

# **Happy Fifth Birthday NAFTA! Thinking Outside the Box**

By

Daniel Drache\*

---

\* The author is the Director of the Robarts Centre for Canadian Studies, York University, Ontario, Canada. Research assistance was provided by Neil Van Ecyk, who gathered many of the studies cited in the text. He was also helpful in clarifying different conceptual points early on.

## INTRODUCTION

What have been the distributional consequences of NAFTA at the end of its first five years of operation? More specifically, have Canadians been badly misled about the bold promise and the many advantages of building a common North American market? Is it a win-win situation for all three countries involved? These are not easy questions to answer particularly when there is no agreement among trade experts about the putative benefits of NAFTA on this its fifth birthday. The chapter that follows addresses why this is so. It is not meant to be 'a study of studies of NAFTA effects' on labour markets, state practices, investment and trade flows; rather to argue the need for one. It attempts to demonstrate the veracity of a single idea. In a borderless world nothing should be taken for granted, complex market and non-market forces no longer respond to simple supply and demand signals.

It makes the case that contrary to predictions many of the direct effects of this trade agreement, on balance, are quite small. Further, it argues that NAFTA has not been the instrumental variable blasting open new market opportunities, dramatically increasing exports, creating hundreds of thousands of new jobs or reducing consumer prices. Yet, its regulatory impacts are, nonetheless, very large on other adjacent policy domains triggering large adjustment movements in the labour market, the competitiveness of firms and more generally on the social cohesion of society. These side-effects are very costly and difficult to control. They affect the reallocation of domestic and international resources, lead to new kinds of problems and pose major difficulties in adjustment and income distribution for

workers, employers and communities who have to bear the brunt of economic restructuring. In these circumstances, given these high costs and the failure of the US Congress to fast track the Free Trade Agreement of the Americas, NAFTA's big sister, it appears that this trade regime is living on borrowed time. There is no momentum for deepening integration at present.

### **INSIDE THE BOX : REVISITING THE FUNDAMENTALS**

As the prototype of a modern liberal trade arrangement, NAFTA is the most advanced market model of economic integration in existence. Its crucial elements include: the commitment by all three member states to stimulate trade and investment flows by dismantling traditional and non-traditional barriers to trade; a legal obligation to enlarge market access dramatically by enlarging investment rights and limiting government regulation of disinvestment; an equally strongly-held belief in the need to link employment growth and social policy reform to success in export markets; and, finally, a commitment to more efficiently resolve trade disputes by creating powerful and effective binding legal norms on governments.<sup>1</sup> (See Figure 1) As a trade regime there are four principal areas: trade and investment, labour and social policy reform, new state practices and trade disputes. Sorting out 'the real life cause-and-effect relationships' in highly open economies has proven to be highly hazardous compared to making predictions of what this trade deal would deliver.(Hart, 1998)

**Figure 1: The Four Principal Elements of NAFTA**

<p>Trade and Investment Flows  ‘The Trade Boom’</p>	<p>Dismantling tariffs and other state barriers is the major rationale of trade agreements for export expansion and promoting foreign direct investment . The new dimension is to enhance investment rights and to give private investors national treatment status to invest and divest without state regulatory oversight. <u>Empirical Measure</u>: growth of exports year over year but market share by sector and changes in the composition of trade are more revealing of the actual benefits of free trade.</p>
<p>Labour Market Reform  ‘Stronger but More Competitive Industries’</p>	<p>Adjustment is the heart of all trade agreement. In theory, job growth, higher incomes and lower consumer prices result from efficiency and welfare gains when industries have to become more efficient and competitive. Assumes optimal employment of all factors and that firms will reinvest rather than move. <u>Empirical Measure</u>: Job loss/new employment opportunities; changes to work and employment conditions; employment levels pre- and post-NAFTA.</p>
<p>New State Practices  ‘Harmonization and Convergence’</p>	<p>The regulatory response to economic integration and harmonization pressures creates new standards for state practices across the broad front of government programs and initiatives. <u>Empirical Measure</u>: Test for convergence (divergence) is change in state spending as well as maintenance of non-market policies. Special attention to the organization of labour market and social policy reform.</p>
<p>Trade Disputes  ‘Building A Level Playing Field’</p>	<p>The administrative legal and non-legal procedures for adjudicating trade disputes are a mainstay of any trade agreement. Comprehensive agreements are authoritative but since the rules require interpretation trade agreements are themselves the source of new disputes between signing partners. <u>Empirical Measure</u>: Number of new disputes; win/loss rate before trade tribunals; penalties assessed.</p>

Everywhere this problem of sorting out the merits and shortcomings of trade agreements is at the centre of public debate. Even if tariffs have fallen and private investment rights have been strengthened, the NAFTA experiment is in trouble with a sceptical Canadian public for good reason. There have been an increasing number of bitter trade related disputes over culture, wheat, lumber, dairy and other agricultural products and extraterritorial measures. Contrary to what

many predicted five years ago, certainly this is not the great success that it was promised to be. So far NAFTA is not a automatic great leveller building one vast undifferentiated market between Canada, US and Mexico. The 'great trade boom' as forecast by most economists never happened. For a country as rich in resource exports as Canada the deepening global crisis has driven primary commodity prices to rock bottom levels. The decade of the nineties produced, in Pierre Fortin's words, the Great Canadian Slump, the product of the Bank of Canada's high interest rate policy that brought the economy to a standstill.

South of the border, the US trade deficit has ballooned to almost \$300 billion dollars annually and the US is becoming "the market of first resort" for many economies suffering from high unemployment, deflation and a falling standard of living.(Gottlieb, 1998) With US growth due to slow, some of its earlier supporters are now predicting that these conditions are bound to trigger a new cycle of American protectionism. Should that happen, NAFTA could unravel.

By contrast, the triumph of the past decade is not NAFTA but the US stock market. Rising share prices have supplied the fuel for the greatest merger movement ever seen. Stock has become the sole yardstick for corporate performance and the pre-eminent currency of reward. Enhanced access and new trade opportunities come a distant second. So given the complexity of market and non-market forces operating in the two countries that do not rely on simple supply and demand indicators, there is something terribly defective about any analytical paradigm that gives the trade agenda top spot *tout court*. There are powerful competing agendas in an era when tough monetary targets by the central bank authority not only rival trade policy as the kingpin of policy-making but surpass it.

What makes belonging to a trade bloc so demanding is that adjustment to the world economy, not redistribution, has become the core activity of states. The commitment to opening the economy regardless of the steep costs incurred by communities, firms and government programs raises many difficult questions about the future capacity of the state to set standards and protect consumers and business from unfair competition. The proof is that the once mighty non-tariff barrier, the commercial safety net that made trade liberalization state-friendly, is under relentless pressure to accommodate the new trading order. These kinds of conditions require close study, particularly when *the causal relation between the stated public goals and policy outcomes of macro-economic policy are less closely linked now than any time previously*. What is different is that it is no longer clear what constitutes good macro-economic performance when public authority is committed to making labour markets, wages and social policy highly flexible and responsive to an environment in which all countries are related to each other in a single market place. This commitment to across-the-board flexibility, dynamic change and constant policy re-evaluation marks a new point of departure for most states.

Not surprisingly, it causes a high degree of uncertainty when countries decide to join a trade bloc. In the recent past, modern government placed a priority on the need for predictability and continuity as fundamentals of public policy, not experimentation. Now many states do not blink at the idea that their major policies and practices must converge with those of their major trading partners. This requires a fundamental reorientation in a double sense: for the first time ever, all states explicitly accept the notion that a country's major policies are to be indexed both formally and informally to those of their most powerful trading partner. So social policy, labour market

adjustment and taxation levels must fall within an agreed upon target or zone. Secondly, national sovereignty also has to accommodate other kinds of transnational constraints that were not present previously. With so much stress on convergence criteria, deficit targets, and debt limits, public policy-makers have agreed to accept to a high degree the judgement of financial markets or the dynamic of export markets or both as the most reliable guide for the setting of national goals and objectives. In theory, this pooling of national resources for the common end of economic integration sounds like a smart forward-looking idea, but is it?

Monitoring the many contradictory consequences of forming a trade bloc is never as direct as it appears for one striking reason. How does one disentangle the NAFTA impacts from other structural changes in labour markets, corporate restructuring, new government practices, a devalued Canadian dollar and change driven by new technologies? The answer is anything but straightforward. The world is too complex a place for simple static computer generated equilibrium economic models, the preferred choice of international trade theorists in recent years. These kinds of quantitative models do not address the new complex realities of interdependence, volatility and increased capital mobility. Today the mechanics of trade adjustment turn on non-empirical structural relationships that encourage capital to move rather than invest. It serves science badly from a Popperian standpoint to rely on economic models that are not a good representation of the real economy, are not historically grounded and are not open models of enquiry. (Stanford, 1996)

If we are indeed to learn to think 'outside the box', when every policy lever touches every other pressure point, then a broader set of measures is needed. Since imports and exports are

never reciprocal in their job effects and export expansion cannot be simply equated with direct job creation any longer, it makes perfectly good analytical policy sense to expect that there will be sharply differing socio-economic impacts on state policy and economic development. From this perspective, mapping NAFTA outcomes begins with the text. It is the one common institution that all three public authorities share. NAFTA, incorporating the earlier bilateral Canada- US Free Trade Agreement (FTA), is a legal document and any new rules and practices stemming from a legal text have to be interpreted. So contrary to appearances, while the text is comprehensive and binding on the signing parties, there is no authoritative interpretation of what each section means, let alone its specific obligations on each of the parties. (Appleton, 1994) Because there are so many grey areas and with Canada, Mexico and the US at such different stages of development each with their contrasting views on the proper role of the state, the prospect for many more trade conflicts is very real. The only question is do the new rules embedded in NAFTA address the 'old problems' that continue to plague continental-wide integration and provide a secure future?

### **THE ARGUMENT IN BRIEF**

This chapter makes three new and important findings: The first is that economic integration is much slower than anticipated. As much as a third of Canada-US trade is now subject to new barriers and restrictions some of which date from the past but many have been imposed since the signing of the treaty in 1993. The exact figures are difficult to come by but the non-liberal measures include auto and auto parts -- managed trade, softwood lumber -- voluntary export restraint, cultural industries and state trading enterprises. In agriculture, trade disputes

have occurred in wheat, cattle, hogs, potatoes and dairy products. Canada has found itself on the front line of US protectionism even though US industries control ninety percent of Canada's film industry, forty percent of home video distribution, eighty-five percent of CDs and music recording, more than fifty percent of books and magazines as well sixty percent of all TV programming. Disputes over the environment, the use of pesticides, and US labour practices multiply and new disputes are on the horizon.

Far from being an unstoppable force, in many areas of public policy divergence in state policy between Canada and the US is becoming more important despite the inability of Ottawa to defend Canadian interests strongly. (Hart, 1998) Economists employ convergence as an important measure to gauge the success of states working toward a common goal of dismantling barriers. Member states have to impose discipline on themselves and build a level playing field if the hoped for result of greater transparency in state practice is to materialize. In this era of states against markets, we see much evidence of divergence between these two countries with respect to labour market restructuring, state policy and monetary targeting. Institutional differences are also significant because the US has a strong set of non-market institutions – its trade laws, corporations with deep pockets and the US Congress -- that together are capable of organizing the continental market in the US interest. To a surprising degree, NAFTA is not the key element of US commercial dominance; rather it is only one factor in a much larger scenario. Without a set of strong non-market regulatory institutions this kind of trade regime is more likely to become the victim of the current global crisis than any kind of viable alternative to it.

The second finding is that the chapter raises serious questions about whether the new legal

norms established by this prototypical text are as important as either its critics or supporters maintain. It appears that there is less than *significant* correlation between NAFTA objectives and outcomes after five years of this trade regime. The core 'NAFTA effects' from the removal of trade barriers and the new legal norms established by this important legal text may in fact be better explained by other policy agendas than this prototypical trade regime. Nonetheless, so far these market-enhancing policies embodied in the NAFTA are disappointing in terms of their economic consequences for Canada and Mexico. With overall growth prospects poor and high unemployment levels a permanent structural feature of the Canadian and Mexican economies, it is not NAFTA which is the source of this policy *mal* but a series of confused and contradictory assumptions about trade policy, monetary policy and social and labour market reforms. The empirical evidence demonstrates that the policy assumption of a frictionless fit is wrong. Trade dynamics are very unpredictable and difficult to capture as the Canadian experience repeatedly demonstrates.

Finally, the harsh but frequent reality of open markets has its own highly visible and concrete dynamic. It will be shown that there are asymmetrical costs from opening the economy particularly on productivity at the firm level; that higher levels of import penetration are responsible for significant job loss and plant closure, and that investment shortfalls and technology lags do indeed explain why high-value added industries perform poorly while low skill narrow gauge performers do well in highly competitive circumstances. NAFTA continues to be a high risk exercise because it has no institutional means to plan and pay for the job loss and the large amount of economic restructuring that this kind of initiative inevitably entails.

## **NAFTA FLASHBACK: SOME RELEVANT HISTORY TO RECALL**

NAFTA came into effect in 1994 and created the largest common market in the world containing over 350 million people in Canada, US and Mexico. It built on and incorporated the Canada-US Free Trade Agreement of 1989. Throughout its history, Canada had always vacillated between establishing a strong national economy with viable Canadian industries and the seductive claims of continentalism offering Canadian companies increased access to the larger US market. If the free trade objective embodied in the NAFTA was not a new story by any means, it represented a defining moment in Canadian public policy. This was because NAFTA (and the FTA) epitomized a very different phase of economic integration, one that was more intense and far-reaching in its goals and dynamics, embracing continentalism on a scale never before attempted. With Canada-US tariff walls already close to zero, it created a wide-angled policy platform that was intended to secure enhanced market access.

What explains the historic decision to jump on board the continental train in the face of so much public opposition and scepticism to the free trade vision of North America? It is important to recall that the 'great U-turn' towards free trade and trade liberalization in Canada came after a decade of the economic nationalism of the Trudeau government in the 70s. His government went further than any other in the postwar period in strengthening the East-West axis of the economy, particularly in the areas of foreign ownership, energy, cultural and social policy.<sup>2</sup> ( McCall and Clarkson, 1994) Particularly, under Trudeau Canadian social policy was transformed along European lines so that it was no longer a pale imitation of its US counterpart. Canadian Unemployment Insurance benefits were increased; a universal health plan established; family

allowance support enriched and social assistance benefits dramatically improved. Canada's social democratic traditions transformed modern Canada into a strikingly unAmerican nation on the northern half of the continent. (Drache and Ranachan, 1995)

For Washington, these kinds of Canadian initiatives seemed to be a dramatic break from the long time neo-colonial economic role that had defined Canada-US relations for most of the century. Economically, Canada had been a resource-based economy of the classic kind supplying US industries with pulp and paper, iron ore, nickel and forest products. More than this, it had an abundance of resources that were shipped largely unprocessed to US factories. But Canada-US relations were always more complex than their export trade because Canada was also an investment frontier for US capital -- more than a third of all US foreign direct investment was in Canada and US interests controlled over 50 percent of Canadian manufacturing; over 75 percent of oil and gas and over 90 percent of the auto industry. Canada was also the most important trading partner of the US, who in turn supplied Canada with most of its consumer, capital and high-tech goods.

With the signing of the Auto Pact in 1965, Canadians had learned first hand the advantages that resulted from 'managed trade' that had reconciled their nationalist aspirations with their long-term commercial interest. This bilateral agreement was a highly effective policy vehicle to address the imbalance in the two way trade. It is important to recall that the Auto Pact guaranteed Canada a proportional share of North American auto production. It was the opposite of the free trade ideal because it established the principle of proportionality that guaranteed Canada its fair share of the production and investment benefits. Over time, the Auto Pact

delivered in ways that no one could have predicted. Under its terms, the US industry kept the high profit full-sized cars for themselves and gave Canada the small, medium-sized cars and utility vehicles. This turned into an unexpected bonanza after the energy crisis in the early 70s because small cars became the fastest growing segment of the North American auto industry.

The 'smart' Auto Pact deal was, of course, the postwar exception. The fact was that Canada had long been overspecialized in resources and under-specialized in high end manufacturing. (Porter, 1991) Canada had access to the US market in spades. What it lacked was a set of policy responses to get the economy back on track and capable of managing structural change. For a trading country, it badly needed a coherent set of policies to target industries and make-large scale investment in human and physical capital. (Drache and Cameron, 1985)

Throughout the seventies, the narrow economic agenda of informal continental integration had taken a backseat to Keynesian welfare policies and economic nationalism. The crisis of the early 80s changed all this. With 95 percent of goods entering Canada and the US duty free, was a fundamental restructuring of the Canada-US relationship required? Was access to the US market best secured by a comprehensive trade treaty? Was there any compelling evidence that significant investment was being diverted from Canada to the US? Would not entry into the FTA (and later NAFTA) be an irreversible decision for Canada? Even if the Agreement's benefits were found to be undesirable, could any agreement be undone, modified or renegotiated? (Ontario Government, 1985 )

There is no need to retell how the free trade option came to capture the elite's agenda.<sup>3</sup> For the bureaucracy and political power brokers, negotiating a comprehensive trade deal became

the policy of choice. Their *idée fixe* was that Canada needed to negotiate a free trade deal with the US to address its internal difficulties and growing US protectionism. For them, free trade was seen as a bold initiative to restructure state-market relations in Canada, in a way that was comprehensive, authoritative and offered new procedures and practices for settling Canadian-US trade disputes. The difficulty was that Canadian firms would be part of free trade from a standing start without any phase-in period and that Canada would be the *demandeur* and thus in the weaker position at the negotiating table. Washington could (and did) use its power to extract a large number of concessions from Ottawa at a time when the two countries' economies had become more integrated than ever through the corporate sector and the deregulation of financial and product markets.

In pushing Canada towards free trade and continental integration Mulroney achieved what no Canadian government had ever dared to propose, namely, a prototypical liberal model of a common market between Canada and the US.<sup>4</sup> Entering into a comprehensive free trade arrangement was Mulroney's gamble, his government's leap of faith.<sup>5</sup> For US negotiators, gaining unprecedented investment rights made the final text the deal of the century. NAFTA would go one step further. It would also be the first free trade area in which Canada and Mexico a developing country “granted investors of the industrialized world the optimal status of national treatment.” (Morales, 1997:135)

The crown jewel of the agreement granted national presence and national treatment to US financial industries. US industries received enhanced access to the Canadian market. Particularly with respect to its energy provisions, Canada gave up the right to a two-price system charging US

customers a higher price for Canadian oil and gas. Significantly, NAFTA accords US investors and companies rights that they did not enjoy previously. Chapter XI creates the new standards to increase capital mobility at the same time as it guarantees the investments coming from NAFTA partners. This has to be read along side Chapter XVII further protecting property rights; Chapter X, deregulating government procurement; Chapter XII, requiring the deregulation of services; and, finally, Chapters XIX and XX, establishing an enforcement mechanism to prevent government unilateral interpretation of the Agreement. By contrast, Canadian governments are not able to discriminate between foreign and domestic capital (Chapter XIV and XVII); nor are they able to introduce policies that allow government to use its legislative authority (if it wished to) to Canadianize sectors of the economy such as auto insurance or to enlarge the state presence in the economy as it had in the past in the area of public utilities. The investment provisions in Chapter XVI act a safeguard against this eventuality.

In such circumstances NAFTA, directly and indirectly, set in motion harmonization and integration dynamics with respect to labour market policy, social policy and state fiscal practice. The intent was that building a level playing field would require major changes to Canadian policy in these areas. What it anticipated was that the new 'high' standard on investment rights would require Canada to align many of its policies with those in the US to an unprecedented degree without any institutional linkages other than the legal norms. This included not only the sphere of economic management and trade but extended to the sensitive areas of social policy, labour market management and culture as well.

A large part of the legal text focussed on redrawing the lines of state authority with

respect to resource pricing, foreign investment, agricultural management boards, state subsidies and public ownership. NAFTA makes other across-the-board changes possible. (See Figure 2) For instance, taken as a whole, the legal text can be considered as a new legal standard that imposes new obligations on the Canadian state. Many of the specific subjects covered are not about trade but about promoting structural change through the market. More than anything else, what the NAFTA accomplished was to create new rules and norms. These would not be definitive but they would establish benchmarks for 'commercially oriented state practice'.

In time it was expected that the new rules would have cumulative effects through the culture of legalism and the creation of enforceable legal norms on state practice. The anticipation of the negotiators was that the legal weight of NAFTA would force Canadian policy to mirror US liberal norms particularly in the area of agriculture, stumpage fees, social policy and culture. For instance, Canadian agricultural marketing boards had long ensured price stability for Canadian farmers and fair prices to consumers through a system of quotas and subsidies. So under NAFTA rules these state trading enterprises would have to be changed, dismantled or their regulatory powers reduced to conform to the guarantees of national treatment provided by the trade deal.<sup>6</sup> Canada's cultural industries were partially exempted in the FTA and later NAFTA. Their future status would be uncertain, again subject to US demands that culture be considered no different from any other traded good.

In both cases the issue was whether these kinds of Canadian domestic arrangements were fair game for cross border competition and whether Canadian policies themselves constituted a distortion to trade and hence possibly a trade injury. In abstracto there was no way this question

could be answered. However, the lagged effects were very large. If the US objected to 'Canadian policy diversity' and US trade tribunals established that Canada was 'subsidizing' key sectors, then, US officials could use the North American free trade agreement to justify retaliation or apply other kinds of political pressure.

From a political and legal perspective the NAFTA final text was riddled with grey areas and legal uncertainties. The biggest was the final text itself. It did not contain any definition of a subsidy nor any arms-length procedure to resolve this issue. So Canada with its large state sector and many non-market programs would be particularly vulnerable since there was no agreement on which subsidies were permitted and which were in violation of NAFTA principles. Most importantly, the absence of any definition gave the US a decisive advantage over its 'putative' trade partners Canada and Mexico. It meant that US trade law became the de facto police of the NAFTA trade regime that created a whole host of new investment rights and investment obligations for both Mexico and Canada.

**Figure 2**

**THE OLD AND NEW MODEL OF CONTINENTAL FREE TRADE COMPARED**

	NAFTA	Previous Trade Liberalization in North America
Phase-in	Comprehensive agreement with zero tariffs, few exceptions; no preparatory or phase in period. A standing start leap of faith	Gradual, partial, and highly selective with only some sectors designated tariff free
Principal Features	National presence and national treatment for US firms; market determined continental energy policy; open borders investment flows; and reshaping parent-subsidiary relations by US parent	Progressive tariff reduction; integration informal; sector agreements in auto to address cross-border issues in trade, production and investment
Adjustment programs	No general adjustment programs for workers or industries in all three countries. Left to member state.	Compensation for losers; each country maintains specific adjustment programs
Convergence Criteria	Largely market driven rather than through the state as in the EU; strong emphasis on harmonization and integration of public policy and programs but not co-ordinated	No commitment to national presence and national treatment; or to a level playing field.
Public Private Sector Balance	Private sector given new rights and standing; national presence and national treatment as well as other non-discriminatory practices. The benchmark is the US state -- smaller, less present, less equity- oriented.	Strong state sector presence in Canada; corporations do not receive enhanced standing
Social and Labour Market Policy	In the big picture, all programs are covered by NAFTA through Chapter XI provisions supplemented by Canada's internal trade agreement	Labour market, social and cultural policy reflected national needs and differences
Structural Adjustment	No compensation for losers; instead significant acceleration of intrafirm integration and co-ordination by US multinationals to market locally, produce regionally and source globally	Compensation for losers; industrial policy and structural adjustment

The final result of this legal asymmetry was that NAFTA would not protect Canada (or Mexico) from US protectionism or the arbitrary application of its trade laws. Washington would be able to impose tough new investment rules on its partners without any increase in discipline on US practice and policy in the absence of any supranational authority. The US Congress, industry lobby groups and the administrative practices of US trade tribunals, not some impartial authority, would determine the high standards of public policy for purposes of this trade agreement.<sup>7</sup>

### **FIVE YEARS ON: EMPLOYMENT ENHANCEMENT vs. TRADE EFFICIENCY**

It was never clear when NAFTA came into force what kind of harmonization it entailed and how many of Canada's programs would be required to adapt to the standards of new trade regime. After five years, there is little correlation between initial predictions and the tangible NAFTA effects and economic integration is beset with difficulties (See Annex I). Many are not NAFTA-sourced but the integration process has been brought to a dead halt. Andrew Jackson is right in arguing that the race to the bottom in labour market standards and practices, corporate reorganization and government spending have been driven by competitive pressures first and foremost. (Jackson, 1997) The removal of trade barriers was intended to spur competitiveness but there is no "new efficient division of labour between the two countries as part of the "bright new trading future" that the *Economist* boldly predicted when NAFTA was signed. Nor has the rise in exports had a dramatic impact on the standard of living. Canada's GDP has grown at a snail's pace at an annual 0.5 percent in the 1990s compared with 1.7 percent a decade earlier. By contrast, the American standard of living grew by 1.5 percent annually in the 1990s.

As can be seen in Table 1, the current environment for trade blocs has not been kind for new

job creation., for the number of job posts being closed per year has grown in the last decade. The Table also shows a negative pattern in the evolution of wages as percentage of value added in different manufacturing sectors.

**TABLE 1**  
**Employment and Adjustment in Canada in the Pre- and Post- Nafta Era**

1) Thousands of job posts closed per year. Various industrial sectors

	<b>1988</b>	<b>1993</b>	<b>January '97</b>
<b>Total</b>	<b>1,192</b>	<b>1,667</b>	<b>1,719</b>
Food	208	180	175
Clothing	121	85	85
Primary Metals	103	80	80
Fabricated Metal Products	174	135	155
Machinery (Non-Electrical)	85	65	91
Electrical and Electrical Prod.	157	116	117
Transportation Equip. (Auto & Aeospace)	224	197	223

2) Production Workers Wages as % of Value Added. Various industrial sectors.

	<b>1988</b>	<b>1995</b>	
<b>All Manufacturing</b>	<b>31.2</b>	<b>27.2</b>	
Food	28.0	27.1	
Rubber	41.4	39.4	
Clothing	47.8	38.2	
Paper & Allied	25.4	20.1	
Primary Metals	30.0	29.7	
Machinery	35.2	30.8	
Transportation Equip.	37.3	30.5	
Electrical & Electrical Prod.	29.7	25.5	

Source: Jackson, 1997.

Labour income growth has been on hold for more than a decade. Between 1986-96, wages for both hourly and salaried workers have increased by only 6% while wage settlements for unionized workers in the business sector just matched inflation (Jackson, 1997). Workers in the public sector have seen their wages fall behind those in the private sector because of government imposed wage freezes and legislated controls. Unemployment in Canada remains twice the US levels at 8.1 percent; compared to just over 4.6 percent in the US (Fortin, 1996).

Furthermore, unemployment benefits pre-FTA and NAFTA covered practically the entire workforce and Canadian benefits were generous by US standards: since 1990 Canada's Employment Insurance now resembles much more the US system. In 1989 85 percent of Canadian unemployed were qualified; today less than 50 percent of those out of work have access to its benefits and all the benefits have been dramatically reduced (Jackson, 1997).

This is certainly not what had been predicted by government sources. Initial studies done by the Department of Finance of Canada contended that increased access to the US market would lead to a 'more efficient and lower cost economy' via economies of scale, higher productivity and higher rates of production have been proven to be dead wrong. The predicted 'real income gains of 2.5% and increased flexibility and dynamism' have not materialized. Nor has the estimated gain of 120,000 new jobs by 1993 happened. The more independently minded Economic Council of Canada also forecast a 2.5% gain in real GDP over 10 years and it predicted a further modest 2-3% job loss in the heavily protected sectors as a result of tariff reduction. It too was off the edge of the envelope with its unstated assumptions that wage differentials would be eliminated by the full mobility of labour and that there are automatic and increasing returns to scale within firms

when tariffs are removed.

In a perfect world, the free trade theorem ought to be based on high wage and efficiency arguments. Stanford (1996) captures its pristine theoretical clarity in the following passage:

“The general equilibrium model assumes that any region can compete with any other region in any industry by simply opening up production if the macro-conditions are favourable. Hence regional firms will be guaranteed access to the market as large as any other producer because the welfare-enhancing gains from trade can be divided and redivided. The pivotal assumption is that product differentiation occurs on a national basis while factor mobility moves across borders where ever the benefits are most attractive. So in short, production is rooted in strong regional growth economies while the inputs are highly mobile often in one direction only”.

In the real world, however, the operative question inevitably is, what will firms do following the elimination of trade barriers? Will they move to take advantage of the new opportunities of lower wages elsewhere or will they stay put, specialize and expand? While there has been much debate about how to best assess the employment effects of NAFTA, there is a growing consensus among many economists that total job loss due to trade-related and Canadian rigid monetary targets has been dramatic. (Fortin, 1996) Over the last thirty years, the number and quality of manufacturing jobs has shrunk in Canada. Less than 15 percent of Canadian workers find gainful employment in the manufacturing sector. No amount of export-led growth is likely to reverse this long term historic trend.

According to Treffler who has written some of the best studies evaluating NAFTA's impact on jobs, tariff cuts explain about half the employment losses though there is still much debate on the exact magnitude of loss directly attributable to trade liberalization measures. He admits that regulatory and institutional factors are more difficult to integrate into the traditional model of losses and gains. In 1993 there were 400,000 fewer jobs than there were in 1988, a “staggering 17

percent of the 1988 workforce” (Trefler, 1998). As well tariff cuts have led to the closure of about 10% of all Canadian plants but have increased the size of those remaining which should have made them more firm-competitive . He concluded that it is hard to say whether the losses and gains balance out. What is less in doubt is that the new competitive conditions have also led to extensive labour shedding and this fact, more than any other, has led to efficiency gains by crude arithmetic means -- fewer hands producing more goods. The question is, has this meant stronger, more efficient and competitive firms?

Here the empirical evidence is unambiguous. Were it not for the \$.70 (Canadian), many of Canada's firms would have been drowned by the rising tide of US imports. In these circumstances the NAFTA effects are small. For Canadian exporters on the ground NAFTA accounts for only a small amount of Canada's export trade. Canadian exports continue to head south in record amounts because so much of the Canada-US trade is organized on an intra-firm basis between Ford Canada and Ford US or IBM Canada and IBM US. Recent estimates suggest as much as sixty percent of manufacturing exports are between American head-offices and their Canadian subsidiaries. With import, export and tariff duties too small to matter for many industries, tariff reduction has not been the primary causal factor in terms of labour market reorganization.

(Trefler, 1997) Many economists concur the view that almost all of Canada’s cost advantage has come from currency depreciation . “A twenty percent swing in cost competitiveness has turned into a 6 percent advantage due mainly to a 20 percent point swing in cost competitiveness of a lower Canadian dollar.” This has made Canada a cheap place to manufacture.

By contrast, the growing jobless rates between Canada and the US stem from the early and

longer 1990s recession and the Bank of Canada's policy high interest rates policy. Canada's jobless rate is double the 4.6 percent rate in the US. Significantly, unemployment rates were on average the same for both countries for most of the postwar period until 1981 when tariffs between the two countries were being dismantled. The gap was only two points in the 80s and shows no sign of closing. Most of the gap is due to the slower economic growth rates in Canada compared to the US. As long as Canada has tougher inflation targets, this bias will continue to choke off growth.

The plummeting Canadian dollar has also had perverse effects. Many exporters have used it as an unofficial but highly cost effective exchange rate subsidy. Firms can export more goods to the US without having to invest in better products, more advanced production processes or skill-training for their workers. The best study by Rubin and Lester (1997) showed that even with falling production costs, Canadian manufacturers are not spending notably more on any of the things that really matter – marketing and product development strategies, moving up the production value chain, investing in skill training in response to the new competitive pressures. Members of corporate Canada are losers on two counts. Tough competitive pressures have not transformed them into broad gauge performers nor have they reinvested massively in any systematic effort to close the big productivity gap between themselves and their US competitors.

## **THE NEXT FRONTIER -- CORPORATE REORGANIZATION**

With tariff protection falling to zero, NAFTA was expected to trigger widespread change at the firm level. Blank and Yu describe this dramatic sea-change as the "integration of Canadian and, somewhat more slowly, the Mexican subsidiaries of US firms" into a fully integrated

continental system.(Blank & Krajewski, et.al., 1995:30) The rationalization of productive capacity and the workforce was to create a new division of labour for Canadian, US and Mexican business operations. Many business experts predicted that US firms would market locally, manufacture regionally and resource globally with common technology, knowledge and supplies. As US firms reorganized themselves on a continental-wide footing to take advantage of the new scale economies, the smaller and less efficient subsidiaries operating in Canada would close down. The model of the successful North American multinational would be a firm that had the capacity for centralizing global planning and the regional co-ordination of their resources and activities. Optimists believed that NAFTA would also force many industries to restructure as continentally organized firms.

Except for the auto industry, which was already organized on a continental basis, corporate restructuring has been largely a hit and miss affair. The biggest manufacturing success story in Canada is Bombardier of Quebec which has diversified as a global entity. With its strength in engineering design and production, it operates very much like a German company – close ties to the federal and provincial state, a recipient of hundreds of million dollars in state aid; a long-term diversification strategy to move up the value chain of production into aeroplane manufacturing and a proven track record to manufacture in many different markets and still maintains a core presence in Canada. It is expected to diversify further into automobile assembly operations although there is no official confirmation of this latest development.

For corporate Canada the embarrassing fact is that Bombardier is a stand-alone-success story in a ‘wilderness of single instances’. The more typical Canadian firm is Northern Telecom,

one of English Canada's leading telecommunication giants. Much of its production and research is done in the US or other markets and it has cut its workforce in Canada dramatically. The point is that corporate Canada looks more and more like Northern Telecom with its cost cutting strategy rather than Bombardier with its ability to move into new product markets. Many Canadian head offices of US corporations such as EverReady Battery are now a skeleton of their former selves. Firms such as Pratt and Whitney, with major production facilities in Quebec have also seen their operations cutback. The dominant trend is that the remaining Canadian and Mexican operations have less autonomy in investment decisions, production planning and research and development expenditures. It is difficult to obtain precise figures on the number of branchplants that closed down completely in the first five years of NAFTA but it is not unreasonable to put the figure in the thousands given the fact that more than twenty percent of jobs in manufacturing disappeared at this time. (Campbell et al, 1999)

The volatility of large continental markets is not only reflected in the instability of employment prospects but also in the precariousness of the small and medium firm. If Canada is to achieve substantial growth in employment, it has to be among small and medium sized firms. It has been assumed that small firms are the generator of most jobs. But here too there are sharp differences between US and Canadian experience. (Statistics Canada, 1998) In its studies, Statistics Canada found that gross job gain is higher among smaller Canadian than US plants but their job loss is higher than small US firms. The reason is that Canadian firms fail to consolidate their gains and that rapid expansion in one period becomes a recipe for failure in the next. Compared to the US, Canadian large firms underperform. In the US, large plants have an equal

rate of job creation as compared to the small firms. This trend is particularly evident in the goods-producing sector and the wholesale-distribution service sectors who hire more new employees than any other sector. Picot and Dupuy, the authors of this study, argue that US job gains are strong in big firms and it may be this fact that explains why Canadian employment creation has fallen short of the US levels. The unspoken belief is that many big firms that operate on both sides of the border in Canada are moving their production facilities southward. (Picot and Dupuy 1998: 14)

Big firms are not a trivial source of employment having created 230,000 jobs in the 80s. (Picot & Dupuy, 1998:26) This evidence is important because most small firms, with a superior job creation record, rarely export to the US but supply local and regional markets and offer dramatically less well paying employment situations. Men in these big firms earned 39% to 46% more than their counterparts in small firms. For women, the wage premium varied between 35% to 42 % between 1986-1977. It is not simply skill premium which accounts for difference between good jobs and bad ones but the size of the firm. Large firms pay 15-20% more than small firms; pension plan coverage remains at least four times higher in large firms than small ones and workers in small firms work at least as many hours as workers in large firms. (Drolet & Morissette, 1998)

What governments are loathe to admit is that increasing exports is no longer an employment-creating strategy in the way it once was in the boom times of the fifties and sixties. All over the continent, new computer-based technologies now enable employers in the old Fordist industries to become leaner and more productive. Lean production practices pose an

irreconcilable dilemma for labour. On one hand, new competitive pressures generated by free trade zones require industries to shed labour in order to boost market share in foreign markets. On the other hand, in the new technologically-intensive sectors with the promise of high value-added industries they cannot generate a sufficient number of new positions when they are forced to compete head to head. This is so because the rules of the game have changed most for corporate giants. Cost-control is now their principal strategy and cutting costs requires smaller payrolls.(Drache, 1996)

### **WORK AND EMPLOYMENT STANDARDS: A NEW GLOBAL DYNAMIC?**

The process of building larger markets that has dramatically altered employment and wage standards in Canada preceded the signing of NAFTA. (Drache and Glasbeek, 1992) The main consequence of the spatial reorganization of industries is that wages, working time and consumption, historically linked for the past four decades, no longer are.

This same trend is also evident in the European community which has a very different trade regime. Since 1980 in Western Europe, real wages in most European jurisdictions have lagged behind productivity growth including in the powerfully organized German trade union movement. (Rodrik, 1997) For the past decade the multi-skilled German worker has turned in an impressive performance. While German wages are seen to be high comparatively, the view on the ground is quite different. Since 1990, real hourly wages have trailed hourly productivity. In 1997, wages grew by 1.5 percent while productivity surged by 3.7 percent. The trend in Germany is no different from other countries as work in the high wage sector declines and firms cut the size of their workforce. Since 1990 job growth in the industrial side of the economy has been negative in

five out of seven years. As far as labour market adjustment is concerned, European economies face intense pressures to modify their social market practices but so far this has not happened anywhere to the degree predicted by many experts. The OECD has not been able to convince European member states to adopt the US model of labour market practices – low wage and few unions.

In Canada and the US, this same de-linking explains the dramatic disappearance of middle-income earners from the employment pyramid. Proportionately, there are fewer blue-collar workers earning a 'family income' and many more single-parent, most often female workers, being paid poor wages. The high turnover rates are explained by the feminization of labour markets in the rapidly growing service side of the economy. (Betcherman, 1992)

The most recent Canadian evidence indicates that the Keynesian virtuous growth cycle has been replaced by a very different set of macro-economic objectives. Under Keynesian practice, governments relied on interest rate adjustment and on currency devaluation to ensure a flexible international economic position.(Boyer, 1989) Now Ottawa is committed to a significant degree of wage flexibility in which Canadian wages are to operate as a mechanism of adjustment. Under the gold standard, the external financial position governed the nominal wage. Competitive labour markets ensured wage flexibility which in turn curbed production costs. For members of NAFTA, a virtuous growth cycle now depends on subjecting wage levels to global competitive pressures. Under a regime of trade-driven monetarism, inflation and relative price movements are seen directly to determine a country's external position and market share. Competitive labour markets as well as wages and working conditions are to reflect international competitive

conditions.(OECD, 1994)

As a social actor, Canada's trade unions are expected to be less of a social partner. Their index of power at the bargaining table has declined even if the level of unionization has not dropped as precipitously. With wages being put back in competition and subject to new global competitive pressures, a free trade zone becomes a key element redefining the terms and conditions of the existing capital-labour compromise.(Boyer, 1996; Albert, 1991)

Unions have always understood that global trade wars bid down the price of labour because companies are forced to produce more with less of everything. (Rodrik, 1997) This was not a problem so long as a country's exports and imports were only a small part of its gross domestic product. Once they are a major element and the economy is wide-open, the effect can only be seismic. Wages will stagnate and the purchasing power of families becomes more unequal across society unless governments intervene to correct growing inequality. So far Canadian governments have cut social safety nets and reduced the redistributive nature of many of their policies over the past decade. Since 1989, there has been a ten year fall in disposable income from \$18,639 to \$17,679.

With increased openness and reliance on the profitability of exports to fuel growth, Canadians should have seen a marked increase in the growth of their incomes, not a steady decline. Studies disclose that since 1990 Canada's after tax income has fallen 7 percent by the second quarter of 1998 from \$19,021 to \$17,644 measured in 1997 dollars. South of the border, real income in the US was up 9 percent from \$20,048 in 1990 to \$22,048 for the same period. Critically, Canadian's disposable income has declined dramatically when converted into US

dollars. In 1990, average take home pay was 80 percent of the US ( \$16,087) and now it is about 55 percent, (\$12,199) the largest gap in years.

The findings show that trade and income are more closely related today than any time previously but not in the way economists predicted. With an unemployment rate at twice the US level, fewer Canadians are working now than in 1990. The crucial difference is that the Canadian employment rate has fallen to 59.6 percent compared to 63.9 percent for the US. This is a huge gap that has grown from 0.7 in 1990 to 4.9 percent in the space of eight years. Economists now say that different income levels really spring from this source, more than any other.

John McCallum who has written extensively on this subject argues that almost all of the declining per capita income of the 1990s can be explained by the share of the population that had jobs. In 1990s, "the annual average growth rate of disposable per capita income slowed by 2.8 percentage points. Of this amount, two percentage points or 71% of the total was due to the reduction in the ratio of gainfully employed persons."<sup>8</sup> (McCallum 1995)

Previously when the economy was less integrated continentally, the export/import ratio was lower than it is today and jobs were more plentiful than they are today. This policy mix could better handle the large number of people entering the workforce and was better at supplying employment. Between 1977 and 1989 those who had a job rose from 41% to 46% of the population. Since 1989 the number of job holders fell to 43 percent in 1994 and the fall has been continuous since then. (McCallum, 1995) If the core of this analysis has validity, it is that trade liberalization is the wrong policy in highly competitive conditions. Free trade becomes job negative in many sectors particularly when, as Jackson argues, the integration process is almost

'exclusively that of deregulation'. (Jackson, 1997) In these circumstances, there is little cross-national equity in the way the gains from closer trade and investment ties are shared.

What makes this situation particularly acute is that the one area where Canadian firms could close the employment gap is in supplying a larger ratio of the intermediate inputs used by foreign firms. Trade in intermediate products should be an important aspect of this trade agreement and these inputs in the production of goods and services should be sourced locally in ever increasing amounts. (Weintraub, 1997:36) They provide a major opportunity for local and regional Canadian producers. If a high proportion of inputs are imported, there are no jobs or investment opportunities for them. Wilkinson (1997) has made the powerful case that many of Canada's consumer and capital goods industries have substantial proportions of imported inputs well over the average import content of about 25 percent. These include aircraft and aircraft parts, telecommunications, business machines, pharmaceutical products as well as the auto industry. Much of Canada's merchandise trade surplus disappears if one calculates the import content of various kinds of exports to the US. Wilkinson (1997:140) shows that Canada's \$20 billion trade surplus turns into a value-added deficit of \$4 billion once the adjustment is made for intermediate inputs.

By contrast, industries that have the greatest benefit to the domestic economy are those that have a high ratio of export to industry output; rely on the least imported volume of intermediate inputs; involve a very significant proportion of domestic value-added as a proportion of the export value; produce a substantial proportion of domestic jobs in relation to domestic value-added and finally entail jobs with higher- than-average salaries. Taken together industries

that meet these criteria contribute most to the domestic economy. The industries that approached this standard are the natural resource producing industries including agriculture, mining, crude petroleum and natural gas. They had the best score ranked by domestic output, employment and income benefits. It is hard to see any substantial body of evidence that highly innovative cross-border networks 'are becoming more pervasive and intensive ' as a result of NAFTA in North America.

Canadians and Americans may increasingly share one market but they do not live in a single economy. Manufacturing firms have sharply contrasting continental strategies in place even in the energy and transportation industries. In terms of measurable economic gains for Canadian industries, outsourcing is still carried out within highly organized US corporate structures and strategies that do not appear to have changed greatly despite the emergence of an integrated North American economy. Corporate restructuring has been driven first and foremost by US stock values and stockholders capital. US trade law, investment flows and corporate restructuring remain the primary force pushing the integration agenda forward. Even here the evidence of US multinationals building a single continental market has been overstated. Cross-border corporate integration has been less far-reaching than most governments realize.

### **FORWARD INTO THE PAST: THE DISAPPEARING LEVEL PLAYING FIELD**

The administrative, legal and non-legal procedures for adjudicating trade disputes are a mainstay of any trade agreement. For Canadian authorities the compelling reason to join NAFTA was to build a level playing field between the three signatories. Since the signing of the legal accord, this path-breaking trade agreement has not ushered in a new era of Canada-US relations.

Critically, the legal text did not establish any harmonization of commercial laws between the three signatories with respect to unfair trading practices and the use of subsidies. This 'silence' in the final text particularly disadvantages Canadian and Mexican firms who lose claims in front of the trade panels because US exporters are able to manipulate the complexities of the US commercial regulatory system in their favour. (Morales, 1997)

Influential supporters of NAFTA such as Alan Gottlieb and Michael Hart, who often write about NAFTA affairs in the influential Canadian newspaper, *The Globe & Mail*, now admit that cross-border disputes have increased in many areas that were thought to be conflict-proof once NAFTA came into effect. These include: the continuation of the voluntary export restraints that hurt BC lumber producers, new border disputes by US customs officials at border crossings that arbitrarily have denied access to Canadians from working in the US even when they have proper documentation roadblocks by US officials in South Dakota preventing Canadian hog exports from entering the US, the erection of new non-tariff barriers by US health officials to limit Canadian exports in food trade, new legal battles on Ottawa's decision to limit split-run advertising in US magazines published in Canada, and the decision by US authorities to contest Canadian wheat exports.<sup>9</sup> This is but a small sampling of the continued ability of US exporters and US officials to harass Canadian (and Mexican) exporters largely with impunity. Under NAFTA they can do much more. The text permits US authorities to take retaliatory measures against Canadian exports that are found to cause US companies trade injury as defined under US trade law.

Contrary to the popular perception, nothing in NAFTA establishes new procedures, practices or norms independent of US trade law. The heart of the problem is low US

administrative standards and US trade laws which “are biased in favour of the home plaintiff.” Tests for trade injury favour US industries – the subsidies of the US plaintiff are never investigated – and trade disputes are regularly used by “US industries to obtain protection or shelter from foreign competition.” (Rugman and Anderson, 1997:936)

Since NAFTA came into force there have been more trade disputes, some rather routine. But many are large and important in the areas of agriculture and seafood, natural resources, industrial and manufactured products and iron and steel products. Canadian cattle exporters face the possibility of being hit with anti-dumping and countervailing duties. More than \$1 billion (Canadian) in exports are at risk. The US has targeted state trading enterprises such as the Canadian Wheat Board as another major problem in international trade. As well, lumber has become a major source of conflict between the two countries. The US forced Canadian authorities to impose voluntary export restraints on softwood lumber exports contrary to the spirit and intent of NAFTA. If there is no resolution of this dispute the US has indicated that it will likely expand the scope of the lumber agreement to include processed lumber and possibly furniture products. (see Hussain’s chapter in this volume)

In total under Chapter XIX, there were 49 new appeals against countervail and anti-dumping decisions taken by Canadian and US authorities -- 21 were reviews of Canadian determinations and 28 were by US authorities. In 65% of the cases, the original decision of the US agency was upheld; by comparison only 35% of the appeals supported the decision of the Canadian agency. Rugman and Anderson (1997) argue that US administrative practice is so ad hoc and arbitrary that there is no level playing field. This is so because foreign firms have fewer

legal rights under US trade law than the domestic parties to a case. Nothing in NAFTA has changed this embedded administrative bias.<sup>10</sup>

With US being able to rely on its own trade laws, Washington has imposed tough new rules on its partners with respect to the formation of public policy without any increase in discipline on US practice and policy. Because it is a trade agreement, NAFTA has to be interpreted and in the North American case, the interpretation rests in the final analysis with the US Congress, lobby groups and US trade tribunals. This gives Washington the right to guarantee US investors and producers their property rights and to minimize their transaction costs. This raises the question of whether US trade law violates the right of national treatment, one of the fundamentals of this trade deal, with respect to Canadian and Mexican litigants.

What is unique about NAFTA is that there is no impartial third party review of non-compliance by governments to any of its provisions. Under its terms, Washington is entitled to review all Canadian and Mexican legislation to see whether the 'offending legislation' (a) impinges on the NAFTA's investment provisions and (b) whether any proposed legislation, particularly with respect to government policy, directly or indirectly fails to extend full protection to US investors. On the other hand, for the US NAFTA creates no new significant norms in American practice, policy or outlook. The US implementing legislation makes this perfectly plain. Wherever there is a conflict between the provisions of the NAFTA and US law, US law will prevail. (Appleton, 1994) There is no evidence that US tribunals feel restricted by the text. It is hard to find any significant change to US administrative law which restricts US practice since the NAFTA has come into force. For instance, the US has not amended its trade laws to raise the

'bar' to determine trade injury that would be a significant step to preventing US firms from using American trade law for harassment purposes. Even the side deals with respect to human rights or other kinds of labour violations carry with them no penalty to enforce US multinationals adoption of any of the tribunal rulings.

The dilemma facing Ottawa and Mexico is that even when a bi-national panel created to arbitrate disputes under NAFTA upholds Canada's (or Mexico's) side, it does not mean that Canadian exporters have won a victory. An unfavourable decision provides American producers further grounds to press for a new investigation as they are entitled to under US trade law. While bi-national panels were supposed to deliver binding decisions, clearly, this is not so. In the recent case involving wheat exporters, US farmers continue to charge that Canadian wheat subsidies are unfair and that they can demand another anti-dumping investigation even though three panels have ruled that Canadian wheat is not subsidized according to existing practices. Canada's trade minister acknowledged that there is little he can do if the US trade representative decides to launch anti-dumping action. (*Globe & Mail*, 1998)

For Mexico, there have been only a handful of cases perhaps because many Mexican firms do not have the resources to finance a panel dispute and the fact that the entire process takes at least a year, if not longer. (Morales, 1997) More important is the fact that Mexico defends its right to maintain state practices labelled as 'restrictive by US agencies. Mexican authorities have insisted on testing products entering the country to determine whether they meet their technical standards. In the area of phytosanitary standards, it has introduced emergency standards that impede the entry of grains, citrus, cherries, cling peaches and Christmas trees. Washington has

also repeatedly complained about the failure of the Mexican authorities to protect intellectual property and prosecute pirated versions of cassettes, compact disks and videos. Mexico continues to have a list of exclusions for government procurement as permitted by Pemex and the Federal Electrical Commission. US trade authorities have complained that Mexican customs procedures are often changed arbitrarily and without sufficient notice but with little concrete results for their effort.

In any event with the devalued peso Mexican firms have a very strong competitive point of entry into the US market and have seen their access broadened. The longer term consequences is that granting US investors the 'right of national treatment and national presence' eliminates to a significant degree the discretionary authority of Canadian and Mexican authorities to favour local firms, communities, regional authorities and industries, measures that are a critical component of a viable industrial strategy. US authorities are extremely tough and vigilant in protecting US interests. From their perspective anything that moves across borders must be subject to liberal market precepts and any departure or 'exception' from the rules discriminate against US investors. This policy does not admit the need for national diversity in sensitive policy areas including culture, social policy, the environment and the labour market. Nor is there any possibility for partial exemptions such in the area of culture that Canadians mistakenly believed was 'off the table' because it received some legal protection in both the FTA and NAFTA.

This kind of crude exercise of market power that blatantly favours the dominant member of the bloc has no parallel in the European community. Large and small members are bound by the decisions of the European Court. In this important way, the European Community has

developed a capacity to reduce the big power influence syndrome within its institutional de facto power of the governors' of the central banks of members states to set the Community's framework. But so far, in a multitude of other ways, the EU's democratic deficit as well as the framework monetary policy underlines just how much asymmetry continues to haunt the European integration.

## **CONCLUSION**

NAFTA promised much on theoretical grounds once trade barriers were reduced. Private firms would be forced to produce at world-competitive costs rather than being subsidized behind tariff walls. Increased competitive pressures would force a reallocation of resources from declining industries to growing industries. While this would have obvious negative impacts on specific sunset industries, the overall effect on business was supposed to be positive because Canadian firms would have larger access to the high-income US market. With this step up, they were supposed to be able to develop new products without having to first establish a niche in the smaller Canadian market. Little of this has happened. The initial growth scenarios were exaggerated; the job creation projections wrong and the expected benefits from the economies of scale largely ephemeral. FDI flows for Canada have neither surged nor declined in the post-NAFTA era. For Mexico they turned negative. (Studer, 1999) Even the trade dispute resolution procedures which to many appeared to be a significant step forward have proven to be badly flawed. Canada and Mexico were searching for finality and the improved dispute resolution has left US protectionist sentiment uncapped. Five years of NAFTA have not created a stable and efficient environment, the principal selling point of this agreement when first negotiated. (Morales,

1997:133)

Trade also has become so broadly defined that it now includes almost practically everything that moves. This too necessitates a departure from the evaluative practices employed in the past to calculate the gains from NAFTA. Thinking outside the box requires new standards of assessment. For instance, it is not acceptable to subtract exports from imports and expect to find the job loss rate. Further, it is almost impossible to disentangle monetary from trade effects. Finally, it cannot be assumed that industries that benefit from tariff reduction will outperform industries that are protected unless this is controlled for. In highly integrated economies the fact is that exports are no longer driven principally by a negotiated trade agreement, but many independent factors such as the business cycle of the dominant partner, the exchange rate and the global price for resources.

Seen in this perspective it is a mistake to artificially examine the benefits from trade liberalization in narrow historically bound time frames. Most of the benefits from forming this continental market likely antedate signing of this formal trade agreement and are a result of a longer process of gradual trade liberalization rather than the Agreement itself. Even so simple a matter as the link between productivity and wage growth cannot be presumed. In many industries each one percent increase in productivity is accompanied by a decline in earnings. Nor does increased access via NAFTA lead automatically to job enhancement, increased productivity growth at the firm level and fewer jobs. In many cases, production workers in exposed firms have no prospect of export expansion because small and medium-sized firms do not have the resources to spend to retool and diversify into new product markets.

Trade agreements require institutions to make them function effectively even those that are market-oriented like NAFTA. Without this dimension, it is only a matter of time before extreme differences in government practice begin to reappear in trade and investment matters as well as other areas of public policy. Asymmetry is likely to increase because it is more difficult for members of the trade bloc to pursue expansionary policies . (Jackson, 1997) The process of adjustment becomes more unmanageable because of increased capital mobility and absolute comparative advantage issues. (Shaikh, 1996) Trade access too grows more unpredictable because of the increase in trade-inspired protection and trade diversion. (Weintraub, 1997) When this occurs a top-rated trade policy initiative such as NAFTA loses its place in the policy hierarchy and becomes but one more policy fundamental in a much bigger political universe.

The fact that the structural transformation of the economy has not happened to anywhere near the degree that experts predicted has made it easier to understand – though not necessarily accept– the fact that the regulatory agenda embedded in NAFTA has many tangible, fixed limits. Probably the most important is while the regulatory pressures for continental integration have been intense, the functions and structures of the Canadian state remain surprisingly intact and the expected signs of cross-the-board convergence with the US model have not occurred. At times Ottawa is unexpectedly activist in intent with more of a policy arsenal at the ready in the area of culture and health in particular but also in social policy. It still has a large amount of public policy space but the collective psychological of the elites is to depreciate the regulatory functions of the state and rely on the meta-narrative of globalization to defend its neo-liberal agenda.

Certainly, downsizing has made Canada's public domain smaller than it once was but it is

still better resourced than its US counterpart. Spending cutbacks have reduced the effectiveness of Canada's social security net but they are still more important than anything in the US.

Canada's commitment to a redistributive model of federalism is still the defining element between the two countries notwithstanding the fact that social cohesion is under tremendous stress much weakened by Ottawa's rigid application of monetarism.<sup>11</sup>

What is clear is that the much smaller Canadian state is not converging to the US model and that Canada has a significant policy arsenal to disregard the powerful dictate of the continental market. For example in terms of taxes, both Canadians and Americans are paying more taxes since 1990. The US tax bill has increased from 16.9 percent to 19.3 percent while the equivalent figure for Canada has climbed from 22.7 percent to 25.1 percent, an increase of 2.4 percent in both cases. (Little, 1998) Tax rates have not converged and if anything the gap between tax rates has increased since NAFTA was signed. In Canada top-middle class tax rate kicks in at around \$63,400. The US taxpayer hits the lower top marginal rate at an income of \$263,750 and US capital gains will be taxed at less than one-half the Canadian rate. (*Globe & Mail*, 1999) In terms of taxes and spending, total government tax revenues in Canada are still about 30 percent higher than in the US. Total government taxes and other revenues in Canada reached about 43 percent of GDP a rise of about three percentage points in 1985 while the US figure has remained at the 30 percent mark since the early 1970s.

In other areas the inequalities between Canadians and Americans have sharpened. Americans are richer than Canadians as measured by real disposable income per capita. Certainly the record low exchange rate has not only failed to deliver the record trade gains but the domestic

sector is constrained by the loss of spending power and falling consumer confidence. Unlike the US consumer who has seen real per capita incomes rise by about 11 percent since the 1990 recession, Canadian consumers suffered a 7 percent decline in real purchasing power. (Wood Gundy, 1998) Income differences are only part of the story; inequality is the other part. In the US income polarization has been absolute, unprecedented and on a scale that exists in no other country. In Canada too economic inequality as measured by income has increased absolutely for low-income and single-parent families. According to a recent Canadian Council for Social Development Study, “overall, the income security system reduces income inequality among Canadian households.” (CCSD, 1998) These programs are less effective than previously but they do redistribute funds to low-income households” on a scale unknown in the US.<sup>12</sup> Canada's social programs are more extensive, comprehensive and generous than their US counterpart. The money collected by governments and redistributed in the form of income security benefits remains ‘critical to the economic security of Canadians. (Ibid.)

In the area of the labour market the US has become the prototype of the union-free workplace. US workers have less security and fewer benefits than any time since the Great Depression. Industrial collective bargaining covers less than 10 percent of private sector employees. Here also the gap between Canadian practice and US standards is wide and has grown sharper since NAFTA was signed. Close to forty percent of Canadian workers are covered by collective bargaining agreements and while many of the industrial unions have seen their ranks diminished, collective bargaining is the norm and not the exception in Canada. Canada's unions are less successful at the bargaining table than ever but Canadian workers have unions that are

effective, linked to social movements and have been politicized by the era of continental free trade.<sup>5</sup>

What these indicators tell us is that there is a conceptual confusion between absolute and relative kinds of change. In a comparative perspective Canada's institutional structures more than any set of focussed government policies continue to resist the logic of the continental market. Inside Canada the view from below is vastly different. It appears that the structural transformation of society is unparalleled and irreversible. So which is it? To an important degree, it is both. As the big trade deal has become unstuck in ways that no one could have predicted, the flow-through effects of economic deregulation do not support the larger agenda of political integration any longer. With so much divergence borders do matter and trade and investment continue to have strong national dimensions. Trade dynamics are not like a 1-800-number, a virtual reality. The empirics of this chapter stand in sharp contrast to the meta-narrative of free trade and the discourse of continental integration. Still it is a chronicle that needs deepening as policy outcomes are less closely linked than ever.

**ANNEX I**  
**FREE TRADE IN NORTH AMERICA: PREDICTION vs OUTCOMES**

<b>Indicator</b>	<b>Prediction</b>	<b>Actual Outcome</b>
Challenges to government regulation	Moderate but not threatening to Canadian sovereignty. A new Canada-US relationship envisaged with a level playing field	Dramatic reduction in federal spending driven by zero inflation and zero deficit targeting. Federal spending as % of GDP drops to 1950s levels
Future of Autopact	Neutral	Global overcapacity more important. Canada maintains share of new investment and production. CAW proves an astute bargainer at the table.
Investor protection	Significant increase in investor rights	Many new conflicts created by NAFTA provisions in a range of sectors with respect to national treatment. Most of the conflicts are in agriculture and cultural areas.
Capital mobility	Increases	Underestimated capital volatility and reverse flows. Canada share of new investment flows no greater or less than previously. FDI is not driven by NAFTA text but by US shareholder capital.
Mexico's economic inequality	Seen to decrease as free trade accelerates the modernization of the economy	Dramatic fall in incomes and rise in unemployment. Mexican small business has collapsed while worker productivity is up 36 percent since NAFTA was signed but wages fell 29 percent between 1993 and 1997
Cost of regulation	Decreases	Little evidence of sharp reduction in regulatory costs – Canadian Business organizations complain about increase in users fees to the private sector

Indicator	Prediction	Actual Outcome
Wages	Income gains for well positioned workers in export industries	In Canada wage polarization deeper than anticipated. Little evidence of high income wage gains. In the US the growth of wage inequality explained by the growth of union-free workplace. Exchange rate for Canada and Mexico the key variable
Labour restrictive practices	Diffusion of US norms and more competitive labour markets post NAFTA	Collapse of US labour movement has less knock-on effects and predates NAFTA. Canadian labour has not gone down US road
Unemployment	With a stronger performance and stronger economy, unemployment levels to fall	Underestimated the magnitude of the job loss for many sectors but much job loss is not NAFTA driven.
Union bargaining power	Decrease	No significant decrease in collective bargaining arrangements in Canada but high levels of unemployment reduce the effectiveness of Canadian labour
Government decision making	Constrained	Impossible to attribute to NAFTA. Too many other competing agendas. Divergence across a broad range of policy areas is pronounced.
Exports	Sharp Increase	The record is mixed; US surplus of \$1.6 B with Mex. → deficit of \$14.6 B; deficit with Canada goes from \$16 B to \$22 b in 1996.

## BIBLIOGRAPHY

Appleton, Barry (1994). *Navigating NAFTA A Consise User's Guide to the North American Free Trade Agreement*. Toronto, Carswell.

Albert, Michel (1991). *Capitalisme Contre Capitalisme*. Paris, Seuil.

Betcherman, Gordon. (1992). "The Disappearing Middle." in Daniel Drache ed. *Getting on Track. Social Democratic Strategies for Ontario*. Montreal: McGill-Queen's U.P.

Blank, Stephen ,Stephen Krajewski, et al. (1995). "US Firms in North America: Redefining Structure and Strategy." *North American Outlook* 5:2(March).

Boyer, Robert (1996). The Convergence Hypothesis Revisited: Globalization but Still the Century of Nations? *National Diversity and Global Capitalism*. Berger, Suzanne and Ronald Dore. Ithaca, Cornell University Press: 29-59.

Boyer, Robert (1989). New Directions in Management Practices and Work Organisation:General Principles and National Trajectories. *Technical Change as a Social Process*. Paris, OECD.

Campbell, Bruce, Et. Al. (1999). *Labour Market Effects Under CUFTA/NAFTA* . A project prepared under the auspices of the Canadian Centre for Policy Alternatives (Ottawa) for the International Labour Organization (Geneva) Employment and Labour Market Policies Branch. Ottawa, Centre for Canadian Policy Alternatives.

CCSD (1998).....

Drache, Daniel (1996). "From Keynes to Kmart: Competitiveness in a Corporate Age." in Boyer & Drache eds. *States Against Markets: The Limits of Globalization*. London: Routledge.

Drache, Daniel & Andrew Ranachan. Eds. (1995). *Warm Heart, Cold Country. Social and Fiscal Policy Reform in Canada*. Ottawa, Caledon Institute.

Drache, Daniel and Cameron, Duncan (1985). *The Other Macdonald Report. The Consensus on Canada's Future That the Macdonald Commission Left Out*. Toronto: Lorimer.

Drache, Daniel and H.J. Glasbeek (1992). *The Changing Workplace Reshaping Canada's Industrial Relations System*. Toronto, Lorimer.

Drolet & Morissette (1998) "Recent Canadian Evidence on Job Quality by Firm Size"..... November.

- Economist, The (1994). *Happy ever NAFTA?* December 10<sup>th</sup>.
- Fortin, Pierre (1996). "The Great Canadian Slump." *Canadian Journal of Economics* (November).
- Globe & Mail* (1999) .....January 20.
- Globe & Mail* (1998). Declarations of International Trade Minister, Pierre Pettigrew, on trade disputes with the United States. May 8.
- Gottlieb, Alan (1998).....*Globe & Mail*.....
- Hart, Michael (1998).....*Globe & Mail*.....
- Jackson, Andrew (1997). *Impacts of the Free Trade Agreement (FTA) and the North American Free Trade Agreement (NAFTA) on Canadian Labour Markets and Labour and Social Standards.* .....
- Little, Bruce (1998) "Are Canadians Better Off in the 1990s" *Globe & Mail*, November 23.
- MacDonald, Michael (1999) "Free Trade Battles Expected to Rage in 1999" *Toronto Star*, January 6.
- McCall & Clarkson (1994).....
- McCallum, John (1995). *Why Have Canadian Living Standards Declined in the 1990's*, Royal Bank.
- Morales, Isidro (1997). "The Mexican Crisis and the Weakness of the NAFTA Consensus." *The Annals of the American Academy of Political and Social Science* 550 (March):130-152.
- Ontario, Government (1985). *Canada's Trading Relationship in a Changing World, Discussion Paper*. Toronto, Government of Ontario.
- OECD (1994). *The OECD Jobs Study*. Paris, Organisation for Economic Cooperation and Development.
- Picot & Dupuy (1998).....
- Porter, Michael (1991). *Canada at the Crossroads*. Ottawa: Business Council of National Issues and Minister of Supply and Services.

Rodrik, Dani (1997). *Has Globalization Gone Too Far?* Washington, Institute for International Economics.

Rubin, Jeff and John Lester (1997). "Has Free Trade Made Canadian Manufacturing More Efficient?" *CIBC Wood Gundy Economics Occasional Report* no.19 (September).

Rugman, Alan and Andrew D. M. Anderson (1997). "NAFTA and the Dispute Settlement Mechanisms: A Transaction Costs Approach." *The World Economy* (November): 935-950.

Shaikh, Anwar (1996). "Free Trade, Unemployment and Economic Policy" John Eatwell (ed) *Global Unemployment: Loss of Jobs in the 90s..* London, M.E. Sharpe.

Stanford, Jim (1996). "Social Structures, Labour Costs and North American Economic Integration A comparative modeling analysis." *Ph.D.*.....

Statistics Canada (1998).....

Studer, Isabel (1999). FDI flows and NAFTA. Seminar presentation, University of Toronto, February 1999.

Treffler, Daniel (1998). *The Canada-US Free Trade Agreement: An Assessment for Canadian Manufacturing.* Toronto, Institute for Policy Analysis and Canadian Institute for Advanced Research.

----- (1997). "No Pain, No Gain: Lessons from the Canada-U.S. Free Trade Agreement". *North American Commission for Labour Co-operation*, Berman Press: 25-42.

Weintraub, Sidney (1997). *NAFTA at Three. A Progress Report.* Washington D.C. Centre for Strategic and International Studies.

Wilkinson, Bruce (1997). "Globalization of Canada's Resource Sector", Trevor Barnes and Roger Hayter (eds) *Troubles in the Rainforest: British Columbia's Forest Economy in Transition.* Victoria, Western Geographical Press, Department of Geography, University of Victoria.

Wood Gundy (1998). *Forecast* (October)

## NOTES

<sup>1</sup> For purposes of this chapter, I am treating the FTA as the template for NAFTA and regard the two trade agreements as one entity even though there are important differences between the two. For instance, some of the energy and investment provisions apply only to Mexico and not Canada. NAFTA builds on the FTA and goes beyond it in the area of services and investment in particular. In other areas, NAFTA is a step up from the GATT at the time which has substantially changed in the Uruguay Round and the establishment of the WTO. See Appleton, 1994.

<sup>2</sup> The Foreign Investment Review Agency (FIRA) was mandated to review foreign direct investment to determine whether it was in Canada's interest to permit such takeovers of Canadian firms, mainly by US investors. Ninety-five percent of all US investment decisions reviewed were given the green light but the very fact that it was established as a review agency created the impression in Washington that Canada had erected significant barriers to US investors. The National Energy Policy (NEP) was the most forthright attempt to Canadianize the energy sector which was over 80 percent in foreign hands, mainly American. The NEP taxed the US multinationals and guaranteed Canadians a made-in-Canada energy policy that set domestic prices below those paid by the US consumer. Finally through its newly created public enterprise, Petrocan, Trudeau gave Canadians a fully integrated public enterprise committed itself to Canadianizing this sector from the oil field to the pump at the local filling station.

<sup>3</sup> Surprisingly, the maximal policy option of a comprehensive free trade agreement captured the public policy agenda quite easily. With the economy in deep trouble, Trudeau appointed the Macdonald Royal Commission to report on Canada's Economic Future in 1983 in the middle of the worst economic crisis of the postwar period. With unemployment levels in the double digit figures, job creation was negative, Canadian productivity poor and Canada's general economic future looked indeed bleak. The role of this influential commission was to propose new policy options to take Canada into the next century. Its recommendations were far-reaching, comprehensive and influential. It reported just after the Mulroney Government had been elected to office, the first conservative national victory in over 25 years. Its final report was decisive in paving the way for Ottawa to open free trade negotiations with Washington. The final report of the Macdonald Royal Commission legitimized free trade as the only framework for restructuring Canadian-American relations. (Drache and Cameron, 1985)

<sup>4</sup> In the late 1940s Ottawa had secretly negotiated a free trade deal but had backed out at the last moment fearing the political consequences of formalizing the continentalist policies that every Canadian administration had followed for the past 100 years. Canada's economics profession had long been an ardent supporter of free trade with the US. Yet, until 1985 the practitioners of the dismal science had never succeeded in convincing anyone in government that building a common market with the US was politically feasible.

<sup>5</sup> A decisive factor was the support from the The Business Council of National Issues, an elite grouping of the top 200 corporations that convinced the newly elected Mulroney government that

the free trade option was the policy of choice. With Keynesian-style social democratic policies having failed to kick start the economies of the Western world, free trade appeared to be the logical next step. It was relatively an easy case to make. In a period of high inflation, low growth and burgeoning government deficits this broad coalition of business, key government decision-makers in the Department of Finance and the economic profession convinced themselves without any real evidence that Canada had a window of opportunity to negotiate 'secure and enhanced access to the US market' despite an increasingly hostile and protectionist US Congress. There is no provision for the Canadian government to monitor, evaluate or review NAFTA should the benefits not materialize. Ottawa did not insist on a review mechanism nor has it any policy mechanism to monitor its effects and consequences. In theory at least, Canada can abrogate the treaty on six months notice but that would be difficult to do if the dominant US partner was opposed.

6. The US farm lobby had long opposed such publicly managed agricultural support systems on the grounds that Canada's state trading enterprises violated the principle of national treatment and involved the use of unfair subsidies that cheapened Canadian agricultural exports in the US market.

7. Noteworthy is the fact that there is no firm commitment from the US to dismantle any of its non-tariff barriers. Each year, Brussels publishes a 250 page list of non-tariff barriers that prevent access to the US market. None of these are to be phased out and there is no mention of these US practices in the final text of NAFTA.

8. McCallum (1995) found that US income growth slowed 1.7% a year between 1977 and 1989 most of this in the pre-FTA period to 0.9% and in the 1989-94 post-NAFTA period saw a remarkable drop of 0.9% between 1989-94. In terms of the sheer magnitude of the drop, the US falloff of 0.8 percent was much less than Canada's 2.8 percent percipient fall. McCallum isolates three factors where Canada fared worse: in labour participation rates -1.3% compared to -0.4% ; productivity growth -.03% compared to 0.5% and direct taxes -0.3% compared to 0.1%. The most significant was the share of the population that had a job at a time of massive amount of industrial restructuring driven by globalization and free trade.

<sup>9</sup>For detailed information on these trade disputes, see Imtiaz Hussain's chapter in this volume.

<sup>10</sup> See Rugman and Anderson 1997 for a detailed discussion of the complexity and bias of US trade law. It also contains a full listing of the anti-dumping and countervail cases heard under Chapter 19 panels.

11. Since NAFTA was signed cutting social spending became the top priority of Ottawa and many of the conservative-minded provincial governments. The Chrétien government, elected in 1994 as an alternative to the business-agenda of the Mulroney Tories, within a year of taking office launched the most extensive review of fiscal and social policy in four decades. (Drache and Ranachan, 1995) The Federal Budget of February 1995 proposed to cut government spending , in the space of three years, to its lowest levels since 1951. The Martin Budget has sent an

unambiguous message to Canadians that a tough-minded, continentally grounded neo-liberalism formed the new framework for governments at both the federal and provincial levels. As a result, the boundaries between the state, civil society and the market are less well demarcated than ever. However, in the 1999 Budget, Ottawa chose to spend \$12 billion on new monies for health care particularly and rejected appeals for deep tax cuts of the US style. This is evidence that Canada still has a redistributive model of federalism and has not blindly followed the US model of less state, less taxes.

<sup>12</sup>. Programs such as social assistance and the Guaranteed Income Supplement are specifically designed to provide assistance to the poor, and they lead to a reduction in income inequality. Other programs such as Old Age Security and the Canada and Quebec Pension Plans are directed more generally at Canada's senior population, but cutbacks have diminished their effectiveness in redistributing funds to low-income households. Other programs such as provincial social assistance provides support to the poorest Canadian households; other schemes, like the Child Tax Benefit, distribute money to a much broader range of income earners. And Employment Insurance – while covering a much smaller proportion of the unemployed than in the past – continues to provide benefits for modest-, middle-, and upper-income households (CCSD 1998).

<sup>13</sup>. See MacDonald (1999) for a sampling of trade union and popular sector views.