

**Out of Equilibrium:  
The Impact of Canada-EU  
Free Trade in the  
Real World**  
*(as opposed to the textbook world!)*

***Presentation by Jim Stanford, Ph.D., CAW Economist  
CETA Conference, Carleton University, Ottawa  
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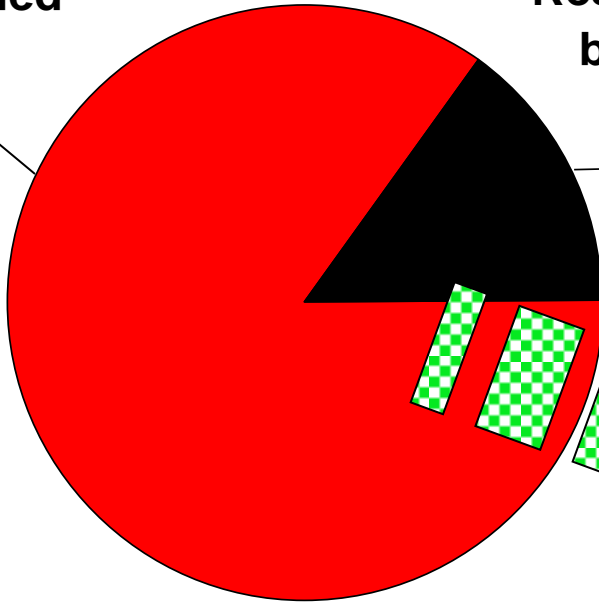
# Not Rocket Science...

**EU Exports to Canada:**

*\$45 billion*

Value-Added  
85%

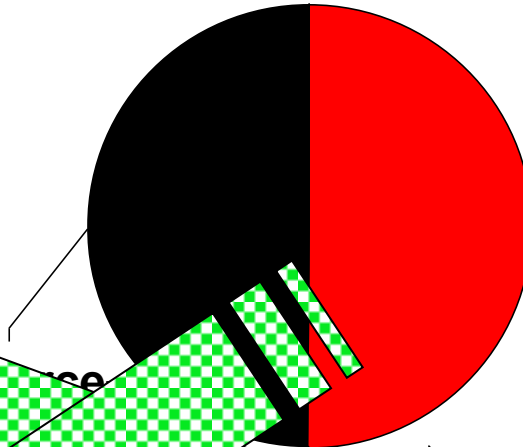
Resource-based  
15%



**Canadian Exports to EU:**

*\$30 billion*

Value-Added  
50%



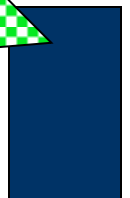
***EU Tariffs on Canadian Imports:***

2.2%



***Canadian Tariffs on EU Imports:***

3.5%

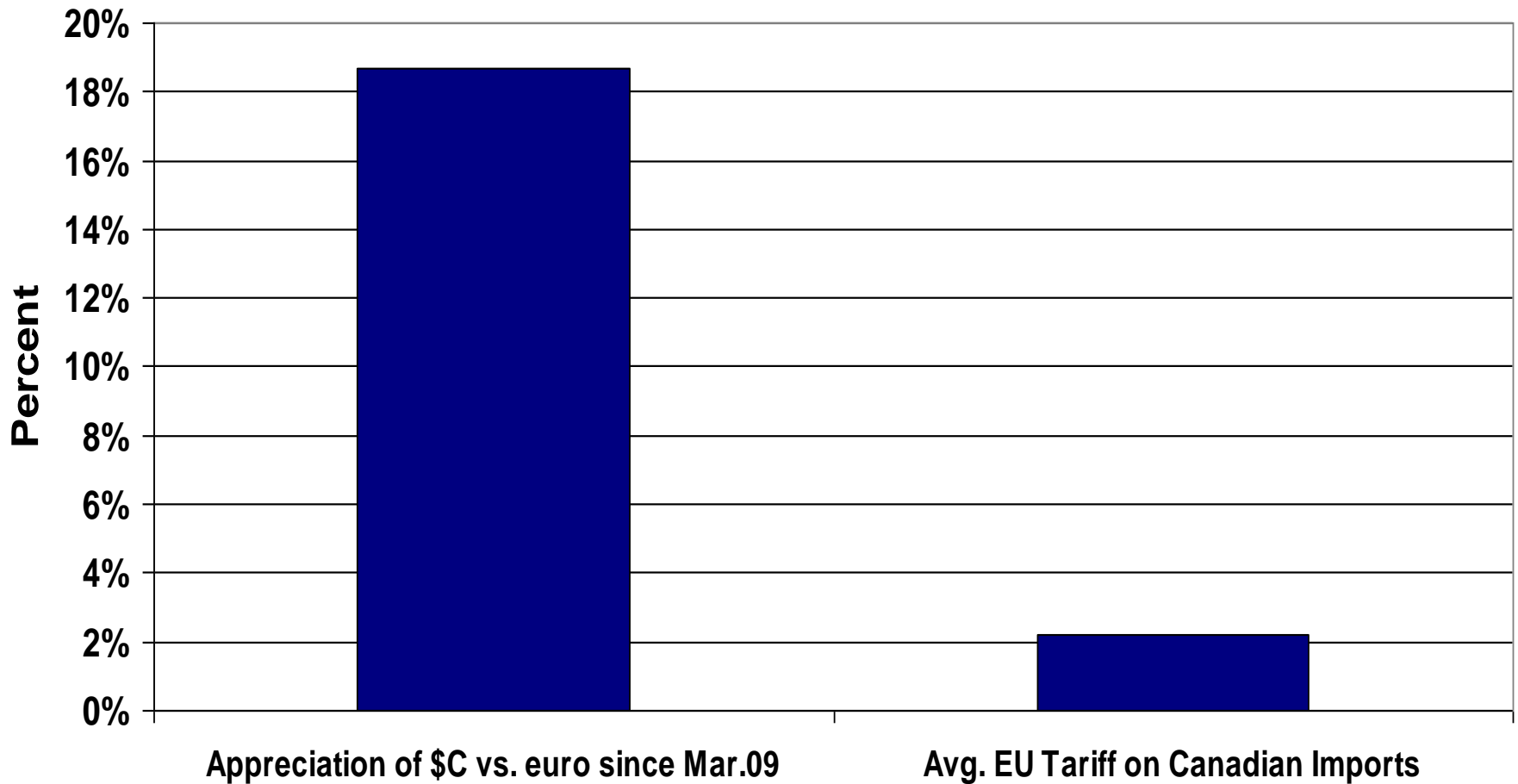


# Not Rocket Science...

- EU's exports to Canada 50% greater than Canada's exports to EU
- Canada's tariffs on EU imports more than 50% greater than EU's tariffs on Canadian imports
- $+50\% \times +50\% = +125\%$
- Expect EU's exports after free trade to grow at least twice as much as Canada's
- Confirmed by many studies
  - INCLUDING the EU-Canada joint report

# The Forest and the Trees

## Exchange Rates and Tariffs



# Now THIS is Rocket Science! (or perhaps alchemy?)

- EU-Canada Joint Report projects a major deterioration in bilateral trade balance
  - Shifts against Canada by 8.5 billion euros
- Yet it also reports GDP and income gains for Canada
  - of 8.4 billion euros!



# How Do They Do It?

1. Standard CGE modeling assumptions
  - Full employment
  - Full utilization of all factors / supply-constrained output
  - Uniform factor pricing
  - Single representative household
  - No international capital mobility
  - Balanced trade
  - Products differentiated by place of production

# How Do They Do It?

## 2. Incremental methodological choices

- Non-tariff barriers to goods trade: assume delivery costs of all manufactured goods fall by 2%
- Barriers to services trade: assume it becomes as easy to trade services between Canada and Europe, as it is within Europe
- Dynamic savings and investment: assume that a share of higher income is automatically saved, and automatically invested at home

# How Do They Do It?

- EU-Canada Joint Report acknowledges major deterioration in bilateral balance
- But it assumes:
  - All displaced workers are hired elsewhere
  - Bigger trade deficit with EU offset by trade surpluses elsewhere (who? how?)
  - Canadian capacity expands thanks to domestic saving and investment
  - Exchange rate is irrelevant
- This is an assertion that free trade will boost Canada's economy, not evidence.



# How Do They Do It?

## Auto: A Case in Point

- Joint Report acknowledges \$600 million deterioration in bilateral auto balance.
- Yet it predicts a 5.7% gain in total Canadian auto output!
  - Snatching victory from jaws of defeat!
- Equivalent of \$2.7 billion in new shipments, likely 3000 new jobs.
- How?
- Would any auto stakeholder believe it?

# A Certain Loss of Sublety...

- The model's builders:

- "Given the necessarily speculative nature of the scenarios we evaluate, and the simplifications that are obviously necessary in modelling the entire world economy, our results should not be taken as precise predictions." (Francois, van Meijl, and van Tongeren, 2005)

- The model's users:

- "A Canada-EU agreement will ... grow Canada's economy by at least \$12 billion."  
(International Trade Minister Peter van Loan, October 18, 2010)

# An Alternative Approach

- Abandon CGE assumptions.
- Describe in detail current trade patterns and employment intensity.
- Apply escalation factors based on specified scenarios.
- Calculate resulting impacts on bilateral trade flows, trade balances, employment, and GDP.

# Initial Data Set

- 23 goods-producing sectors.
- Actual 2009 bilateral trade flows (Industry Canada Strategis)
- Sector-specific tariff data and consumer elasticities (EU-Canada Joint Study)
- Sector employment intensity of production (Statistics Canada CANSIM)

# Three Scenarios

- A. Mutual tariff elimination (including agriculture).
- B. Bilateral trade grows in line with previous 5 Canadian FTAs.

# Learning from Experience

## Impact of Previous Canadian FTAs on Export and Import Flows

Country and Year	Annual Growth in Exports (pre-FTA to 2009)	Annual Growth in Imports (pre-FTA to 2009)
<b>U.S. (1989)</b>	4.61%	4.57%
<b>Mexico (1994)</b>	11.64%	9.79%
<b>Israel (1997)</b>	3.01%	10.22%
<b>Chile (1997)</b>	3.43%	13.28%
<b>Costa Rica (2003)</b>	1.19%	5.48%
<b>5 FTAs</b>	<b>4.77%</b>	<b>8.67%</b>
<b>All Other Countries<sup>1</sup></b>	<b>5.11%</b>	<b>7.25%</b>

# Three Scenarios

- A. Mutual tariff elimination (including agriculture).
- B. Bilateral trade grows in line with previous 5 Canadian FTAs.
- C. Mutual tariff elimination combined with impacts of \$C appreciation.
  - 18.7% vs. euro from March 2009 (joint recommendation for an FTA) to first 9 months of 2010.
  - Assume imperfect pass-through (40%) in manufactured goods only.

# Impact of EU-Canada Free Trade: Alternative Scenarios

	A. Tariff Elimina- tion	B. Other FTAs	C. \$Cdn. Appreciation + Tariffs
Change Trade Bal. (\$b)	-\$8.5	-\$13.7	-\$45.7
Change Employment	-28,043	-46,170	-152,409
Change Direct GDP	-0.56%	-0.90%	-2.99%

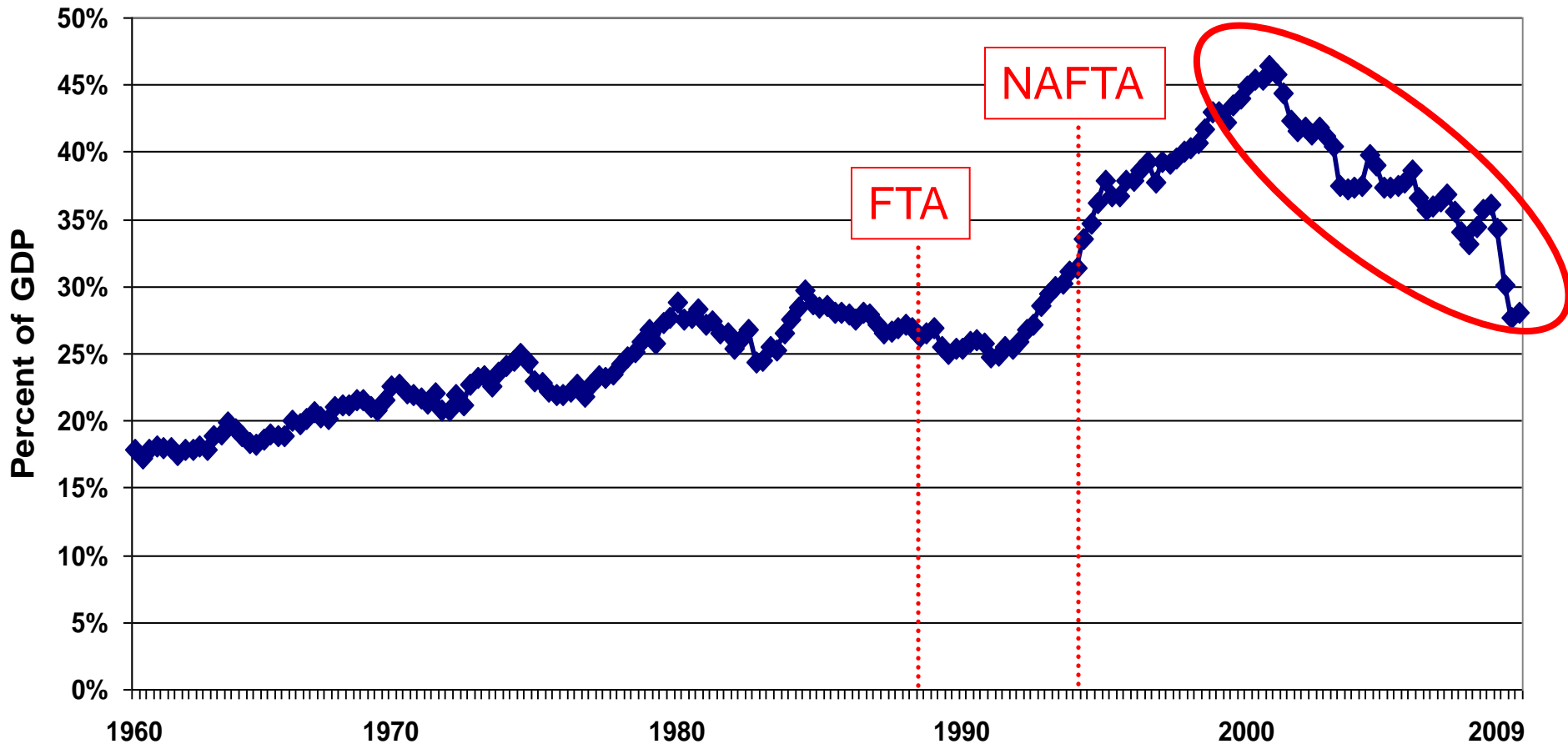


# EU-Canada Free Trade and the Broader Failure of Canadian Trade Performance

- Globalization in Canada today is causing:
  - A shift to non-tradeables
  - A shift to lower-productivity-growth sectors
  - De-industrialization
  - Trade deficits and reduced GDP
  - Tremendous financial instability

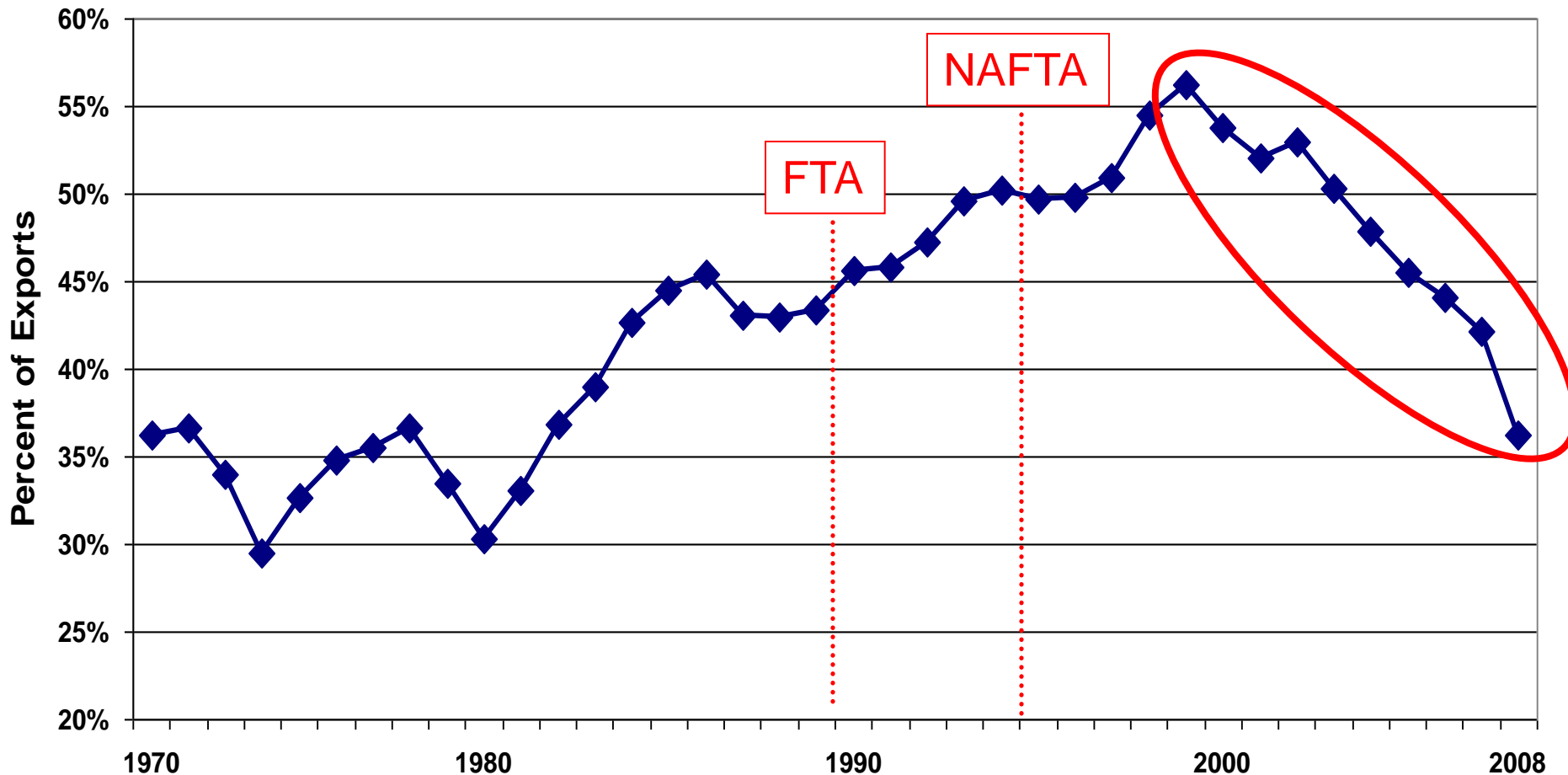
# Canada's Exports are Shrinking

Exports of Goods and Services as % of GDP



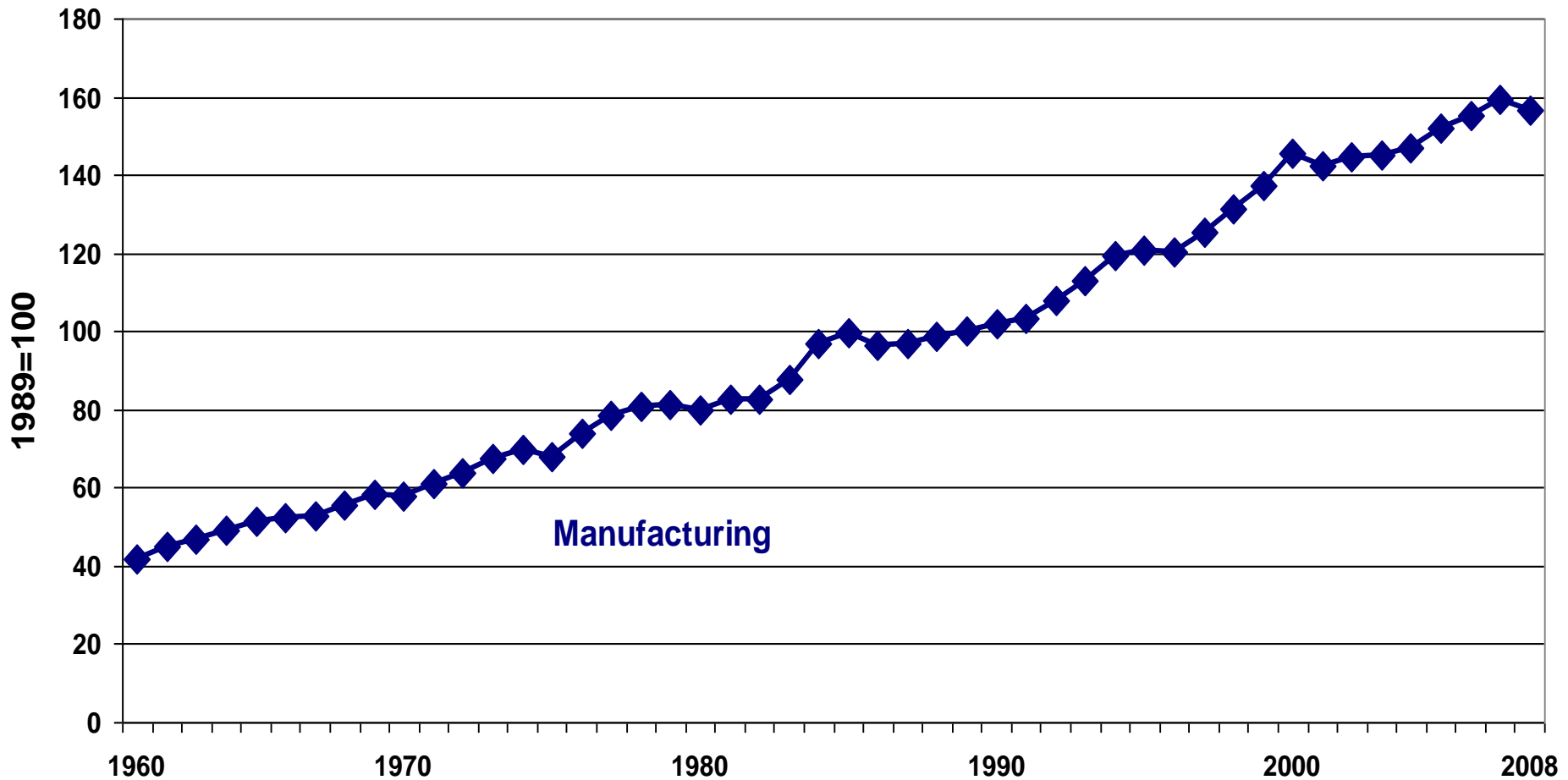
# Canada's Exports are DE-Industrializing

"High-Value" Exports as % of Total Exports



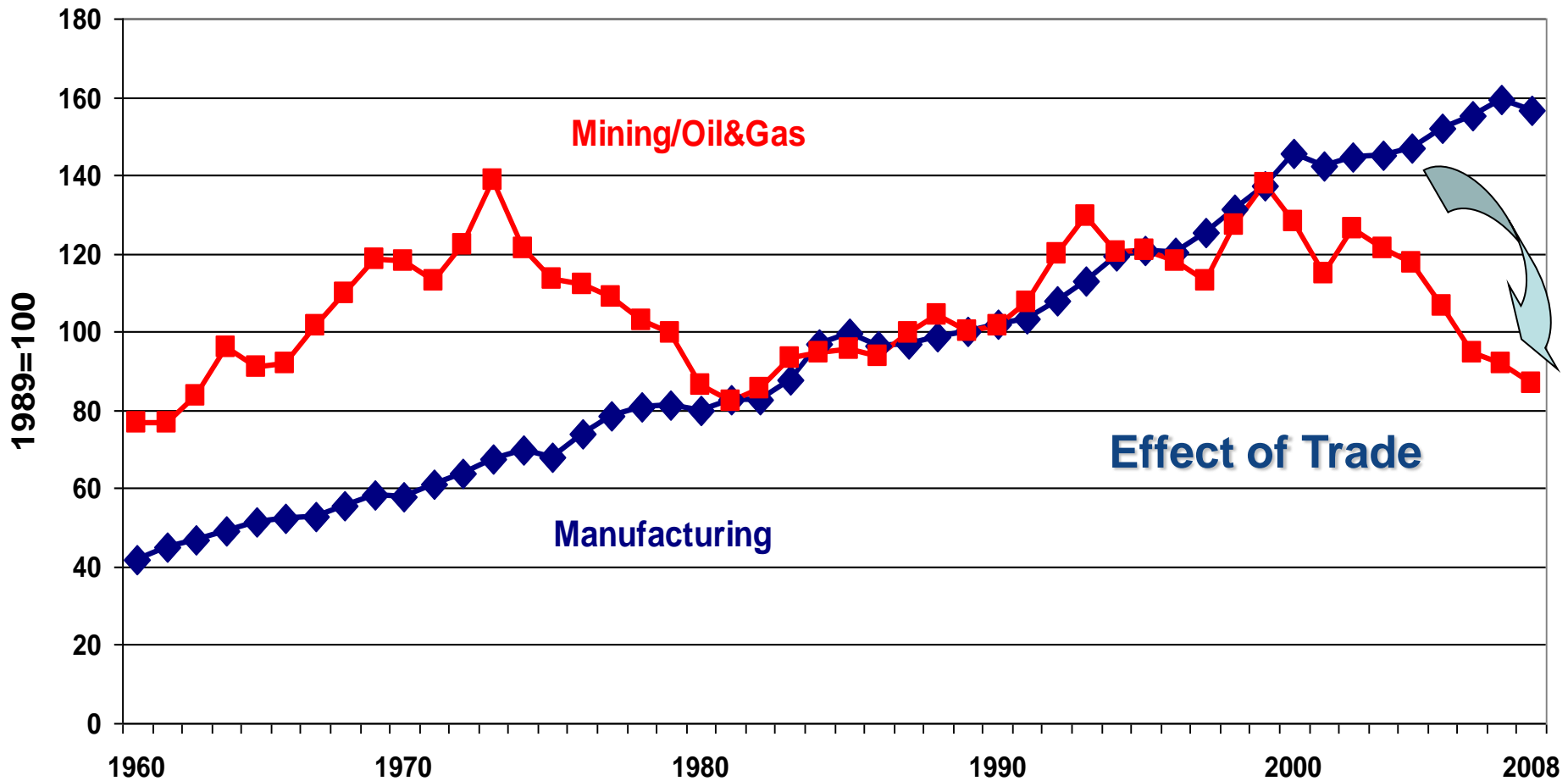
# Trade is Reducing Canada's Productivity

## Labour Productivity Indices



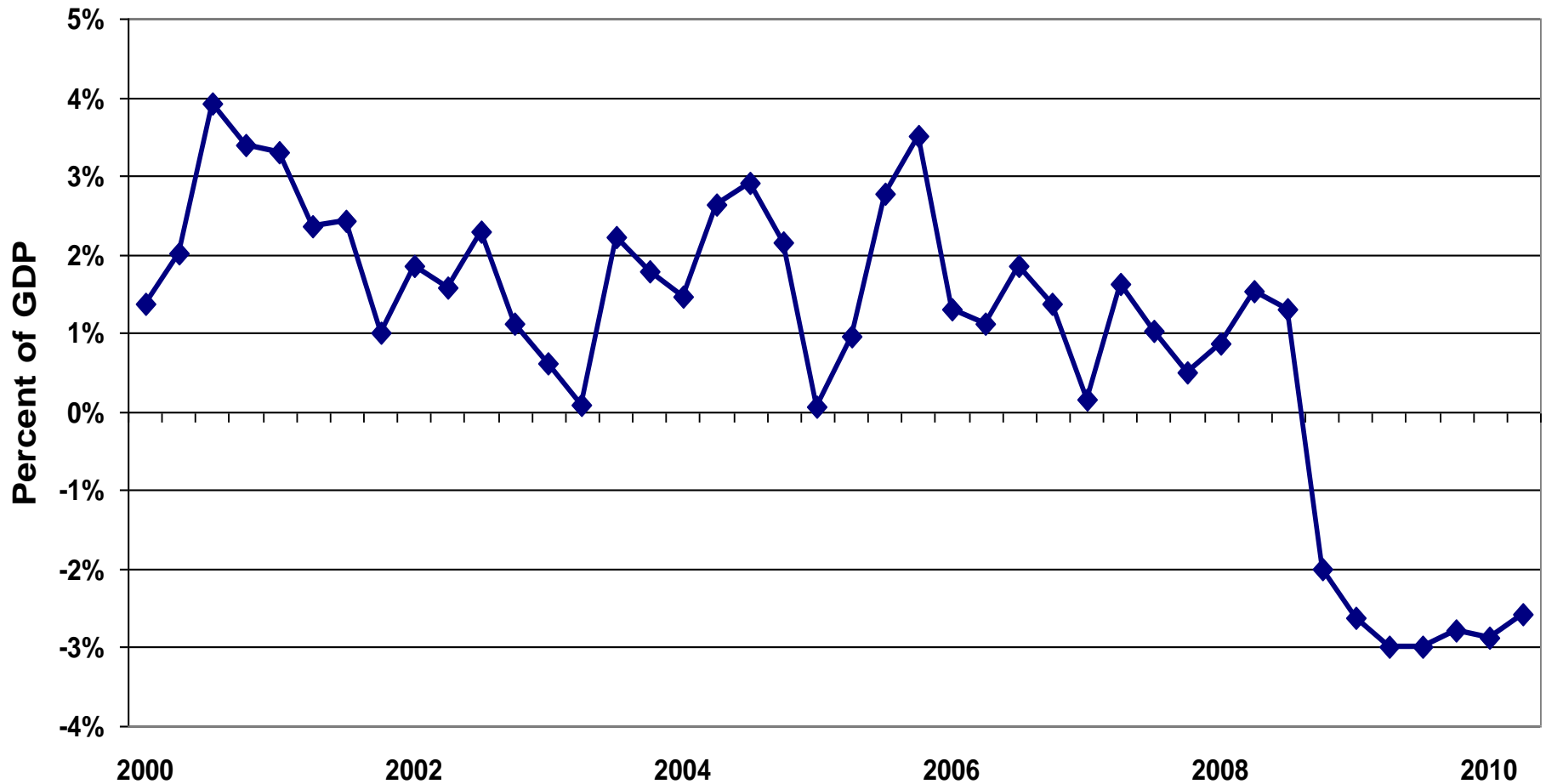
# Trade is Reducing Canada's Productivity

## Labour Productivity Indices



# Trade is Reducing Canada's GDP

## Current Account Balance



# Don't Worry

- Jim Stanford doesn't support autarky
- Trade, foreign investment, and global exchange of ideas & people is essential to our prosperity
- Export-led growth can be dynamic and tremendously beneficial
  - Proof: Germany (6% of GDP)
  - But it has nothing to do with "free trade"
  - And absent global management it spurs beggar-thy-neighbour deflation

# Ottawa: Another FTA Cures Whatever Ails You...

*(and if nothing ails you, it cures that too!)*

- All-purpose solution to Canada's trade woes: sign more FTAs
  - Solution to Buy-America
  - Solution to Korea ban on \$50m Canadian beef
  - Solution to quantitative & qualitative trade imbalance with EU
  - Solution to human rights abuses in Colombia
  - Etc. etc. etc.
- In fact, more FTAs will make things worse



# WHY does Europe do Better?

- Not costs of production.
  - Though unfettered appreciation of \$C hurts
- Not resource availability.
  - In fact, Canada's abundance could be a curse.
- Deep structural lack of competitiveness by Canadian producers of value-added products.
  - Few globally oriented Canadian companies.
  - Chronically weak investment in innovation.
  - Government passivity in industrial policy.
- Will signing an FTA change all that???

# A Better Way: Integrated Industrial & Trade Strategies

- À la Auto Pact, aerospace, pharmaceutical
- À la Asian, German, Scandinavian experience
- Don't leave it to "comparative advantage"  
...whatever that is!
- Deliberate, focused efforts to stimulate high-tech innovation-intensive sectors
  - Using trade, but not "free trade"
- Supported by consistent approaches to trade policy, exchange rate policy

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