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Debunking the Myths: A Review of the Canada-US Free Trade Agreement and the North America Free Trade Agreement

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Executive Summary[1]

Most economists would agree that free trade is an essential component of sound economic policy. By exposing national markets to international competition, free trade works to ensure that nations produce goods and services according to their comparative advantage. This encourages an efficient allocation of resources and allows individuals in each country to consume the largest possible bundle of goods and services.

Although the merits of free trade are widely accepted by economists and policy makers, criticism of free trade as sound economic policy is still widespread. In both Canada and the United States, critics of free trade attract substantial public attention. Protectionists and economic nationalists argue that free trade causes economic ruin and the loss of national identity. According to these critics, the Canada-United States Free Trade Agreement (FTA) and the North American Free Trade Agreement (NAFTA) among Canada, the United States, and Mexico are the source of significant economic hardship in both Canada and the United States. The public finds these claims persuasive because they have considerable emotive appeal and provide an easy explanation for particular economic developments.

Ten years have passed since the signing of the Canada-United States FTA. The time is ripe, therefore, to review the economic case for free trade and to scrutinize the arguments made by critics of free trade. A careful analysis of their arguments combined with an examination of the empirical data reveals that the claims made by economic nationalists and protectionists about the negative impacts of free trade on the Canadian economy are incorrect or exaggerated.

(1) Jobs have not been lost as a result of either NAFTA or the FTA. Neither economic theory nor the empirical evidence give us reason to believe that there has been a net loss in employment on account of free trade. Job losses experienced in the early 1990s were due to a decline in overall macroeconomic conditions that was entirely unrelated to the free-trade agreements. Moreover, total employment has been rising, not falling, in both Canada and the United States over the past several years. In Canada, total non- agricultural employment has risen from 12.4 million in 1988 to 13.22 million in 1996. In 1997 alone, the Canadian economy created an additional 324,000 full time jobs. Hence, fears of massive job losses due to free trade are without empirical foundation.

(2) Lower wages in Mexico have not caused jobs and investment to migrate to Mexico. Furthermore, free trade has not resulted in Canadian wages falling to Mexican levels because Canadian workers are considerably more productive than Mexican workers. Indeed, statistics from the Organisation for Economic Cooperation and Development (OECD) show that Canada's *unit labour costs* are lower than Mexico's. Furthermore, Statistics Canada data show that average weekly earnings and average hourly wages have been rising, not falling, in Canada over the past few years.

(3) Canada's manufacturing base has not been destroyed as a result of the FTA or NAFTA. Manufacturing as a share of total output has remained fairly constant over the past several years. The share of Canada's gross do-

1 The authors would like to thank Jason Clemens, Stephen Easton, and Michael Walker for helpful comments and suggestions. Many thanks also to Joel Emes for assistance in preparing the graphs.

mestic product (GDP) due to manufacturing was 19.2 percent in 1988 and declined only marginally to 17.3 percent in 1996. This does not signal the destruction of the Canadian manufacturing base.

(4) Canada's agricultural sector will become more, not less, competitive as a result of free trade. Furthermore, losses to producers will be outweighed by gains to consumers in lower prices and increased product variety.

(5) NAFTA will not undermine Canadian food-safety and health standards. If anything, NAFTA encourages upward harmonization of such standards across the three countries.

(6) Canada will not become more vulnerable to arbitrary trade actions from Congress as a result of NAFTA or the FTA. Indeed the effect of NAFTA and the FTA is to increase the security of Canadian access to the U.S. market.

(7) Environmental standards will not decline as a result of NAFTA. Both economic theory and the empirical evidence suggest the opposite. In Canada and the United States, environmental quality, as measured by a number of indices, has improved over the past twenty years. International trade fosters faster economic growth which in turn raises environmental standards. As Mexican incomes rise, environmental quality will likely improve there as well.

(8) National sovereignty is not lost as a result of either NAFTA or the FTA. Globalization does not spell the end of the nation state. Indeed, government's share of GDP in Canada has increased from 13.3 percent in 1920 to 44.7 percent in 1996, in spite of increased international trade and investment over the same period. This pattern is mirrored in nearly every OECD country.

Hence, the evidence sharply contradicts the alarmist claims of protectionists and economic nationalists. There is no evidence to suggest that either NAFTA or the FTA have caused the economic destruction of Canada. The gloomy predictions made by protectionist doomsayers like Maude Barlow and Mel Hurtig about the impacts of free trade on the Canadian economy have not materialized. Therefore, the practical case for pursuing a policy of free international trade remains as strong as ever.

Introduction

> If there were an Economist's Creed, it would surely contain the affirmations "I understand the Principle of Comparative Advantage" and "I advocate Free Trade." For one hundred seventy years, the appreciation that international trade benefits a country whether it is "fair" or not has been one of the touchstones of professionalism in economics. Comparative advantage is not just an idea both simple and profound; it is an idea that conflicts directly with both stubborn popular prejudices and powerful interests. This combination makes the defence of free trade as close to a sacred tenet as any idea in economics. (Krugman 1987: 131)

As the renowned international trade economist Paul Krugman notes in the quotation above, economists have long recognized that free trade is the cornerstone of a sound economic policy. Free trade raises economic welfare because it enables national economies to specialize according to their comparative advantage. When economies specialize in the production of those goods at which they have a comparative advantage, they can trade these items for other goods that the consumers in that country value but are less efficient at producing. Free trade therefore allows individuals to consume more than would be possible in the absence of trade. It is in this way that a policy of free trade raises national income and increases economic well-being.

Perhaps more than any other time in history, ours is an era of relatively free trade among nations. Since the end of World War II, super-governmental organizations like the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO) have promoted freer multilateral trade among nations. From the Kennedy Round in the 1960s to the Tokyo Round in the 1970s and, most recently, the Uruguay Round of the 1980s, the GATT has sought to reduce barriers to trade among nations and promote a more open trading environment. Meanwhile, the European Union (EU), Asia-Pacific Economic Cooperation (APEC) and agreements like the North American Free Trade Agreement (NAFTA) have worked to reduce barriers to trade on a more regional level. The proliferation of free trade arrangements among nations reflects the extent to which the wisdom of free trade as an economic policy has gained broad political acceptance.

Trade liberalization has formed a major part of Canadian economic policy in recent history. Ten years has passed since the signing of the Canada-United States Free Trade Agreement (FTA). The addition of Mexico to the FTA resulted in the formation of the North American Free Trade Agreement (NAFTA), creating the world's single largest free trade zone.[2] Yet, in spite of general agreement among economists and policy makers about the desirability of these developments, criticism of free trade as a sound economic policy continues unabated and critics of free trade continue to attract considerable public attention. In the United States, protectionist politicians like Ross Perot and Pat Buchanan enjoy substantial public support. In Canada, the opinions of nationalist anti-free trade crusaders like Maude Barlow, Mel Hurtig, and the Council of Canadians resonate throughout the country. According to Barlow, Hurtig, and others, free trade has ruined the Canadian economy and resulted in the

2 Some Canadian trade statistics are provided in the Appendix.

"sale" of Canada to foreign multinationals.[3] In addition, it is claimed that free trade is responsible for destroying thousands of jobs and has undermined the ability of governments to intervene in the economy.

The purpose of this study is to analyze critically the claims of these opponents of free trade in light of the empirical evidence. Now that we have reached the tenth anniversary of the Canada-United States Free Trade Agreement, the time seems ripe to embark on such a task. We begin by outlining the economic arguments for free trade. This is followed by a discussion of regional versus multilateral free trade with special focus on the FTA and NAFTA. We then consider non-economic reasons for the pursuit of regional trade agreements. Finally, we proceed to dissect several of the major claims made by the opponents of free trade about the effects of NAFTA and the FTA. We find, in each case, that the claims made by protectionists about the impacts of free trade on the Canadian economy are either exaggerated or completely false. Free trade has not ruined the Canadian economy. Rather, free-trade policies have increased economic growth and raised economic welfare, precisely as the standard arguments in favour of free trade predict.

The Economic Case for Free Trade

Comparative advantage, trade, and technology

The standard economic argument offered in support of free trade is straightforward. Free trade is beneficial because it induces countries to produce according to their comparative advantage.[4] When countries specialize in the production of goods at which they have a comparative advantage, the value of national income is maximized. Trade enables countries to sell these goods on the world market and exchange them for other goods which domestic consumers value but are not particularly good at producing. Hence, by encouraging domestic producers to specialize in the production of those goods at which the country has a comparative advantage, free trade creates more wealth than would be possible if the country had to produce everything on its own. With this greater wealth, domestic consumers are able to consume more of both domestic and foreign goods. This raises overall economic welfare.

An important insight that can be derived from this standard model of international trade is that no country loses as a result of free trade. When a country moves from autarky to a free trade regime, national income rises and consumers are able to buy more of all goods.[5] These gains from trade will arise even when one country is, in absolute terms, less efficient in the production of all goods (Pomfret 1991). The fact that all countries, regardless of their productivities will gain from trade is a powerful endorsement of the potential for free trade to raise real incomes in all nations.

3 See, for instance, Hurtig 1991 and Barlow 1990.

4 This model of trade is usually called the Ricardian Model and is named after the famous nineteenth-century classical economist, David Ricardo. See Ricardo 1817.

5 Autarky is a situation where there is no international trade.

Another way of thinking about trade is to view it as simply another technology for the production of goods.[6] To understand this idea, consider the following example. There are two technologies available for the production of cars in Canada. The first technology involves the physical production of cars in factories in south-western Ontario. The second technology involves growing wheat in Saskatchewan and exporting wheat to Japan in exchange for cars produced in Japanese factories. While the two technologies may differ in terms of the "inputs" used, the net result is the same: Canada gets the cars. Whether Canada should use the first or second technology should depend only on which one enables Canadians to get more cars.

Most people would probably agree that technical progress—being able to produce more goods and services with fewer inputs of labour, capital, and other factors of production—is desirable because it enables us to use scarce resources more efficiently, Indeed, most economists would argue that technical progress is what drives economic growth and the creation of wealth (Lipsey 1996). Yet it is curious that while most people would be in favour of using the most efficient methods of production available, many of these same people object to free international trade. This is illogical because free trade is simply another technology for the production of goods and services, and, in some cases, it is the most efficient technology available. If technological progress is desirable because it drives growth and prosperity, then so is free trade.

More sophisticated trade models

Of course, the standard economic model of trade discussed above is not the only way economists think about free trade. Although the Ricardian classical trade model is certainly the most intuitive international trade model, it has generally not been the model of trade preferred by academic economists. For a variety of reasons, most neoclassical international trade economists have, until quite recently, preferred to think about trade in terms of the more sophisticated Heckscher- Ohlin-Samuelson Model.[7] While the motivation for trade in this model is somewhat different than in the simple Ricardian model,[8] the general conclusions about trade policy are the same: the welfare of all nations rises as they move from autarky to free trade (Pomfret 1991; Jones 1987). Hence, the case for free trade remains intact even in the more complicated Heckscher-Ohlin-Samuelson Model.

In the last 20 years, trade theorists have developed alternative models of trade that, at least at a theoretical level, have called into question the optimality of a free trade policy. The distinguishing feature of these models is that they depart from the standard assumptions about perfect competition and allow for imperfectly competitive market structures and scale economies. According to the "new trade theory," it is possible under particular circumstances for nations to raise their welfare by introducing protectionist policies. For instance, in two very influential papers, Brander and Spencer (1983, 1985) demon-

6 This approach to understanding trade is taken from James Ingram (1966).

7 The Heckscher-Ohlin-Samuelson Model is sometimes called the Factor Proportions Model of Trade.

8 What distinguishes the Ricardian model from the Heckscher-Ohlin-Samuelson model is that in the Ricardian model trade is driven by technological differences across countries while in the Heckscher-Ohlin-Samuelson model all nations are assumed to have the same technology. The motivation for trade in this model is differences in factor (i.e. resource) endowments. See Pomfret 1991.

strate that export subsidies and import restrictions can, under certain conditions, deter foreign firms from competing in profitable domestic markets. This approach to understanding international trade has been refined by other authors and is generally called "strategic trade theory." Other scholars have noted that, when there are significant externalities associated with a particular industry—particularly knowledge-based externalities resulting from research and development expenditures—a policy of protection can raise national welfare (Cordon 1974). While there are many variants of the new trade theory, the general conclusions call into question the optimality of free trade as an economic policy.

Is free trade still optimal?

Demonstrating that free trade may not be the theoretically optimal policy does not necessarily discredit free trade as a rule of thumb to good international trade policy in the real world. In fact, Paul Krugman, one of the major contributors to the new trade theory, argues that it is so difficult to implement successful state intervention that we would be foolish to follow any policy other than free trade (1987, 1993a). In Paul Krugman's view, practical considerations—informational constraints on the part of policy makers, general equilibrium concerns, the possibility of retaliatory trade wars, and rent-seeking domestic politics—may result in a strategic trade policy causing more harm than good. Krugman writes:

> If the potential gains from interventionist trade policies were large, it would be hard to argue against making some effort to realize these gains. The thrust of [my] critique ... is that is that the gains from intervention are limited by uncertainty about appropriate policies, by entry that dissipates the gains, and by the general equilibrium effects that insure that promoting one sector diverts resources from others. The combination of these factors limits the potential benefits of sophisticated interventionism. Once the expected gains from intervention have been whittled down sufficiently, political economy can be invoked as a reason to forego intervention altogether. Free trade can serve as a focal point on which countries can agree to avoid trade wars. It can also serve as a simple principle with which to resist pressures of special-interest politics. To abandon the free trade principle in pursuit of the gains from sophisticated intervention could therefore open the door to adverse political consequences that would outweigh the potential gains (1987:143).

Hence, in spite of recent theoretical developments, the practical case for free trade remains strong. Sophisticated intervention, according to Krugman, may ultimately cause more harm than good. Therefore, the principle of free trade should remain the cornerstone of a sound international economic policy.

GATT versus the FTA and NAFTA: multilateralism versus regionalism

Broadly speaking, there are two processes by which countries can liberalize trade. The first approach, usually called multilateralism, involves the gradual reduction of trade barriers among a very large set of countries. The GATT process and the various round of trade reductions which occurred under the Kennedy, Tokyo, and most recently, Uruguay Rounds are examples of multilateralism.

The other approach to trade liberalization involves the reduction and/or elimination of trade barriers among smaller groups of nations that are, typically, geographically contiguous. This approach to trade liberalization is called regionalism. The Canada-United States Free Trade Agreement (FTA), the North American Free Trade Agreement (NAFTA), the Australia-New Zealand Free Trade Agreement, and the European Union (EU) furnish examples of regional trade liberalization.[9] Nations that belong to the GATT are permitted to engage in such regional trade initiatives under the GATT Article XXIV.[10]

Given the choice, most international trade scholars would prefer trade liberalization to occur on a multilateral as opposed to a regional basis. The preference for multilateral over regional trade liberalization stems from concerns about the possible "trade diverting" effects of regional trade agreements.[11] To illustrate the concept of trade diversion, consider the following example. Suppose Canada, as a result of NAFTA, eliminates its tariff on Mexican textiles but not on Indonesian textiles. Since a tariff is eliminated, domestic textile prices fall and Canadian consumers will buy more textiles. However, because the tariff structure now favours Mexico, it is likely that textile imports to Canada will be "diverted" from Indonesia to Mexico. If Mexico is at least as efficient as Indonesia in the production of textiles, then economic welfare is improved: consumers get more textiles and they purchase them from the producer having lower costs. However, if Mexico is a less efficient textile producer than Indonesia, then economic welfare is diminished because Canada is importing from a producer having higher costs. If Canada had reduced tariffs on both Indonesian and Mexican textiles (*i.e*. if Canada had pursued multilateral as opposed to regional trade liberalization), then this problem would be avoided: consumers in Canada would get more textiles and they would purchase them from the most efficient producer. Hence, because regional free trade agreements can result in trade diversion that could reduce economic welfare, most economists prefer multilateral to regional trade liberalization.

Of course, whether or not regional trade initiatives like the FTA or NAFTA are the cause of significant trade diversion is ultimately an empirical matter. Unfortunately, on this particular issue, there is little empirical evidence. It is interesting to note, however, that while all economists recognize the potential for regional trade agreements to cause trade diversion, many are skeptical about its empirical relevance. For instance, in a recent symposium on regional trade blocs, Lawrence Summers, a Harvard economist and now Deputy Secretary of the United States Treasury, writes that he "find[s] it surprising that this issue [*i.e*. trade diversion] should be taken so seriously—in most other situations, economists laugh off second best considerations and focus on direct impacts" (1991: 299). Summers also argues that since trade blocs such as the FTA, NAFTA, and the EU are usually formed amongst countries that are natural trading partners in the sense that the bulk of their trade would be with each other regardless of the trading regime, the likelihood of trade diversion is minimal:

9 It is important to distinguish among different types of regional trade initiatives. A "free trade area" is formed when a group of countries agrees to reduce tariffs amongst themselves but each country is allowed to set its own tariff level with other (non-member) countries. NAFTA, for instance, establishes a free trade areas among Canada, the United States, and Mexico. A "customs union" occurs when a group of countries not only reduces trade barriers amongst themselves but also agrees to set common external tariffs. The European Union is an example of a customs union.

10 For a succinct discussion of regionalism versus multilateralism and the GATT rules, see Bhagwati 1991.

11 The potential for regional trade agreements to cause trade diversion was first identified by Viner 1950 and was later expanded by Lipsey 1957.

> Are trading blocs likely to divert large amounts of trade? In answering this question, the issue of natural trading blocs is crucial because to the extent that the blocs are created between countries that already trade disproportionately, the risk of large amounts of trade diversion is reduced (1991: 297).

In a similar vein, Paul Krugman writes:

> If a disproportionate share of world trade would take place within trading blocs even in the absence of any preferential trading arrangement, then the gains from trade creation within blocs are likely to outweigh any possible losses from external trade diversion (1991: 21).

Hence, there are reasons to believe that the costs of pursuing a regional as opposed to a multilateral trade liberalization strategy are likely to be small relative to the potential gains.[12] Without question, Canada, the United States, and, to a lesser extent, Mexico qualify as "natural trading partners." Even before the FTA, the overwhelming bulk of Canada's international trade was with the United States. Likewise, exports to Canada represented a very significant portion of America's international trade. Hence, the likelihood that a North American free trade bloc would result in significant trade diversion appears to be small.

A final point to be made about regional versus multilateral trade liberalization is that regional free trade liberalization need not be inconsistent with the pursuit of broader multilateral free trade.[13] In fact, as noted earlier, regional trade agreements are fully consistent with the GATT rules. Certainly, the ultimate objective of any sound international economic policy must be free trade among all nations. Nonetheless, it is important to note that Canada's membership in NAFTA does not preclude the attainment of this larger objective. Seen in this light, pursuit of regional free trade may be a positive first step towards achieving freer trade among all nations. Indeed, given the slow pace of multilateral trade negotiations, regional free trade may represent a viable way to accelerate the process of multilateral trade liberalization.

Other Arguments in Favour of a North American Free Trade Zone

In addition to the standard economic arguments, policy makers, and politicians have offered a number of other arguments in favour of free trade agreements. In fact, some of the strongest arguments offered by non-economists (and also by some economists) in favour of the FTA and NAFTA were of a non-economic nature. These arguments reflect the sentiment expressed by Krugman in a quotation cited earlier: that "[free] trade can serve as a focal point on which countries can agree to avoid trade wars" and that it "can also serve as a simple principle with which to resist pressures of special-interest politics."

Without doubt, one of Canada's main motivations for seeking a free trade agreement with the

12 Jagdish Bhagwati remains skeptical. See Bhagwati and Panagariya 1996: ch. 1; see also Bhagwati 1991.

13 Bhagwati 1991 argues the opposite.

United States was growing protectionist sentiment in the United States and the adverse effects of "politicized" trade policies on the Canadian economy (Lipsey and Smith 1985; Grey 1981). A free trade agreement was one way Canada could defend itself against the growing arsenal of non-tariff barriers imposed by the United States on imported goods. Indeed, the failure of the GATT to deal effectively with the issue of non-tariff barriers constituted a major rationale for a comprehensive free trade deal with the United States. By pursuing a binding free trade deal, trade policy becomes more independent of the political process because politicians' hands are tied. A free-trade agreement, therefore, establishes a commitment that prevents politicians from using trade policy to serve special interests at the expense of general economic welfare. The result is that a greater degree of stability and certainty is thereby introduced into the trading environment.

Myths and Facts About NAFTA and the FTA

In the remainder of this paper, we will discuss some of the popular myths about the effects of the FTA and NAFTA on the Canadian economy advanced by opponents of free trade and Canadian nationalists. We confront each myth with both economic theory and the empirical facts and find that the objections of the opponents of free trade to NAFTA and the FTA are either exaggerated or completely incorrect.[14] Free trade with the United States and Mexico has not resulted in the demise of the Canadian economy. Rather, it has injected a much needed dose of competition into the Canadian economy and, in so doing, has improved the prospects for growth and prosperity in all three economies.

Myth 1: The FTA and NAFTA have caused enormous job losses in Canada

This is the first, and oldest, claim of opponents to free trade. Protectionists and nationalists everywhere have always argued that free trade causes significant unemployment at home. This claim is based on the erroneous belief that there is only a fixed amount of work to be done and, if some of that work gets exported to foreigners, then there will be less work to do at home. Economic theory and the empirical evidence show that this belief is both absurd and incorrect.

Consider the matter first at a theoretical level. Economic theory does not give us any reason to believe that trade liberalization should result in a net loss of jobs. As noted earlier, when economies open up to trade, they tend to specialize in the production of goods at which they have a comparative advantage. While this certainly means that employment in those sectors in which the country does not have a comparative advantage is likely to shrink, it is also the case that opportunities for gainful employment in those sectors where the country does have a comparative advantage will probably increase. Without question, there will be job displacement. However, there will be job creation too, as the economy specializes in the production of a different mix of goods.[15]

14 For an excellent defence of free trade from an American perspective, see Burtless *et al*. 1998.

Furthermore, as noted earlier, specialization raises overall national income. When individuals are wealthier, they will consume more of all goods—both domestic and foreign. In so doing, more opportunities for gainful employment are created as the demand for all goods increases. What opponents of free trade fail to realize is that the purpose of trade and economic exchange is to create wealth, not to create work. We value wealth because it enables us to consume. In fact, the only reason we work is to facilitate consumption. The reason free trade is desirable is that it raises wealth and thereby enables us to consume more of all goods. If we valued free trade because it creates work, we would be getting everything backwards!

Earlier, we made the claim that trade is simply another technology for the production of goods and services. In many instances, free trade is a more efficient technology than the physical production of those goods at home. Because the purpose of all economic exchange is to facilitate consumption (and not to create work), our only concern should be about what technology enables us to consume more, and not about what technology will create the most work. If Canada were to invest heavily in greenhouses and sophisticated temperature control systems, it would be feasible for us to produce bananas domestically and doing so would certainly create a great deal of work. However, this would be a very inefficient way for us to get bananas. A far better way to produce bananas would be for us to grow trees, chop them up, and export them to Mexico in exchange for bananas. This would involve less work, and would yield us many more bananas. Since the only reason we want bananas is so we can eat them, we should use the technology which gives us the most bananas for the least amount of work. Hence, the value of free trade is that it enables us to get a given amount of bananas for less work than before.

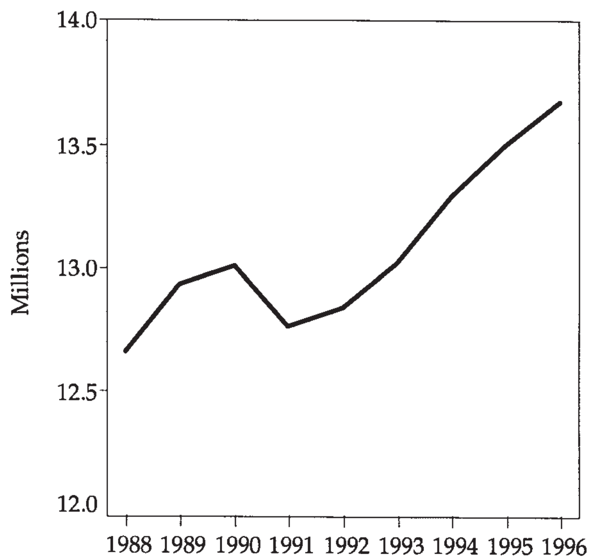
Of course, there will not be less work. There will, in fact, be the same or possibly even more work after we implement free trade. However, the work will be of a different kind. Instead of producing bananas, we will be growing trees and harvesting them in exchange for Mexican bananas. This work will create greater value, in the sense that any given amount of work will enable us to consume more bananas than before. For precisely that reason, this new work makes us richer than before. And with this additional wealth, we can consume not only more bananas but also buy more houses and more maple syrup too. This is why we value free trade.

Now, let us confront the empirical evidence. Protectionist rhetoricians like Maude Barlow and Mel Hurtig claim that hundreds of thousands of jobs have been lost since Canada signed the FTA with the United States 10 years ago (Hurtig 1991; Barlow 1990).[16] Is there any evidence of this?

First, it is almost impossible to tie any job loss directly to a trade liberalization agreement. Jobs are lost for a multitude of reasons including incompetent management, changing macroeconomic conditions (*i.e.* changes caused by business cycles), sectoral adjustment strategies, and so on. It is certainly the case that unemployment rose during the early 1990s. However, this probably had everything to do with a severe recession in central Canada and rather little (if anything at all) to do with the FTA.[17] Employment levels are largely a macroeconomic phenomenon that depend on the level of aggregate demand in the short run and the natural rate of unemployment in the long run,

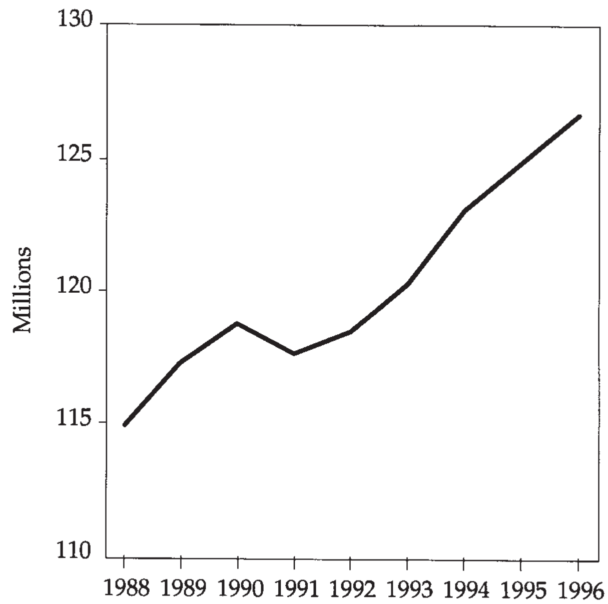
15 On this score, it is interesting to note that the sectors most liberalized by the FTA have experienced the fastest export growth. These results are detailed in Schwanen 1993.

Figure 1: Total Employment in Canada



Source: OECD (1997).

Figure 2: Total Employment in the United States



Source: OECD (1997).

with tariff rates having at most a negligible effect (Krugman 1993b).

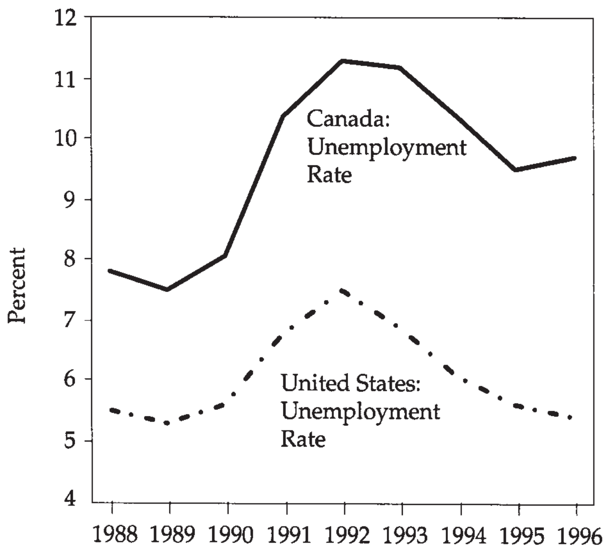
Second, employment has not declined since the FTA and NAFTA have taken effect. Figures 1 and 2 show that total employment has been rising in both Canada and the United States since 1988. Total non-agricultural employment in Canada has risen from 12.4 million to 13.22 million from 1988 to 1996 (Statistics Canada 1998). In 1997 alone, an additional 372,000 full time jobs were created (Canada, Department of Finance 1998). Meanwhile, the American economy has produced 14 million new jobs over the past few years (US Trade Representative 1998).[18] Furthermore, as shown in Figure 3, unemployment rates are falling in both countries. These statistics reveal that the thesis "free trade kills jobs" has no empirical

16 Barlow includes a "Job Loss Register" in her book (1990) that lists every job lost in the aftermath of the FTA. According to Barlow (and the Canadian Labour Congress, which compiled the list), every job lost since 1988 was a casualty of the FTA. Barlow makes the naive logical error of assuming that if one event happens after another, the first event must necessarily be the cause of the second. Specifically, Barlow writes: "Canada's job-creation record in the years from 1982 until the signing of the free-trade agreement was a good one. If the five year average preceding the signing of the agreement had continued, the economy would have created an additional 650,000 new jobs. Instead it created only 50,000" (1990: v). Hurtig is also guilty of making this logical error. See the chapter entitled "Employment and Unemployment: The Devastating Impact of the FTA on Jobs in Canada" in Hurtig 1991.

17 Hurtig laments that "jobs in the goods-creating sector of the Canadian economy had been increasing steadily since mid-1986 until the end of 1988 but beginning in January 1989, they dropped all the way back to the level of 1984" (1991: 19). The inference here is that the FTA (which came into effect in 1989) caused all these job losses. Hurtig makes no effort to explain that the period from "mid-1986 until the end of 1988" was a time of significant macroeconomic expansion and that beginning in early 1989, the Canadian economy slumped into a recession. The expansion and contraction of employment that Hurtig discusses can be easily explained by macroeconomic influences that were entirely independent of the FTA.

18 In fact, these 14 million new jobs account for 95 percent of all jobs created among the Group of Seven (G7) nations over the past five years. See US Trade Representative 1998.

Figure 3: Employment Rate in Canada and the United States



Source: OECD (1997).

basis whatsoever and that the link between free trade and employment is tenuous at best. Job creation is up and unemployment rates are down in both Canada and the United States because general macroeconomic conditions are good in the two countries. There is no solid statistical linkage between free trade and unemployment because the effects of free trade on aggregate employment are extremely tiny.[19]

Myth 2: Lower wages in Mexico will encourage Canadian and American firms to relocate their plants and factories and this will drive down Canadian and American wages

Another fear about free trade that has been popularized by nationalists, by protectionists, and, often, by organized labour, is that free trade will result in an exodus of investment from Canada as firms move to Mexico and the United States to take advantage of the lower wage structure.[20] It is also believed that this exodus of firms will drag wage levels in Canada down to Mexican levels.

First, let us deal with this fear on a theoretical level. Is there any basis in economic theory to support this claim? Consider the following hypothetical example. Suppose workers in Canada and Mexico are perfect substitutes for each other (*i.e.* assume that Mexican workers and Canadian workers are identical in terms of the skills they possess and their ability to produce goods). Assume also that, prior to free trade, wages are higher in Canada than in Mexico because there are fewer Canadian workers than Mexican workers. If free trade allows firms to relocate to Mexico, then certainly the demand for labour will fall in Canada and will rise in Mexico. As firms move from high wage Canada to low wage Mexico,

19 Taking an American perspective on this issue, Krugman writes: "the whole idea of counting jobs gained and lost through trade represents a misunderstanding of the way the US economy works. In particular, it overlooks the fact that other economic policies, especially monetary policy, will almost surely neutralize any potential impact of NAFTA on jobs" (1993c).

20 In a chapter entitled "Heading South," Hurtig documents the decline in business investment that occurred following the FTA. He writes: "The decline in business investment in Canada began shortly after the FTA went into effect, and investment has dropped drastically ever since. The last annual report of the governor of the Bank of Canada has a graph of business fixed investment in Canada showing year-over-year percentage changes; for the years since the FTA legislation, this graph heads straight downhill at an angle resembling the near-vertical north face of Mount Robson" (1991: 30). Once again, Hurtig makes the classic logical error of assuming that if one event precedes another, the first event must necessarily be the cause of the second. Hurtig fails to mention that the decline in business fixed investment also coincided with the recession of the 1990s, and that business fixed investment, like employment and unemployment rates, is largely determined by macroeconomic factors that are entirely independent of the trading regime.

wages will fall in Canada and rise in Mexico. This process will continue until wages are equalized across the two countries.

But Canadian and Mexican workers are not identical, and in the absence of this assumption, there is no *a priori* reason to suppose that firms and jobs will migrate to Mexico. In reality, Canadian workers are more productive than Mexican workers because they work in conjunction with more capital. Hence, when firms make decisions about location, they will consider not only the direct costs of employing labour but also the cost of labour adjusted for differences in productivity. In other words, what matters to the firm is not labour costs but "unit labour costs." Wage rates in Canada are certainly higher than wage rates in Mexico but this is completely justified and should not result in the migration of firms from Canada to Mexico if Canadian workers are proportionately more productive than Mexican workers.

The view that unit labour costs and not just wage rates is what matters receives considerable empirical support. In a paper entitled "Comparative and Absolute Advantage in the Asia-Pacific Region," economist Stephen Golub (1995) demons-trates that while Malaysian wages were only 15 percent of American wages in 1990, the average Malaysian worker was only 15 percent as productive as the average American worker. In other words, unit labour costs were identical in the two countries. America is able to justify higher wages because it is proportionately more productive than Malaysia.[21] Likewise, Canada should be able to afford higher wages than Mexico because Canadian workers are more productive than Mexican workers. According to the OECD (1997), Canada's unit labour costs have been lower than Mexico's from 1992 onwards. There need not be an exodus of jobs or a reduction in real wages if Canadian workers are more productive than Mexican workers.

Indeed, a quick look at the data shows that these fears are unfounded. As noted earlier, total non-agricultural employment in Canada has risen between 1988 and 1996 from 12.4 million to 13.2 million. Meanwhile, average hourly wages have also risen over the same period. Statistics Canada's index of average hourly wages (set with 1986 = 100 as the base) increased from 107.7 in 1988 to 142.1 in 1996. Average weekly earnings increased from $460.67 to $568.06 over the same time horizon (Statistics Canada 1998). The fact that both total employment and average earnings have risen over this period shows that fears about jobs migrating south and wages falling to Mexican levels are without empirical support.

Of course, this is not to say that some firms (and hence, some jobs) will not leave Canada for Mexico. Certainly firms in some sectors may find it profitable to migrate from Canada to Mexico if their unit labour costs would be lower in Mexico than in Canada. But in other sectors, it may be profitable for firms to move in the opposite direction.[22] The net result is that the mix of jobs changes in both countries but overall economic welfare rises as well. The tendency for firms to migrate to where unit labour costs are lowest improves economic efficiency in both Canada and Mexico.

21 Golub (1995) also finds that unit labour costs are higher in both India and the Philippines than in the United States, in spite of the fact that wage costs are significantly lower in these two countries.

22 For instance, Philips, the Dutch electrical products group, recently moved two light bulb production lines from Mexico to London, Ontario.

Myth 3: The FTA and NAFTA will destroy Canada's manufacturing base

This sentiment is reflected in the following excerpt from an article in *Maclean's* (October 23, 1989) by Peter C. Newman.[23]

> Since the Free Trade Agreement came into effect . . . our industrial base has been seriously eroded . . . In nearly every sector, factories are curtailing their operations, being abandoned, moving south of the border, or being converted to mainly distribution and storage functions . . . The most immediate effect of free trade has been the accelerated de-industrialization of Canada; we've gone straight from smokestacks to warehouses . . . Canada is establishing an unheard-of precedent. We are about to become the only country in recorded history to reverse the traditional evolution from underdevelopment to a manufacturing economy."

For reasons similar to those outlined in the previous section, critics of NAFTA and FTA have argued that manufacturing firms and manufacturing jobs will be lost to the United States and Mexico. The result, so they claim, is that Canadians will somehow be made worse off.

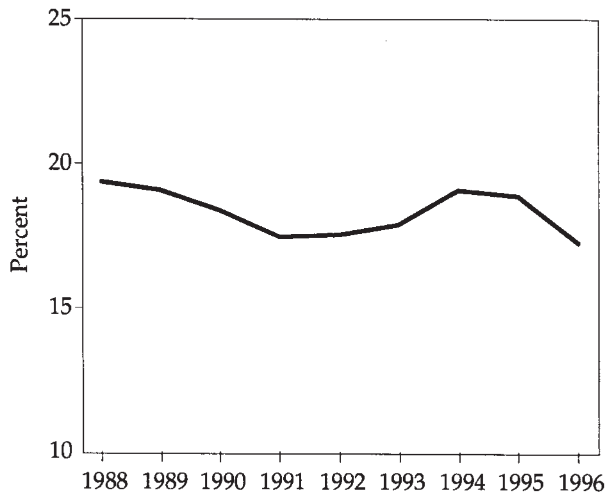
Our first objection to this claim is to simply shrug our shoulders and ask: Who cares? Why should we care where the manufacturing companies locate, so long as we get to consume manufactured goods? If the purpose of economic exchange is to raise our wealth so we can consume as much as possible, then why should we care how that wealth is created? And why does it matter where the goods we consume come from?

Consider the following hypothetical scenario. Suppose that Mexico has a comparative advantage in the production of manufactured goods while Canada has a comparative advantage in services. If Canada and Mexico sign a free trade agreement, the manufacturing base of Mexico will expand while Canada's manufacturing base will shrink. Meanwhile, Mexico's service industry will contract while Canada's will expand. But, specialization according to comparative advantage raises real incomes in both countries and with higher real incomes both Mexican and Canadian consumers will be able to consume more manufactured goods and more services. The fact that Canada does not produce any manufactured goods at home is immaterial if the ultimate goal of Canadians is to consume as many manufactured goods as possible. Indeed, by producing only services, Canadians will be able to consume more manufactured goods than they could have if they had to produce both manufactures and services domestically. Seen from this perspective, the shrinking of Canada's manufacturing base could be a very positive development in that it would allow Canadians to purchase even more manufactured products than before.

Perhaps what raises concerns about a shrinking manufacturing base is the mistaken belief that somehow manufacturing is better than services. Why might manufacturing be "better" than services? Because manufacturing jobs are "good jobs" while service sector jobs are "bad jobs?" Or because there is something more "virtuous" about producing very tangible manufactured goods than producing less tangible services?[24] Whatever the case, this belief is puzzling. The only reason we work is to facilitate consumption. Alternatively stated, a good job (or a "virtuous" one) is simply a job that enables us to buy all the

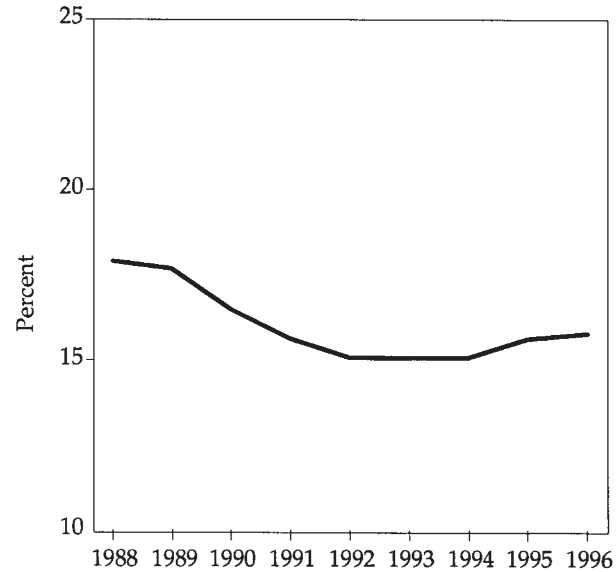
23 Similarly, Hurtig claims that the process of "deindustrilization" sets us "on the road to a warehouse economy." He also believes that the "Free Trade Agreement" should be renamed the "Deindustrialization of Canada Agreement" (1991: 22–23).

Figure 4: Manufacturing's Share of Canadian GDP



Source: Statistics Canada (1998).

Figure 5: Manufacturing's Share of Total Non-Agricultural Employment



Source: Statistics Canada (1998).

consumption items we want; meanwhile, a "bad job" is one that does not. What exactly we do is irrelevant because when there is free trade, there need be no correlation between what we produce and what we consume. The only reason we might want a large manufacturing base would be if the production of manufactured goods enables us to consume the largest quantity of both manufactures and services possible. If it does not, then we should allow free trade to decimate the manufacturing base and move our inputs into the service sector.

It is important to note, however, that manufacturing employment and the share of total output in Canada devoted to manufacturing have remained fairly constant over the past 10 years. Figure 4 displays the share of Canada's gross domestic product (GDP) due to manufacturing over the period from 1988 to 1996. Manufacturing's share of GDP was 19.2 percent in 1988 and declined only slightly to 17.3 percent in 1996. Meanwhile, as shown in Figure 5, the share of the non-agricultural labour force employed in manufacturing industries was 17.9 percent in 1988 and 15.8 percent in 1996. These small declines hardly constitute the destruction of the manufacturing base. In fact, we would not expect Canada's manufacturing base to simply disappear as a result of NAFTA or the FTA because Canada does have a comparative advantage in the production of many manufactured goods.[25] The central point that needs to be made here, however, is that there would be nothing inherently bad about the export of our manufacturing sector to Mexico. If Mexico has a comparative advantage in manufac-

24 Hurtig maintains that service-sector employment "offers lower wages, fewer full-time jobs, poorer benefits, and overall substantially less income than is normally received in the goods sector" (1991: 19). Barlow claims that "the rise of the service economy accounts for almost all net employment growth and is a key factor in the growing poverty of women and young people. As public services are privatized, and as the goods-producing sector of our economy declines, more and more Canadians are going to be among the service-sector working poor" (1990: 104). Hurtig and Barlow fail to realize that many service-sector jobs are in high paying and rewarding professions like engineering, computer services, and financial services. They both seem to be under the mistaken illusion that service-sector employment is equivalent to working at McDonald's.

tures, then Canada is wealthier if Mexico specializes in manufactures. That we do not produce manufactured goods does not mean we cannot consume them.

Myth 4: NAFTA will hurt Canadian and American agricultural interests

Another claim made by critics of free trade is that NAFTA will hurt farmers and agricultural interests in the United States and Canada.[26] Under NAFTA, tariffs, import quotas, and licenses on agricultural products will be gradually phased out over a 15-year period (Globerman and Walker 1993). Because the agricultural sector is politically sensitive to trade liberalization, a longer transition period was granted for certain products. Special treatment was given to sugar, frozen orange juice concentrate and peanuts for the United States and for corn, dry beans, and powdered milk in Mexico. For Canada, poultry and dairy received special treatment. However, trade will be significantly liberalized in these sectors over the course of the next few years.

To the extent that the elimination of tariffs, quotas, and licenses lowers agricultural product prices, trade liberalization does make agricultural interests worse off since they must now sell their products at a lower price than before. However, this does not constitute a reason for opposing the liberalization of agricultural goods. Although agricultural producers who previously faced protection will be made worse off, consumers gain since the prices of agricultural goods will be lower. Lower prices will increase consumption of agricultural goods and this raises economic welfare.[27] Hence, the removal of trade barriers to agricultural goods is a positive development because it eliminates the deadweight losses caused by artificially insulating domestic agricultural producers from the world market (Grennes 1993).

Furthermore, it is important to note that while some agricultural interests (poultry and dairy in the Canadian context) may be made worse off, others may be unaffected (or possibly even positively affected). For instance, Canada's wheat farmers are extremely competitive by international standards and are currently unprotected by tariffs or other trade barriers. Hence, wheat farmers will not be made worse off by NAFTA. Indeed, NAFTA could potentially make Canadian wheat farmers better off if Canada has a comparative advantage in wheat production relative to either the United States or Mexico. It would be misleading to suggest, however, that all agricultural producers will be made worse off as a result of NAFTA.

Agriculture continues to be one of the most heavily protected industries worldwide. Without doubt, there will be some losers as a result of trade liberalization in agricultural products. However, to resist trade liberalization simply because there

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25 See Schwanen 1993 for more details about which sectors have done better in terms of export growth under the FTA.

26 For instance, Barlow writes: "No single group stands to lose as much under the new regime as farm families ... this community has been hung out to dry ... Free trade, and this government's insistence on abandoning farmers to the play of free-market forces, may destroy farmers ... What will take its place will be a handful of transnational giants, committed to pesticides and other harmful farming practices, and supported by cheap labour" (1990: 91).

27 The most common error made in public-policy analysis is to concentrate on highly visible, politically concentrated costs and to ignore longer term, less visible, and more diffuse benefits. In her section on the impact of the FTA on the agricultural industry in Canada, Barlow (1991, p. 91-93) laments the effects that trade liberalization will have on small_scale family farms without mentioning once the gains to consumers from lower food prices.

will be some who are made worse off would be short-sighted for the gains to consumers in the form of lower prices and greater product selection outweigh all losses to agricultural producers.

Myth 5: NAFTA will undermine Canadian food safety and health regulations

Some critics of free trade argue that NAFTA will force Canadian governments to lower their food and health safety standards.[28] There is, in fact, no basis whatsoever for this belief. Under NAFTA, Canada, the United States, and all sub-national jurisdictions within each country are allowed to set their own health and safety standards as high as they want provided that a scientific basis is provided and both imports and domestic producers are treated the same way. Furthermore, the supplemental agreements to NAFTA include a commitment by the United States, Canada, and Mexico to harmonize food and health regulations upwards (J.W. Anderson 1993). Hence, concerns that NAFTA will result in a downward slide in health and food safety regulations are simply unfounded. If anything, these standards are likely to move upwards rather than downwards.

Myth 6: Canada is not protected against bullies in Washington, DC, who initiate arbitrary trade actions against Canadian producers

Another complaint levied by opponents of free trade is that it will make Canadian producers vulnerable to protectionist "bullies" in Washington, DC. This view is completely wrong: the FTA and NAFTA serve to protect our producers from the arbitrary whims of policy makers and politicians in the United States. A major reason for pursuing a free trade agreement is to shield international trade from domestic political pressures. From a public-choice perspective, a binding free trade deal is desirable because it prevents politicians from using trade-policy instruments (*i.e.*, tariffs, quotas, export or import licenses) as redistributive tools in order to appease special-interest groups. This not only improves economic efficiency but also creates a more certain trading environment since the ability of politicians to interfere in the market place has been limited.

Under the FTA and NAFTA, trade disputes among member countries are referred to an impartial panel for review. To date, this panel has adjudicated approximately 30 disputes involving reviews of American countervailing and anti-dumping actions against Canada. In many major cases—including softwood lumber, red raspberries, and frozen pork—the dispute resolution mechanism worked in Canada's favour and American countervailing measures were overturned. The ability of politicians in Congress or the White House to "bully" Canadian producers has therefore been circumscribed by the dispute resolution process. In our opinion, this is a significantly better scenario than that which would have prevailed in the absence of a binding dispute resolution process.

Myth 7: As a result of NAFTA environmental standards will deteriorate

Environmentalists and opponents of free trade often claim that, as a result of NAFTA, environmental standards will decline. A common pre-

28 Barlow, for example, quotes American agricultural analyst Mark Ritchie who believes that as a result of the FTA, "[c]onsumers will have to accept the lowest common denominator in environmental, health, and safety standards" (1990: 93).

sumption made by environmentalists and opponents of free trade is that economic growth and free trade are inimical to the environment since production and consumption necessarily result in more pollution. These claims are wrong. For one thing, NAFTA does more than any existing trade agreement to protect environmental standards. In addition, both economic theory and the empirical evidence suggest that free trade and economic growth are perhaps the best thing we can do to improve overall environmental quality. The process of economic growth and development sets into play forces on both the supply side and the demand side that work to improve overall environmental quality.

Let us start by considering NAFTA itself. NAFTA ensures each country's right to safeguard its environment. Furthermore, it encourages Mexico to strengthen its environmental codes. NAFTA's side accords create a North American Commission on the Environment that oversees the enforcement of each country's environmental laws. Any individual, business, independent organization, or government is allowed to file a complaint with the commission. If the matter is not resolved, the disagreement will be forwarded to an arbitration panel of independent experts. If the panel finds that a particular country has failed to comply with the standards agreed upon, then it will be free to impose fines. Hence, NAFTA is "environmentally friendly" in that it sets up a credible mechanism for protecting and enforcing environmental standards (Anderson 1993).

Second, let us examine at the economics of environmental quality. Economic theory suggests that environmental quality is affected by the forces both of supply and of demand. On the demand side, environmental quality is what economists would call a "normal good." A normal good (as opposed to an "inferior good") is a good that we demand more of as our incomes rise. Sports cars and caviar are normal goods since people tend to buy more of these items as they become wealthier. In a similar vein, environmental quality is a "normal good" in that we desire more of it as our incomes rise. At low levels of income, one might be willing to trade environmental quality for more money: if one is very poor, one would probably prefer to have three meals a day than to enjoy an unobstructed view of the rain forest. However, as incomes rise, individuals become less inclined to make such trades. For each additional dollar in income, one is less and less willing to give up environmental quality. Alternatively stated, as individuals become wealthier, they "demand" a better environment.

On the supply side, pollution is generally, although not always, a by-product of production. For a given type of technology, more production may indeed result in more pollution. However, if technology changes, then more production need not cause more pollution. As noted earlier, technological change is one of the driving forces behind economic growth. Improvements in technology often enable firms to substitute into cleaner production methods.[29] Thus, by enabling firms to substitute cleaner and more efficient methods of production, the process of economic growth and development works to enhance overall environmental quality.

This positive relationship between economic growth and environmental quality receives considerable empirical support. In a paper recently published in the *Quarterly Journal of Economics*, Princeton University economists Gene Grossman and Alan Krueger (1995) show that environ-

29 Consider, for instance, the difference in pollution emissions resulting from a substitution of hydroelectric power generation for generation of electricity by coal-fired plants.

mental quality, as measured by various indices, declines until income per capita reaches approximately $5,000 (1988 US dollars). Beyond this threshold, most indices of environmental quality register an improvement. Similar results were found in a study completed by economists at the World Bank (1992).[30] Hence, the empirical evidence suggests that economic growth is an antidote to a poor environment. Environmentalists and opponents of free trade have got the relationship between the two variables precisely backwards!

Indeed, the empirical evidence shows that environmental quality in both Canada and the United States has improved steadily over the past two decades (DeWeil, Jones, Hayward, and Smith 1997). Air pollution due to sulphur dioxide, nitrogen dioxide, carbon monoxide, particulates, and lead has decreased substantially in both countries. Between 1975 and 1993, the ambient level of sulphur dioxide decreased by 54.5 percent in Canada and 50.3 percent in the United States. Meanwhile, ambient lead concentration fell by 96.9 percent and 97.1 percent in Canada and the United States respectively between the same years. Since 1980, overall water quality in both countries has improved. These trends show that concerns about rapid environmental degradation are misplaced.

Liberalized trade among Canada, the United States, and Mexico will raise incomes as each country specializes in the production of goods at which it has a comparative advantage. With higher incomes, consumers in each country will demand a better environment. Furthermore, economic growth in each country will stimulate the development of newer and cleaner production technologies. Openness among these countries will ensure the rapid diffusion of these technologies. Combined, these forces will work to improve overall environmental quality in each country. It is for this reason that environmental economist Terry Anderson writes that "trade liberalization ... is the friend not the enemy of the environment" (1993: xi).

Myth 8: National sovereignty is lost as a result of NAFTA

A final myth dear to critics of free trade is that it will result in the erosion of the nation state as we know it.[31] According to critics of free trade, the signing of regional and multinational free trade and investment accords will result in a loss of national sovereignty as power is transferred from governments to international organizations and free market forces. In such a climate, they claim, the ability of governments to pursue policies in the "national interest" is significantly circumscribed and the outcome of these trends will be the "sale" of Canada to faceless multinationals, a surrender of national autonomy, and the destruction of uniquely Canadian institutions and Canadian culture.

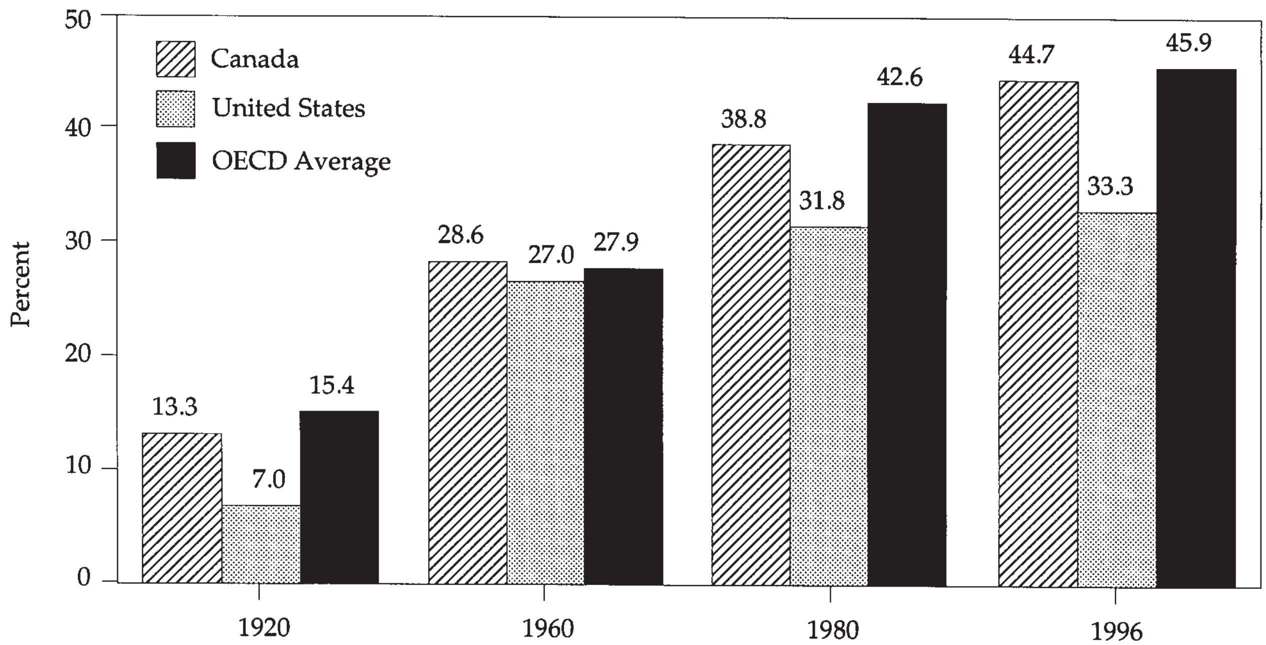
Without a doubt, the forces of globalization make it more difficult for governments to pursue certain types of economic policies.[32] For instance, it is a well-known fact that the ability of govern-

30 In fact, the World Bank estimates that the threshold is at $2,500 (1988 US dollars). According to Globerman (1993), Mexican income per capita in 1991 was $2,365 (1988 US dollars).

31 This sentiment is reflected in the following quotation from Barlow: "In its policy of free trade, and the resulting process now leading to the destruction of the Canadian social network, the Tory government has sacrificed Canada's heritage, history, and sovereignty, and is leaving a bitter legacy of unemployment, poverty, and inequality" (1990: 104).

32 For an excellent discussion of the impacts of globalization on the state, see the survey entitled "The World Economy: The Future of the State" in *The Economist*, September 20, 1997. See also the survey entitled "The World Economy: Who's in The Driving Seat" in *The Economist*, October 7, 1995.

Figure 6: Government's Share of GDP



Source: *The Economist*, (September 1997).

ments to stimulate aggregate demand using fiscal policy instruments is limited under a regime of free capital mobility and flexible exchange rates. Additionally, when capital markets are truly global, greater fiscal discipline is placed on indebted governments, who must be more fiscally responsible if they are to remain competitive in the eyes of bond holders. Finally, when procurement policies are limited by binding multilateral agreements like the Multilateral Agreement on Investment (MAI), it becomes more difficult for governments to favour domestic producers above foreign producers. These limitations certainly do represent a loss of national sovereignty.

However, two important questions need to be raised here. The first is theoretical and asks whether sovereignty is as desirable an objective as it is made out to be. Is the loss of economic sovereignty which may have resulted from globalization something to lament? In an earlier part of this paper, we noted that one of the virtues of a free trade agreement is that it prevents politicians from using trade policy to serve domestic political interests. One positive outcome of the FTA is that it makes it more difficult for American politicians to impose tariffs on Canadian goods. Likewise, the FTA hinders the ability of Canadian politicians to impose retaliatory tariffs on American goods. Since the costs of trade wars are known to be large, it may be well worth sacrificing some national sovereignty (*i.e.*, the ability to impose tariffs to protect domestic industry) in exchange for a less politicized trading environment. Hence, the loss of national sovereignty to the forces of globalization is not unambiguously a bad thing, at least from the perspective of economic efficiency.

The second important question is empirical. Specifically, have the forces of globalization truly resulted in the "shrinking" of the state? One way to examine this issue is to look at the ratio of government spending to GDP (a rough measure of government size) over time. What one finds is that, far from decreasing, government spending as a share of total output has increased over the past century in nearly every major industrialized country. As shown in Figure 6, government's share of total output in Canada was 13.3 percent in 1920, 28.6 percent in 1960, 38.8 percent in 1980, and 44.7 percent in 1996. In the United States, the proportion of total output taken by government was 7 percent in 1920, 27 percent in 1960, 31.8 percent in 1980 and 33.3 percent in 1996. The evidence suggests, therefore, that government has continued to grow in spite of globalization. Examining the data more closely reveals that most of this increase was due to the "blossoming" of transfers and subsidies to individuals and the growth of the welfare state (Tanzi and Schuknecht 1995). Hence, the increase in free trade and international capital mobility over the past half-century has not curbed the growth of the national social welfare state.

Of course, numbers alone will not capture everything. Cultural nationalists in Canada will argue that there are more subtle forces at work and that Canada's unique national identity has been sacrificed as a result of freer international trade and increased foreign ownership. This is a hard claim to assess since it is difficult, if not impossible, to know what exactly is meant by "Canada's unique national identity." In the absence of a well-defined benchmark, we cannot assess the view that our country is any less "Canadian" today than it was 10 years ago. To make such claims without a clear definition of terms is to engage in a level of subjectivism that renders intelligent debate impossible.[33] Moreover, implicit in such a claim is a failure to recognize that national identity is not static;[34] Rather, national identity is something that can and should evolve over time as circumstances change. Indeed, to presume that Canada's unique national identity will simply dissolve in the wake of globalization is both insulting and absurd for it suggests that Canadians are incapable of redefining themselves as a unique national culture in the absence of the visible hand of the state.[35]

Conclusion: The Defence of Free Trade

In his recent book, *Fair Play*, economist Steven Landsburg writes that "a national refusal to trade is a national refusal to prosper" (1997: 12). Among economists, this is not a controversial statement. Since the time of David Ricardo, economists have always known that a policy of free trade works to raise economic welfare in all countries. However, the idea of comparative advantage, as Krugman notes in the quotation cited at the beginning of this study, "conflicts directly with both stubborn popular prejudices and powerful interests" (1987: 131) and, in spite of the efforts of economists, popular discussion about the effects of free trade—in particular, the impacts of NAFTA or the FTA on the Canadian economy—are almost invariably negative. According to economic nationalists and protectionists, free trade is the cause of almost every conceivable economic "evil" ranging from unemployment to the destruction of the natural environment. That

33 It would be rather like trying to have an intelligent argument about whether "red" is a better colour than "blue."

34 Or perhaps it simply reflects an unwillingness on the part of cultural nationalists to recognize that national identities do change over time.

35 For a more detailed critique, see Law and Mihlar 1996: 65–68

these claims are spread about with so little scrutiny reveals the extent to which they have become part of the "conventional wisdom." According to this conventional wisdom, trade and economic exchange are a zero-sum game: if Mexican incomes rise, then Canadian incomes must fall; if jobs are created in the United States, jobs are lost at home; if firms move south of the border, then there will be fewer good jobs at home. There can be no benefit to trade if it is a zero-sum game; trade and exchange are equivalent to mugging.

But trade is not a zero-sum proposition. It is positive sum. An understanding of the principles of basic economics and, in particular, the principle of comparative advantage shows that it must be positive sum. No country loses as a result of free trade; this is true for precisely the same reason that no individual loses as a result of voluntary exchange. Once this idea is understood, it becomes clear that the claims made by the opponents of free trade are either absurd or completely false.

In this paper, we consistently apply the "tried and true" principles of free trade and comparative advantage to popular criticisms about NAFTA and the FTA and show that these popular criticisms do not withstand logical scrutiny. We also find that they are inconsistent with the empirical facts. Jobs have not been lost as a result of free trade. Firms are not queuing up to leave Canada for the lower costs of Mexico. Wages in Canada and the United States have not and will not fall to Mexican levels. Trade and economic growth have not caused environmental devastation. Hence, the claims made by critics of free trade have neither a theoretical nor an empirical foundation. They have no scientific basis whatsoever and this must be pointed out emphatically.

In the introduction to this paper, we remarked that the tenth anniversary of the Canada-United States Free Trade Agreement provides an important opportunity for reflection about the merits of free trade. It is our hope that this exercise will make the public defence of free trade over the next 10 years a much simpler and far less controversial task.

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Appendix: International Trade Data

Table 1: Foreign Direct and PortfolioInvestment in Canada 1988-1996 (in $Cdn millions)		
Year	**Direct Investment**	**Portfolio Investment**
1988	7,538	13,767
1989	7,116	22,063
1990	8,843	12,943
1991	3,301	27,073
1992	5,708	19,802
1993	6,125	43,761
1994	11,551	22,386
1995	14,769	24,819
1996	8,726	27,353

Source: Statistics Canada (1998), *Canadian Economic Observer Historical Statistical Supplement 1996/97*, Ottawa: Statistics Canada.

Table 3: Canada's Net Merchandise Exports 1988-1996 (in $US millions)			
Year	**Total Net Exports**	**Net Exports with US**	**Net Exports with Mexico**
1988	6,318	11,512	-776
1989	3,315	10,756	-1,053
1990	6,774	20,136	-1,143
1991	5,708	20,549	-1,958
1992	8,617	24,566	-1,814
1993	5,834	26,689	-2,332
1994	9,746	33,484	-2,723
1995	52,504	43,908	-2,989
1996	57,151	50,135	-3,426

Note: Net exports are defined as exports less imports.
Source: International Monetary Fund (1997, 1995), *Direction of Trade Statistics Yearbook 1990-96/1988-94*, Washington: International Monetary Fund; and calculations by The Fraser Institute.

Table 2: Canada's Merchandise Imports and Exports 1988-1996 (in $US millions)						
Year	**Total Exports**	**Exports to US**	**Exports to Mexico**	**Total Imports**	**Imports from US**	**Imports from Mexico**
1988	116,418	81,962	404	110,100	70,450	1,180
1989	120,673	85,305	525	117,358	74,549	1,578
1990	126,447	95,388	488	119,673	75,252	1,631
1991	126,160	95,574	386	120,452	75,025	2,344
1992	133,447	103,860	613	124,830	79,294	2,427
1993	140,748	114,448	599	134,914	87,759	2,931
1994	161,269	133,112	715	151,523	99,628	3,438
1995	190,187	152,896	785	137,683	108,988	3,774
1996	200,146	164,761	855	142,995	114,626	4,281

Source: International Monetary Fund (1997, 1995), *Direction of Trade Statistics Yearbook 1990-96/1988-94*, Washington: International Monetary Fund.

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