approach in such cases is to use economic models to simulate the impacts of such changes on economic behaviour and performance. Economic models are designed to approximate the basic behaviour and functioning of the economy, as well as the key interactions among different sectors. To assess the effects of such changes, the economic models are simulated both with and without the assumption of the policy change. The economic impacts of the policy change are then measured by the differences in the simulation results for key economic variables such as real income, real output and productivity.

In recent years, a number of researchers and organizations have used both macroeconomic and general equilibrium models to estimate the economic impacts of Canada-U.S. free trade. The Department of Finance has prepared estimates of the long-term economic gains from the Free Trade Agreement using a large-scale general equilibrium model of the Canadian economy. The results of the Finance analysis and other studies are summarized in Tables 4 and 5. The Department of Finance has also analyzed the medium-term (five-year) economic impacts of the adjustment to the Agreement using a conventional macroeconomic model, and these results are presented in Chapter V. A more detailed description of the Department of Finance technical analyses is provided in the Annexes.

The Department of Finance analysis of the permanent, or long-run, economic benefits of the Free Trade Agreement incorporates the following provisions of the Agreement: the elimination of all bilateral tariff barriers to trade; the reduction of preferential purchasing practices by federal governments; the elimination of preferential provincial pricing with respect to wines and spirits; and the elimination of quantitative restrictions on imports of red meats and grain products. Quantitative estimates of the economic impacts of free trade are sensitive to assumptions regarding the competitive pricing behaviour of Canadian producers and the demand response of Canadian imports and exports to price changes. The Department of Finance's general equilibrium model incorporates the assumption that Canadian firms set their prices so as to remain competitive with imports, and restructure to exploit more fully the economies of large-scale production. It also assumes that bilateral trade is quite responsive to price changes.

All aspects of the Agreement cannot be quantitatively captured in a model, no matter how large and detailed the model may be. Generally these models are able to capture only the elimination of trade barriers that apply to goods-producing industries.