
tiveness of the Canadian economy. The cost of consumer goods imported from the United States could be reduced by about 5 per cent on average, once all bilateral tariffs have been fully eliminated. The removal of tariffs will also lower the cost of intermediate goods imported from the United States by an average of about 3.7 per cent, which will mean further reductions in consumer prices.

The removal of trade barriers in both countries will enable Canadian producers to reduce their production costs as imported materials become cheaper and as Canadian firms exploit the advantages of large-scale production through product specialization and other means. In the manufacturing sector, for example, average production costs could be reduced by more than 3 per cent if the potential cost savings that are estimated to be achievable through larger-scale production are fully realized. This will help Canadian firms to maintain their domestic market share and to increase their export penetration of the U.S. and other markets.

Some of the economic gains from the Agreement are less quantifiable than others, but no less real. For example, increased competition and freer access to the large U.S. market will result in a more flexible and dynamic economy, and this should yield further gains in productivity performance and higher real wages. As well, the new procedures and sets of rules that both countries will follow in the application and modification of their respective trade legisla-

tion will ensure more secure access to each other's market. Thus, the Agreement will significantly reduce a major source of uncertainty for Canadian producers who already conduct a large part of their business in the U.S. market. However, since such benefits are difficult to quantify precisely, they are not incorporated into the Department of Finance empirical estimates of the long-run real income gains from the Agreement.

Quantitative Estimates of the Long-Term Benefits of the Agreement

In assessing the impacts on the economy of such structural policy initiatives as free trade, it is important to measure the permanent, or long-term, impacts – that is, when the policy change has been fully implemented and the structure of the economy has fully adapted to it. In the long term, the extent of the economic benefits from Canada-U.S. free trade will depend largely on the extent of the productivity improvement in the Canadian economy. This is not to say that the transitional effects as the economy moves to the new free trade environment are unimportant – how the Canadian economy will likely respond in the transition to the Free Trade Agreement is the subject of the next two chapters.

How do economists analyze, and attempt to quantify, the impacts on the economy of a major structural initiative such as free trade? The standard analytic