

FREE TRADE:

Part one: a proponent's view

In the first of a two-part series examining the pros and cons of the free trade issue, *Excalibur's* Kevin Bray and Lorne Manly interview Don Daly, an economics professor in the Faculty of Administrative Studies since 1969. Before moving to York, Daly worked with the federal Ministry of Trade and Commerce and the Economic Council of Canada. This week, Daly explains why he believes negotiating a free trade agreement with the US is so imperative for Canada, and details the repercussions if one isn't reached.

EXCAL: Recent commentaries on the free trade debate have suggested that Canada is at a crossroads. The proponents of free or freer trade have maintained that the choice is either free trade or protectionism and the recent shakes and shingles episode is viewed as an excellent example of what will befall Canada if a free trade agreement is not reached. Do you subscribe to this point of view?

DALY: Yes (we are at a crossroads) although I think one can give too much attention to some current crisis episodes. I think it would be unfortunate if we attach too much attention to the short term pressures on the US Congress and Senate where they have reacted with protectionist measures which have affected only a small part of our foreign trade. The slow growth we have been experiencing (induces) the US to move towards more protectionist policies, while Canada tends to solve its problems by looking outward and achieving lower tariffs. So, in a sense the timing now where Canada is interested in lower tariffs is just the wrong time, in a way, for the US. We are unlikely to see much . . . progress until after the elections in November, which will resolve some of these issues. I'm hopeful we can then move forward to some form of agreement because it has such important long term potential gains for Canada.

EXCAL: A rise in the standard of living is one of the expected benefits Canada will receive from free trade, according to proponents of such an agreement. What other benefits will Canada obtain if it goes through?

DALY: Improvements in the standard of living, is the key one, but there are also benefits from lower prices for manufactured products for the consumer, higher real incomes for people in manufacturing and elsewhere, and increases in manufactured exports. If we solve some of our problems in high costs and low productivity then we can have stronger balance of payments, less unemployment, and higher real incomes. All of these benefits could really, in a sense, make the land flow with milk and honey.

EXCAL: You've mentioned the problem of high costs and low productivity, but another problem is that even if we did achieve free trade with the US, Canadian managerial talent is so inferior to their American counterparts that we might not be able to take advantage of a free trade environment.

DALY: One of my concerns is that evidence indicates Canadian management has been effective in adopting a new technology. There are a number of reasons for this. One is that the level of formal education of Canadian managers has been lower. The proportion of business people in the US who had done graduate work is five times as high as the proportion of 18-25 year olds in Canada who had done graduate work. As well, Canadian managers only get

promoted to middle and senior levels much later in their working lives. Formal education and youth produce better managers and Canada tends to be weak in both of these. One of the reasons we tend to have higher average ages is the protection of the tariff. You can be inefficient and stay in business behind a tariff wall. I think the adjustment problems with free trade would be considerably reduced if the government and the private sector became aware that free trade isn't just a matter of getting access to a larger market. You also have to ensure that our costs are reduced and that our managers will be faster at adopting new technology.

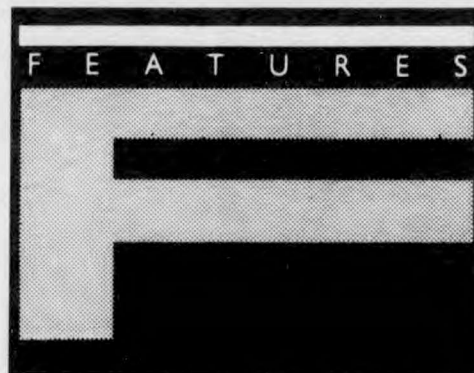
EXCAL: We've heard from both sides, pro and con, regular studies that show what the net effect would be on Canada, in terms of jobs. The Canadian Labour Congress has a study stating that we will lose a million jobs, Ontario indicates that 280,000 jobs are at stake whereas the pro side suggested a net gain of jobs. What is the reality?

DALY: I don't think you can give a clear-cut number. The reason for that is that it depends, to an important degree, how well the companies respond to the increased international competition that would take place with a reduction in tariffs. This in turn depends partly on how managers would respond to that change in the environment. If they were to continue with existing production methods, high real wages and high costs, then you would end up with a very pessimistic picture of the net gain.

The Ontario study is just a shoddy piece of work. They implicitly assume that all of the high cost problems that we've had historically would persist after the tariff. That's just plain wrong because we do know from what has happened already over the past 30 years with the reduction in tariffs, there has been a significant narrowing in the productivity gap between Canada and the US. The Ontario study assumed these differences would continue to exist with free trade. In fact, they didn't even recognize the nature of the problem.

The more carefully done studies are the ones by Wonnacott and the other by Harris. Harris allowed for changes in productivity over a 10-year time period—managers would respond to a change in the environment and increase their productivity and get their costs down—and ends up with a net gain in employment. The reason for this is that with free trade, the net increase in exports of manufactured goods more than offsets the net increase in imports of manufactured goods. The outcome does depend on the willingness of Canadian management and labour to make these adjustments. This is why I hesitate to put a number on it, but the need to make these adjustments is essential.

To maintain the existing way of doing things would surely create problems. We want to encourage positive adjustments rather than preventing change from taking place. The posi-



tion of the unions is one that favours the status quo, maintaining tariffs where they exist and arguing that the solution to Canada's unemployment problem is stimulative monetary and fiscal policy.

EXCAL: After the 1987 GATT negotiations, 95 percent of Canadian industrial exports to the US will be left with tariffs of five percent or less. You have made continual reference to the reduction in tariffs we've already achieved, but is the free trade debate not about non-tariff barriers?

DALY: Well it's not just that. With the reduction of tariffs that has taken place, this doesn't mean that the non-tariff barriers tend to become relatively more important (although in some sectors they remain important). Of Canadian companies that I have interviewed, one out of 30 said their exports were handicapped by the existence of non-tariff barriers in the US. An example of this might be a company producing street railway cars wanting to export to a US state where the state has preferential bidding system for local suppliers. Canada has non-tariff barriers as well (such as voluntary controls on Japanese exports) even though we make a great fuss about other countries. My impression is that we have more non-tariff barriers than the US. (US) non-tariff barriers are primarily designed to limit imports from Third world countries. They aren't really aimed at Canada. The conclusion I have drawn is that people who are arguing about the importance of non-tariff barriers have overstated their importance.

EXCAL: We've heard the term 'level playing field' mentioned in the free trade talks and the US is insisting on it as part of the free trade talks. This means that everything will be on the bargaining table, ranging from seasonal unemployment benefits for fishermen to our entire social system. The US views these as subsidies and therefore fall under the category of non-tariff barriers. Are our social programs in jeopardy with free trade talks?

DALY: This is a little hard to tell, from the outside, how it's going. There are some instances, for example, the operation of seasonal benefits, that can have an effect. One of the suggestions made by Richard Lipsey and Smith in their book, published by the CD Howe Institute, is that instances where the US is critical of Canadian social programs, when the US has similar programs, Canada should be negotiating on any net difference in subsidies between the US and Canada. In other words, if our subsidy was just the same as the US then there would be no grounds for an anti-dumping charge against Canada. I don't think, as the unions have suggested, that we will end up scrapping our social programs. By and large, if we have a higher program in say health, that is reflected in higher taxes. So in a sense, we are paying for some things through the government that in the US are paid for privately, but that doesn't mean there will be significant differences in the competitive position of the two countries.

EXCAL: Is it a scare tactic used by the opponents of free trade?

DALY: I think that is part of it. You get the same thing from some of the people talking about the cultural industries. What you find with some of these policies advocated by economic nationalists is that they lead to higher prices to consumers and lower real wages. The beneficiaries tend to be a relatively small number in that economy who have income above the national average. Nationalistic policies tend to redistribute income from the poor to the rich. What you find with European countries, that have had free trade, is that their differences are persistent. Trade doesn't lead to changes in the characteristics of social and cultural backgrounds. I think it's just a bogey that the oppo-

nents of free trade use to create an unnecessary degree of public concern about the changes following free trade.

EXCAL: There is a difference between cultural identity and cultural industries. Would you agree that our cultural industries will be threatened by a free trade agreement?

DALY: Take book publishing as an example. Some of our Canadian publishers are very incompetently run. They are propped up by government subsidies. Students have to pay substantially more for textbooks than students in the US. Book publishing, under free trade, would not disappear, they would become more efficient, more specialized with a greater use of computers, word processing systems. Canadian publishers have not yet adopted all developments with respect to new technology. It seems to me that there has been a tremendous increase in the number of television programs and movies being produced in Canada. I would not visualize a disappearance of our cultural industries with free trade. Some of them will have to adjust.

EXCAL: Do you think there is a Canadian identity?

DALY: I think there are some differences on the Quebec side, and certainly they are very much a minority within the total North American economy. I've travelled a lot in the States, I studied in the States and they can always identify me as Canadian by how I say 'about' or 'house,' but apart from that they don't seem to be that much different.

EXCAL: So are you saying that there really is no separate English Canadian identity?

DALY: Not really. What we have in Canada is a tremendous postwar immigration of visible minorities. How much common culture is there in Toronto? It's completely fractured, an entirely different situation than what you would find in the prairies. We have followed a pattern of encouraging immigrants to retain their culture, a mosaic. In the US, they very clearly emphasize a melting pot, the absorption of cultures. I think you do have an American identity . . . I think we've got less of an identity than we did 30 years ago.

EXCAL: So on that way we are different from the Americans, insofar as we promote a mosaic?

DALY: Insofar as we are a fractured and non-homogenous group, our cultural identity is a mirage.

EXCAL: Free trade won't take away the minorities' cultures?

DALY: Not one bit.

EXCAL: People argue that political sovereignty is threatened by free trade that by losing economic independence under free trade, you lose latitude in political independence.

DALY: A political scientist at Carleton examined instances where countries had moved to free trade, such as Ireland and the European Common Market. What he found was that there was practically no connection between these areas. In other words, you can achieve economic integration and continue to have differences in language and culture, continuing as essentially before.

Most professional opinion has tended to go against the generalization that complete political integration would follow, but there are still some people who would argue to the contrary. We should grant one point, that in a small and open economy there is no way Canada can go in a markedly different direction than the rest of the world. Clearly, you will never have complete independence. You can't set tax rates in Canada without thinking what they are in the US. This is true whether or not you have tariffs. I would say that the degree of interdependence among countries is greater than it was three decades ago. I don't think that is going to be reversed. Under these conditions, there has to be some indirect influence on Canadian policy. As long as Canada continues to have a separate monetary policy then I think you can have a fair amount of inspiration among your policies. You still have complete independence in

A FREE TRADE GLOSSARY

AUTO PACT - The Automobile Products Trade Act. Negotiated in 1965. The pact allows for tariff-free importation of US automobile products by Canadian manufacturers. It also requires that 10 percent of the automobiles sold in North America be made in Canada.

BILATERAL TRADE - trade between two any two countries.

DUMPING - the export of a commodity below cost or at least the sale of a commodity at a lower price abroad than domestically.

GATT - the General Agreement on Tariffs and Trade. It is an international organization devoted to the promotion of freer trade through multilateral trade negotiations.

GNP - Gross National Product; the total output in dollar terms of goods and services in the economy during the year.

KENNEDY ROUND - the multilateral trade negotiations completed in 1957 under which agreement was reached to reduce average tariff duties on industrial products by 35 percent.

MULTILATERAL TRADE - trade obstacles outside of tariffs which include licensing agreements, procurement policies favouring domestic products, anti-dumping regulations, and subsidies for exports.

SMOOT-HAWLEY TARIFF ACT OF 1930 - legislation passed by the US congress which raised import duties to the all-time high of 59 percent.

TOKYO ROUND - the multilateral trade negotiations completed in 1979 in which agreement was reached to cut average tariff rates by about 30 percent and to adopt a uniform international code of conduct for applying non-tariff barriers.