

# Medium-Term Macroeconomic Effects of Moving to Canada-U.S. Free Trade



## Introduction

Empirical analyses of Canada-U.S. free trade agree that the long-term economic benefits for the Canadian economy will be positive and substantial. But there has been less analytic focus on the transitional period during which the Canadian economy will be adjusting to the new trading environment. How effectively will the Canadian economy be able to take advantage of the new opportunities provided by the Agreement during the transition phase? How quickly will the long-term benefits from free trade be realized? What would be the risks to the Canadian economy from possible increases in U.S. protectionism in the absence of the Free Trade Agreement? These issues, which all have an important bearing on the medium-term macroeconomic effects of moving to a Canada-U.S. free trade environment, are the subject of this chapter.

Analyses of the medium-term macroeconomic impacts of the Free Trade Agreement by the Department of Finance suggest that the economic benefits from the Agreement will begin to be realized shortly after its implementation on January 1, 1989. Prices for a wide range of consumer goods will decline, beginning in 1989, as existing trade barriers are phased out. Lower consumer prices will add to the purchasing power of Canadian households, stimulating consumer sales. Investment spending for new plant and equipment will increase as Canadian firms move to take advantage of their enhanced and more secure access to the huge U.S. marketplace. Increased consumer and investment spending will result in stronger economic growth and enhanced job creation.

Department of Finance estimates of the impacts of the Agreement on employment over the government's medium term fiscal planning horizon indicate that 120,000 net new jobs will be created by 1993, only five years into the phasing-in of the Agreement. Moreover, without the Free Trade Agreement, increased U.S. protectionism would threaten the healthy pace of economic expansion that Canada has experienced in recent years. Thus, the Agreement will not only create new employment opportunities for Canadians, it will also help to secure existing jobs.

## Macroeconomic Impacts During the Transition to Free Trade

The Canada-U.S. Free Trade Agreement will have a positive, and growing, impact on Canada's economic performance from the beginning, as a result of increased household purchasing power due to lower prices, increased investment spending, and an improved trade balance.

The reduction of tariffs and other non-tariff barriers will lower the prices of both imported goods and domestically produced goods that compete with imports. It is estimated that the direct and the induced effects of the Agreement will be to reduce overall consumer prices in Canada by about 1 per cent by 1993. These lower prices will, in turn, boost real personal disposable income and increase consumer spending. Finance estimates indicate that, as a result of lower prices and rising wages, there will be a 2-per-cent increase in consumer spending by 1993. Significant further

① employment

② consumer prices

③ consumer spending