

Too Early to Tell Whether Free Trade Will be a Success

About all that the federal government is able to do as far as the first anniversary of its Free Trade Agreement with the United States is concerned is to try to reassure Canadians that 'implementation ... is proceeding in an orderly fashion.' That's courtesy of a Department of External Affairs analysis issued by International Trade Minister John Crosbie. The country's largest chartered bank, The Royal Bank of Canada feels much the same way, but one of the FTA's principal architects warns that as a combination of factors put the brakes on the U.S. economy, Canada could be thrown through the windshield. 'The politics of American trade are miserable at the best of times', observes Gordon Ritchie, who was Deputy Chief Negotiator through the FTA discussions and who now is an Ottawa-based consultant. 'In a recession they are positively vicious.'

Mr. Crosbie stresses that it is 'too early yet for any objective observer to make a definitive judgment of its economic impact' of the FTA. While he declines to attribute it to the FTA, he says there was a net increase of 193,000 jobs in Canada since the agreement went into effect at the beginning of 1989. The government's report on the FTA was released a day after The Royal Bank of Canada stated that the first year 'appears to have been positive for business capital spending, industry restructuring and exports.' The bank's economists also caution that it is too early in the 10-year phase-in of the FTA for a definitive assessment, but they do say the FTA 'has not led to any major or dramatic dislocations in the Canadian economy.'

Treasury Board President Robert de Cotret joins Mr. Crosbie in defending the FTA as 'an indispensable tool for Canada's prosperity' and cites the formal dispute resolution mechanism that has been put in place and which is beginning to come into play, albeit with mixed results. Asked whether the ongoing sectoral disputes — which the Trade Minister attributes mainly to protectionist lobbies within Congress — were a bellwether of future difficulties, Mr. de Cotret replies that there always have been sectoral disputes between Canada and the United States. He points out that the cur-

rent disputes involve only about 1% of the total two-way trade of some \$250 billion and that the pre-FTA regime did not provide for satisfactory resolution of disputes. 'I can't tell you that the new ... system is perfect, that we are going to win each case,' the Treasury Board President says, 'but now we can defend our cause.'

In the External Affairs report, which is bolstered by an analysis prepared for the department by Informetrica Limited, the government says that just as the FTA is 'a long-term initiative ... the economic benefits which will accrue are also long term.' It points out that only a small proportion of proposed tariff reductions are in place and that preparatory work continues in the reduction of non-tariff barriers such as government procurement rules, temporary entry, services and agricultural technology. 'Not surprisingly, expert opinion within the federal government, the Economic Council of Canada and private think-tanks conclude that discernible and substantial FTA effects are still several years away.' As for the spate of recent allegations that job layoffs and plant closures in Canada can be blamed on the FTA, the Informetrica report concludes that 'lags in availability of reliable data, difficulties in isolating FTA from other effects on the economy, and the uncertain nature of results provided by models of behaviour all point to great difficulties in developing any systematic evaluation.'

The Royal Bank report, which takes up the entire issue of its latest monthly *Econoscope*, looks at more than two dozen industries as well as the main economic indicators in arriving at what it emphasizes is a preliminary assessment of the FTA's main effects. 'The impact of free trade with the United States cannot be measured simply by counting the number of plant closures and openings', comments Alex Thomson, vice-president and deputy chief economist for the bank. 'Only by studying the ongoing and cumulative effects of the agreement from the dual perspectives of individual industries and the broad indicators for the economy as a whole can government, business and labour appropriately adjust to a free trade environment.'

As for the bank's report itself, it says that the effects of the FTA so far have been overshadowed by other forces, including a cyclical deceleration of the Canadian economy, high interest rates and a relatively strong Canadian dollar that is the result of investment inflows. It also echoes the government lines that the FTA should result in more secure access to American markets for key primary industries and that the Canadian manufacturing sector is particularly well poised to benefit from this access as well as from the phase-out of tariff barriers and the harmonization of technical standards in many industries.

There apparently is little evidence that the FTA has affected the Canadian service industries so far, but the bank says that competitiveness is the key to success, regardless of the sector involved. 'Canadian economic policies and business cycle dynamics remain the fundamental determinants of Canada's competitive position and the recent news on this front has not been encouraging', it says. 'The sharp appreciation of the Canadian dollar in the past three years and the widening gap between Canadian and U.S. labour costs have hindered many Canadian exporters in many markets abroad.... However, the cause of Canada's deteriorating competitive position has very little to do with the trade agreement. Canada's current weak competitive position reflects developments that were under way well before the implementation of the FTA.'

Notwithstanding the government and Royal Bank positions on plant closures and layoffs in Canada, Mr. Ritchie suggests in his own analysis that it is an issue the government must address. 'As the economy slides into a recession over the next year or two [Editor's note: there are conflicting opinions on the prospect of recession], there will be an increasing cacophony of announcements of layoffs, plant closings and economic hardship', he predicts. 'Inevitably this will be portrayed as directly attributable' to the FTA. However, he argues, high interest rates, the dollar and the federal government's spending and taxation policies will have more of a short-term economic impact on the economy than the FTA will.

R&D Slippage Troublesome for the High-Tech Sector

Last year evidently was a good one for investment in research and development but the Conference Board of Canada worries that the business community's uncertainty about the economy could lead to a gradual decline in crucial R&D. There is concern too at the Economic Council of Canada, where researchers say this country's competitive position in high-technology trade is 'weak on several scores' and requires immediate corrective action.

The independent Conference Board says R&D spending growth should decelerate this year, barely keeping pace with inflation. Furthermore, 'in the medium term (through to 1994), growth is expected to deteriorate further.' The projections are based on a survey of 170 member corporations, 153 of which were either involved in, or purchased, R&D services. Only 48.3% felt it was a 'good time' to expand R&D, a drop from 52% in a year-earlier survey. Some 19.5% felt it was a 'bad time' for expansion, up from 18%. The proportion that was unsure rose to 32.2% from 29.7%. Services and technology-intensive manufacturing companies remained the most optimistic with 62.5 and 53.3%, respectively, feeling that it was a good time to invest in R&D. Also, medium-sized and very large corporations were more optimistic than others: 59.6% and 48.3%, respectively.

Last year's climate was due to several factors, including federal Patent Act amendments protecting developers of proprietary pharmaceuticals against 'generic' copies. There also were enhanced incentives in Ontario and Quebec. 'The foremost reason for the positive 1989 spending is the continued confidence of Canadian business in the strength of the Canadian economy', the Board says. 'This factor was greatly reinforced by a growing awareness of the need to maintain global competitiveness.... When asked how significant development was for a company's competitiveness, 93% ... replied that it was important.' Even so, R&D spending over the next five years is expected to slide 'significantly' with average growth declining in real terms as sectors fail to offset inflation. Industry, Science and Technology Minister Harvie Andre laiments the evident trend, saying R&D is

an obvious target when the economy is not as healthy as the corporate sector might anticipate. 'Our view is that Canadian industry doesn't do enough research now', he says. 'Research and development is discretionary and so when companies are tightening their belts, they frequently do cut there.'

Government policies are highlighted by the Board as a primary concern and this is echoed in the government-funded ECC's analysis of Canada's high-technology sector. Working with Statistics Canada's &World Trade Data Base, ECC researchers Sunder Magun and Someshwar Rao say the current climate 'demands ... a major review' of Canada's science and technology policies. They made their findings public at a meeting in Quebec City of the Canadian Economics Association. 'Striking proof ... is offered by Canada's significant losses on world markets and its persistent trade deficits', according to a summary issued by the EEC. The researchers are particularly disturbed by the 'dramatic' decline in Canada's share of the United States market as well as its 'very low' penetration of the newly-industrialized countries (NICs) around the Pacific Rim.

'Canada's share of exports of high-technology products in its total manufactured exports is lower than for

any other industrialized country', the summary says. It rose to only 14% from 11% between 1971 and 1986, 'indicating relatively little change in Canada's export capability over a 15-year period when both markets and competitors have changed rapidly.' Over the same period, Canada's share of the global high-tech market shrunk to 2.6% from 3.5, which the summary describes as 'a meagre share' of a market worth some \$330 billion annually. In contrast, Japan's share rose to more than doubled to 17% over that period while the share of the Asian NICs mushroomed to more than 9% from 1.5. 'Canada's decline ... is not confined to a few product areas, but has affected the entire range of high-technology goods', the researchers say. This includes the sectors in which Canada has clearly established expertise, such as aircraft, telecommunications and data-processing.

Inquiries about the Conference Board's report, R&D Outlook 1990: Current Environment, should be addressed to Ranga Chad, Director of the organization's International Business Research Centre, 255 Smyth Road, Ottawa K1H 8M7, telephone (613) 526-3280, Telex 053-3333 or Fax (613) 526-4857. The EEC summary is available from its Publications Division, Post Office Box 527, Ottawa K1P 5V6.

Canada-Japan Financial Markets

Canadian and Japanese financial institutions are reassessing their long-term strategies and product lines in an effort to build on opportunities arising from the growth in business between the two countries. 'Canadian financial institutions in Japan are concentrating on the investment banking, treasury operations and investment advisory services, rather than corporate banking services,' the Conference Board of Canada comments in a report prepared by its Financial Services Research Programme. 'The banks and their affiliated securities dealers are rationalizing and integrating their investment banking operations.' Their ability to capitalize fully on the situation has been curbed by the regulated separation of banking and securities, but the Board says some securities dealers are exploring the opportunities for upgraded operations.

It also points out that Japanese entry into the Canadian market has been typically non-aggressive. 'Their experience in the Canadian markets has been characterized by stable growth and effective diversification The Canada-U.S. Free Trade Agreement is seen by several Japanese institutions as an important factor behind their positioning ... within the North American continent.'

Copies of The Canadian and Japanese Financial Services Industries: Opportunities and Prospects from Mutual Access may be ordered from the Board at 255 Smyth Road, Ottawa K1H 8M7; telephone (613) 526-3280; Telex 053-3333; Fax (613) 526-4857.