
trade. This model was developed at the Department of Finance in collaboration with Professors Richard Harris and David Cox of Queen's University. This large-scale Canadian general equilibrium trade model is explained in more detail in Annex 3.

In addition to analyzing the long-run impacts, there is also the broad question of the effects of Canada-U.S. free trade on key economic variables such as employment and inflation during the transition phase when the Agreement is being implemented. The Department of Finance also estimated the effects of the Agreement over the 1989 to 1993 period, the government's medium-term fiscal planning horizon. Again following the conventional professional approach, the Department of Finance used a macroeconomic model⁽¹⁸⁾ to examine the medium-term effects of the Agreement. Macroeconomic models are particularly suitable for this role as they include economic variables whose performance is of particular focus over the short to medium term, including employment, inflation, consumer spending and investment. The general equilibrium models are less appropriate for capturing the short- to medium-term effects of the Agreement. This is because general equilibrium models, in contrast to macroeconomic models, are usually timeless (or static) models, a characteristic which restricts them to the estimation of the impacts of policy

changes for a period over which the policy change has been fully implemented and the economy has fully adjusted to the new policy environment. Over shorter periods, resource allocation, efficiency and economies-of-scale effects – the main areas of focus of general equilibrium models – are relatively less important than the direct effects of structural policy changes on key macroeconomic variables such as employment and inflation.

⁽¹⁸⁾ Readers interested in obtaining more details on the structure and properties of conventional Canadian macroeconomic models are referred to *The State of the Art in Canadian Macroeconomic Model Building*, a report prepared for the Department of Finance by Grady Economics and Associates Ltd., March 1985 and available from the Department of Finance (Mr. D. Drummond, Assistant Director, Economic Analysis and Forecasting Division, Fiscal Policy and Economic Analysis Branch) upon request.