

Revisiting the Myths of Free Trade

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WHEN A POLICY INITIATIVE IS remarkably successful—after having been hotly contested by its opponents at the time of its inception—one would think there would be a time for rejoicing on the part of its adherents, even a little “I told you so”. Unfortunately for free trade, despite a ten-year track record of substantial accomplishment, the die-hard nay-sayers are denying the celebrants their victory party, and even reiterating the old myths about the evil free trade has wrought despite mountains of evidence to the contrary.

Worse, the enemies of free trade cannot be dismissed as nut-cases or as professional adversaries of change. Some of them are thoughtful, trained economists and others are passionate advocates for a role of the state that is receding in the face of historical trends. The way to deal with the foes of open commerce is to engage them intellectually, myth by myth, and to establish what the benefits have been for Canada since the Free Trade Agreement (FTA) came into force in 1989, followed by the North American Free Trade Agreement (NAFTA) in 1994.

Judging the Success of Free Trade

Part of the problem in evaluating the success of any policy lies in that venerable assumption of economic analysis: *ceteris paribus*, or other things being equal.

Of course, all other things have not been the same since 1989, and one can

never unscramble the omelette of policy implications. What was the effect of monetary policy during the last ten years (at first, a vigorous attack on inflation resulting in high interest rates and an 89-cent dollar and, later, a policy where interest rates were considerably



below those in the United States and the dollar fell as low as 63 cents)? What were the consequences of high taxes and a large public debt in discouraging investment? How much did government regulation influence investment and employment levels? How did technological innovation and the globalization of capital movements affect Canada's GDP? In other words, if Canada is not the Garden of Eden ten years after the FTA, we may need to look at some of our other government policies before we conclude that free trade's record of accomplishment is blemished.

Part of the problem, also, is that people on both sides of the debate overstated the expectations for free trade. Free trade was never expected to be a cure-all for economic ills, any more than it could be held responsible for “every sparrow that falls”, in the now-famous phrase of Roy McLaren. Free trade with the United States was negotiated with three simple goals in mind:

(i) to counteract growing protectionism in the United States, which already constituted Canada's principal export market by far, (ii) to establish an objective set of rules to settle trade disputes involving US-government agencies and tribunals, where politically driven remedies had increasingly become the norm; and (iii) to put Canada in the mainstream of trade liberalisation taking hold in the world and to foster a new spirit of competitiveness, including the necessary structural adjustment, that would enable Canadians to continue prospering in a changing environment.

All three have been clearly accomplished, with notable success. Canada now has market access to all of North America, and as part of the NAFTA group will participate soon in a Free Trade Area of the Americas, joining

North and South America in a treaty entitling its members to negotiated entry to all of these markets.

The dispute-settlement mechanism was never intended to eliminate disputes. Rather, it was meant to introduce the rule of law to the trade remedy regime in the United States that had been a protectionist tool in the hands of partisan administrators. It has accomplished this in spades. Canada has won its fair share of reviews by the bi-national panels, mostly where it *should* have won. It has also lost some appeals, mostly where Canada *should* have lost,

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because its position was untenable. There will always be disputes between partners in a huge trading relationship. What is important is that the mechanism to resolve these disputes is fair.

Finally, Canada's sectoral winners and losers have not been as predicted at the time the FTA was signed. Competitive talent often emerged in industries which, frankly, were not expected to prosper in a free-trade environment. Notable entrepreneurial success has improved the positions of wine-makers and clothing manufacturers, both of whom were written-off by commentators at the time of the agreement. Canadian employment has shifted to higher value-added enterprises just as it was supposed to. Employment has risen in Canada from 12.8 million jobs in 1988 to 14.6 million in March 1999. Two-way trade with the United States has risen from \$197.8 billion in 1988 to \$504.7 billion in 1998. GDP was \$686.2 billion in 1988 and \$830.8 billion ten years later. Much of this, of course, is the consequence of normal prosperity since the end of the recession in the early 1990s. But friends of free trade argue that free trade and prosperity are related, in a causal way, to each other.

The Myths Are Still Out There

Yet the myths persist. Many of the myths are the same as those circulated during the 1988 election campaign. They are rarely new. Sometimes the myths are recast in the light of more recent events, but no one has been able to put them to rest (in the sense of the proverbial stake through the heart)! Here is a survey of some of them:

Myth: The recent imbroglio over culture left Canadians feeling very vulnerable. It is not right that the United States could threaten trade sanctions against steel, lumber, plastics and forest products merely because we tried to ensure that our magazine industry offered Canadian content.

Fact: Leave aside the embarrassment of being a citizen of a country that, in order to find a "legitimate" way around a World Trade Organisation ruling that overruled our previous regime of denying tax deductions for ads placed in split-run editions of foreign magazines, purported

to make it a criminal offence to place such an ad. The reason the United States was entitled to threaten retaliation for our ill-considered magazine policy is that culture is *exempt* from the FTA and NAFTA. An exemption does not mean freedom to subsidise at will, or to dump with impunity or to erect non-tariff barriers that harm imports. It means that, as regards the subject matter (in this case, culture), it is as if the FTA and NAFTA were not ever entered into. In the absence of a trade agreement, this kind of retaliation is exactly what international trade law would have subjected us to in every field of endeavour and for every good or service. In essence, it is proof of the opposite of what the protectionists and nationalists claim. What happened to culture could not happen in areas that are *not* exempt from the agreement. I will not mention that our back-off from our foolish interventionist stance was even more embarrassing than conceiving a criminal prohibition of commercial ads.

Myth: Once fresh water is found to be an article of commerce, the Americans can force us to sell every last drop of it to them.

Fact: In a stunningly incompetent piece shown recently on CBC *News-world*, the editors permitted this shibboleth to be broadcast without interviewing a single expert on trade law. The theory of this myth is based on a failure to distinguish between the roles of government as owner of an asset or resource and government as regulator. The free-trade agreement prohibits governments from interfering, except on specified grounds, such as health and safety or protection of the environment, with the free movement of goods or services across the international border. It *never* obliges an unwilling seller to sell anything. Government, as owner of the vast majority of our fresh water resources, can *never* be obliged to sell them on the pretext that, in its capacity as regulator, it would be constrained in its ability to prevent articles of commerce from entering into international trade. I am not arguing that governments can discriminate in the granting of permits to draw Crown-owned water for commercial purposes. Provinces *do* need to have a policy, and need to bear national treatment in mind. But if they do not want to

grant these licenses, the FTA is not a vehicle to force them to.

Myth: Funding for our social programmes has been cut in order to tailor medicare to the competitive marketplace, the way it works in the United States. We will soon have US-style private sector, or at least two-tier, health care.

Fact: Our recent budget cuts have nothing to do with the FTA or NAFTA. Rather, they have to do with the unsustainable chain of budget deficits that had to be eliminated lest they imperil the very ability to continue to fund our social safety net. The greater the proportion of the tax dollar devoted to servicing the debt, the less is available for programmes Canadians cherish. The cuts may not have enhanced our medicare system, but they were made where the money was. Now that we are back to a federal budgetary surplus, we have a real government again, namely one that can make choices, including enhancing spending on health care, or reducing taxes, or attacking our accumulated debt, or some of each.

Myth: When we were negotiating the dispute-settlement mechanism in the FTA, we should have won an exemption from arbitrary trade remedies or preserved the right to retaliate against bullying, or held out for an agreed-upon definition of a subsidy.

Fact: The negotiation to create an agreed-upon subsidies code was doomed from the start, partly because the remedy against subsidies in international trade is defined in relation to the harm done by the subsidy. Since we export to the United States a far greater proportion of our output than they export of their output to Canada, we are more likely to cause harm by our subsidies than they are. The ideas of a double standard, or of safe harbours, were briefly toyed with and abandoned. What we settled for was an arrangement whereby no country can attempt to be judge and party in its own case, or take a politically motivated countervailing action which cannot stand scrutiny, even under that country's own laws.

Myth: We should not sign a Free Trade Area of the Americas (FTAA) treaty because that would allow more workers in low-wage countries to steal our jobs.

Fact: Employment levels are not based on remuneration, but rather the comparative advantage obtained by producing a product or a service in a manner that justifies the allocation of resources involved in that industry. It is good, not bad, to produce goods and services that require a higher skill level and command higher wages. Specialisation in the things that maximise our output and which we can trade for more of the other things we do not produce (or used to produce) improves our standard of living. Self-sufficiency is not the goal, or if it is, it comes at a price we should identify before we assume it is a good idea.

Myth: Under NAFTA, foreign corporations can sue Canada if we exercise our sovereign right to ban substances that are harmful to the environment or jeopardise our health or safety.

Fact: The federal government recently paid \$20 million to a US company, Ethyl Corporation, to settle a lawsuit alleging that Canada's ban on a gasoline additive called MMT violated Ethyl's right to sell this product to Canadian refiners. Under NAFTA, each signatory country is accorded national treatment in the application of a government's right to ban harmful substances—that is, Canadians, Americans and Mexicans are treated the same. But no Canadian company makes this stuff. As a result, the ban appeared to be aimed at the *importation* of MMT, which goes to the fundamental purpose of NAFTA, which is to prevent governments from erecting tariff or non-tariff barriers to the trans-border movement of goods and services. Unfortunately for the Canadian government, it could not prove that MMT was harmful, and even admitted as much in the settlement documents. The moral of this story is that if you purport to “protect” Canadians from harm to their persons or their environment, you had better know what you are talking about. Incompetent grandstanding is not shielded by NAFTA.

Myth: The concepts of international competitiveness and the globalisation of markets promote a Cult of Impotence

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whereby governments are deemed to have no power to influence events beyond their borders or to protect their residents against these powerful forces. Government attempts to control markets are called impractical or inadvisable. The net result is that rich multinational corporations profit from lower wages and benefits, lower taxes and less regulation while the poor get poorer.

Fact: Nothing could be further from the truth! Openness promotes growth in investment, employment opportunities, national and individual incomes, and tax revenues to pay for programmes that assist the less fortunate.

It is true that when our economy shifts to more sophisticated jobs, these new occupations may not be filled by the same individuals whose jobs have migrated to our trading partners. This is what is meant by “adjustment” and programmes to mitigate individual experiences may well be needed to ensure training and mobility to the newer, better jobs! It may even be that the shift to newer skills is intergenerational, and that some current workers may not be able to assume the upgraded opportunities our economy can now offer. But none of this is a good reason to oppose change. In Canada, our governments are already adept at dealing with occupational and geographic labour mobility. Millions of Canadians change jobs every year.

Trade and Prosperity

In the final analysis, Canada has too small a domestic market, spread too thinly throughout a vast territory, to permit the creation of a truly competitive economy without relying on international trade. If we must trade to make a living, we ought to have a negotiated say in the arrangements that govern and regulate such trade. Ultimately, prosperity is

the way to preserve sovereignty, not, as the free-trade critics say, to lose sovereignty. A government with revenues and a fiscal margin of manoeuvre is a government with the ability to maintain and improve our preferred programmes. What we cannot have is the world just as it was before, where the state gets to approve all change. That world disappeared in the last two or three decades as the globe grew smaller, investment more mobile, and markets more international. Adjusting to this change, instead of opposing it, is the more intelligent choice.

Competitiveness is not easy to achieve, and liberalised trade is only one element in a successful economy that generates a country's wealth and higher personal incomes. An appropriate saving rate and a shift in the composition of GDP toward capital goods (in order to renew our productive capacity and remain in the forefront of technological innovation) play an important role. So do an appropriate level of research and development expenditures, and an exchange rate that prods us to make those structural changes that will keep us on our toes while inhibiting a resurgence of inflation.

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Risk-taking entrepreneurship and a skilled and motivated workforce that cares about the quality of what is being produced and about the price at which the economics of the firm permit the product to be brought to market, are also part of the puzzle. Income-tax rates and other supply-side incentives, including interest rates and the treatment of capital gains count for a lot in

individual decisions about where to live and work and invest.

This said, and recognising the fact that free trade alone cannot guarantee our economic well-being, only those who would have Canada left at the starting gate in the global competition for jobs and investment would deny the free-trade champions their high fives and their victory laps. ♦