada's foreign trade has increased substantially since 1989: exports have increased from 26% to 46% of GDP, while imports have shot up from 26% to 40%. This has afforded Canada comfortable trade surplus over the past decade. However, it is important to keep a factor in mind that there was more than FTAs at work in the picture.

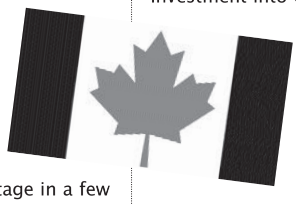
Indeed, from 1992 to 2002, Canada's currency depreciated from US$0.87 to US$0.63. This drop allowed Canadian producers to benefit from a temporary competitive advantage. Moreover, strong growth in the US over that period benefited most exporters around the world, but Canada most specifically, for reasons of market proximity. All in all, it has been estimated by government researchers that over 90% of the growth in Canada's exports to the US over that period were due to currency depreciation and the stronger growth in the US. CUFTA accounted for only 9% of overall exports growth.

There is no denying that Canada's industrial structure became more integrated with that of the US over that period. Canada's relative exports dependence on the US market increased from 73% to 85% over the period. Moreover, the share of imported inputs in goods production has increased from 29% to 37%. While the resources and the automobile sectors were already quite integrated before CUFTA (Canada and the US had a sector specific agreement in the automobile sector since 1965), this spread to other manufacturing sectors. The US market accounts for more than half of Canadian manufacturing production as opposed to a third back in 1989.

When it comes to employment, there has been an actual increase in the number of people working in the manufacturing sector in Canada since 1989. Again, there are strong reasons to think that this increase was in great part due to contextual factors such as exchange rate fluctuations and the strong growth rate in the US. Indeed, it is worth pointing out that during the first three years of the CUFTA (when the Canadian dollar was trading at an abnormally high value), more than 250 000 jobs were lost. Since then, 400 000 have been created.

However the growth in jobs has not translated into an increase in wages. Indeed, since 1992, the real wages of Canadian production workers have not improved at all, despite the fact that real productivity per worker has actually increased by 2.5% annually over the same period. Despite the growth in manufacturing jobs, the overall unionisation rate has declined in Canada from 45% to 32% over the period.

Moreover, when it comes to the relative productivity performance of Canadian industry -- the alleged primary policy reason for adopting CUFTA in the first place -- Canada's relative performance relative to the US has not improved over the period. While Canada has a productivity advantage in a few industries such as pulp and paper, primary metals, wood and lumber, and a slight edge in transportation equipment and furniture, Canada's overall output per worker in the manufacturing sector was two-thirds of that of the US. Much of the difference is due to the fact that over a third of US industry is in the high tech sector as compared to less than 10% in Canada, and that in that sector, Canadians are much less productive than Americans.



Among other reasons that explain Canada's slower productivity growth are Canadian industry's chronic low investment in plant and equipment, in research and development as well as training, and the smaller size of production outfits.

Canada's export performance record with the US has to be further nuanced in that, despite the fact that Canada is exporting more to the US, it has only maintained its market share in that country. This stands in contrast with Mexico and China who have made large market share gains over the same period. In this context, the recent appreciation of the Canadian dollar relative to the US (more than 20% in a year) does not bode well for the future, and might well mean that Canada's good export performance in the 1990s was only temporary.

On the investment front, while there was indeed an increase in inward foreign investment to Canada, this was largely outdone by outward Canadian investment to the US. Moreover, much of the foreign investment into Canada was the actual purchase of already existing production facilities as opposed to the creation of new ones. Even free trade boosters have had to admit that Canada did not manage to attract the sort of foreign investment they had anticipated when CUFTA and NAFTA were signed.

These observations underline if anything the problems of using trade policy as a substitute for a bona fide industrial policy, as has been the case in Canada for the past 15 years.

The social front

During the Great Free Trade Debate of the 1980s, proponents of CUFTA often made the argument that free trade would mean better social programmes thanks to greater economic prosperity. In Canada, the past decade has been a relentless battle to keep social programmes alive and preserve public provision of services. In fairness, coming out of the last recession, Canada ranked particularly badly in terms of public deficits and debts when compared to G7 countries. The newly elected Liberal government made it its priority to address the situation, and did cut it. In less than six years, the federal government reduced its contribution to programme spending from 18% to 11% of GDP – its lowest level since the late 1940s. When all levels of governments are included, programme spending fell almost 10% from 43% to 33.6% of GDP in 2001.

The impacts have been felt in all areas: unemployment insurance programmes, Medicare, education, housing and public transit systems. Moreover, Canada has piled up a deficit in the maintenance of its basic public infrastructure.

While the initial cause of the cuts was rooted in public finances, many of the cuts were done in the name of maintaining Canada's fiscal competitiveness with the US. In this regard, it has to be said that Canada has closed the 'fiscal gap' with its neighbour from 11% to 3% of GDP.

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Canada's relation with the US

It is certainly an understatement to say that, when it comes to foreign policy, Canada's primary concern is how to manage its relation with the superpower at its doorstep. So one key test of the CUFTA is whether it has helped Canada in its relationship with the US.

As was mentioned above, one central reason for the FTA in the first place was a desire to limit US arbitrariness towards Canada. It is customary for free traders in Canada to say that although there are still important trade conflicts with the US, for example on softwood lumber, wheat, or more recently beef, these are few and far between and concern only a small segment of our overall trade with that country. The fact of the matter is that this was also the case prior to the signing of the CUFTA. Moreover, the ongoing and irresolvable nature of some conflicts (softwood lumber in particular) demonstrates the failure of CUFTA to provide an adequate arbitration mechanism.

After 15 years of free trade, it is fair to say that Canada is emerging more economically integrated, but also more dependent, on the US market than it was. This was shown rather spectacularly after September 11 when US security concerns very soon became Canada's own, if only to maintain the border open and fluid.

Already, conservative policy circles (including some around the current Prime Minister Paul Martin) have been busy using the security card to push for broader integration deals with the US. Some have advanced the creation of a customs union between the two countries along with similar security measures. Others have pushed for the need to have a monetary union (in actuality, adopting the US dollar). In all cases, it is argued that this would finally allow Canada to get protection from arbitrary treatment from the US. While there are some business merits to the proposals, they are made typically with little concerns as to what they would mean in terms of Canada's sovereignty and its ability to maintain its own programmes and institutions in a common area. Again, the corporate sector has all to gain from greater integration.

The truth of the matter for Canadian workers is that the proposed integration scripts do not include realistic prospects for the inclusion of any social component (such as exists in Europe) or even for common joint institutions to share sovereignty with the US (as that country is notoriously allergic to any such dilution). If anything, CUFTA and NAFTA have increased the policy quandary for Canadian policy makers, not lessen it.

Where to next?

In view of the combined impacts of CUFTA, NAFTA and, one should add, WTO agreements, it is clear to the Canadian labour movement that everything possible has to be done to protect the remnants of sovereignty – and those are not insignificant. Further economic integration with the US can only translate in a gradual loss of more policy levers to promote economic development as well as the gradual erosion of the institutions of our welfare state.

More importantly, it has become clear over the past 15 years that the only way forward is to build international alliances to resist the further spread of neo-liberal trade agreements, and promote alternative multilateral policies that will support a demand-led employment growth as well as workers' rights.

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Laliberte is a senior economist of the Canadian Labour Congress. Most of the arguments found in this article are based on a more detailed paper by Andrew Jackson, 'From Leaps of Faith to Hard Landings: Fifteen Years of 'Free Trade',' Canadian Centre for Policy Alternative, 2003. Those interested in reading more about NAFTA can refer to Lessons from NAFTA: The High Cost of 'Free Trade' by the Hemispheric Social Alliance, Canadian Center for Policy Alternative, 2003.