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After 25 years, free-trade deal with U.S. has helped Canada grow up

By JOHN IBBITSON

A quarter century ago, Brian Mulroney signed an agreement with the U.S. that divided a nation – and forever changed how it did business

A quarter century of free trade has transformed this country, but not in the way its champions hoped, or its critics feared.

Canada has not, as opponents predicted, become an economic appendage to the American giant, a 51st state in all but name, since the Canadian and American governments reached a comprehensive free-trade agreement. We are, if anything, a freer actor in the world than we were before the deal was signed, 25 years ago Thursday.

But the benefits are also debatable. After a decade of rapid increase following the ratification of the Canada-United States free-trade agreement (commonly referred to as FTA), trade with America has levelled off and even, by some measures, fallen back to where it was before the deal.

Despite rosy predictions, Canadian productivity continues to lag; too little gets researched here and not enough is developed.

"There are a lot of good things going on in this country," says David Peterson, who was premier of Ontario at the time of the free-trade debate, and who campaigned against the deal. "But we are still hewers of wood and drawers of water."

The real legacy, however, may be intangible. "It's not just a question of numbers," maintains Kevin Lynch, who was clerk of the Privy Council – Canada's most senior public servant – from 2006 to 2009.

Free trade helped Canada to grow up, to turn its face out to the world, to embrace its future as a trading nation, to get over its chronic sense of inferiority.

Free trade got Canadians to "believe in ourselves – to take down the tariff barriers and think we could compete with the world's largest and most competitive economy, and do well at it," Mr. Lynch argues.

"All these things were made possible by thinking about the world through a totally different prism," he believes. "And free trade allowed us to do that."

As the federal government prepares to unveil a new free-trade agreement with Europe this year and with India next year, as it strives to become part of a new Pacific accord, and contemplates entering into talks with China, let's look back at the father of all trade agreements: how it came about; what was at stake; and what it meant for our future.

Because 25 years later, it shapes us still.

The generation born after 1980 may not appreciate how grim things were at the beginning of that decade. Canada and the United States were in the grip of a recession far worse, in many respects, than the one of 2009. Inflation reached just over 12 per cent in 1981; mortgage rates were over 21 per cent; the next year unemployment peaked at 13 per cent.

Pierre Trudeau, having contributed to the mess with his ill-considered national energy program, ordered up a royal commission on how to fix the Canadian economy.

Donald Macdonald, its principal author, surprised everyone by calling for a free-trade agreement with the United States, which he described as "a leap of faith."

Brian Mulroney, by then the Progressive Conservative prime minister, decided to take that leap, holding hands with American president Ronald Reagan. The negotiations were long and intense. At almost literally the last hour, with congressional authority to fast-track a deal about the expire, the whole thing almost foundered, over Canadian insistence on a dispute resolution mechanism.

As Mr. Mulroney remembers it, Treasury secretary James Baker told him Congress would never approve a clause limiting its power to oversee international trade.

"And I said 'OK Jim, fine. I'm now going to call President Reagan at Camp David, and I'm going to ask him ... how the United States of America can sign a nuclear reduction treaty with its worst enemy, the Soviet Union, but cannot sign a free-trade agreement with its best friend, Canada," Mr. Mulroney recalled in an interview in the journal *Inside Policy*, to be published Thursday.

Twenty minutes later, Mr. Baker walked into the room where the Canadian negotiators were waiting and dropped a piece of paper on the table, declaring: "There's your goddamn dispute settlement resolution."

"I was feeling worried," Mr. Mulroney acknowledged in an interview with *The Globe and Mail*. Failure would not only have set back relations with the United States; it would have been a body blow to his government.

But the deal was far from sealed. Opposition to free trade with the United States

was broad and deep. The Americans would take over any parts of the economy they didn't own already, critics warned; they would use the agreement to force an end to public health care; they would siphon our water and force us to sell our oil at fire sale prices.

"Canada was in many ways somewhat fearful," Mr. Mulroney observed in the interview, "concerned about the size of our neighbour, and deeply concerned as well by the matter that had always been out there, namely the absorption by the United States."

Both the Liberals and the NDP were dead set against the deal. Liberal Leader John Turner declared that stopping it was "the cause of my life."

"I'm a free trader, but I want mutual free trade," Mr. Turner explains, 25 years later. "The way it was negotiated with the United States, only Canadian jobs were at stake."

When the Canadian Senate blocked ratification, Mr. Mulroney called an election in the autumn of 1988. There has never been an election quite like it. Canadians bitterly disagreed among themselves over whether to embrace free trade with America. They all agreed, however, that the future of the country was at stake.

"If you went into a bookstore or you went into a laundry, people were arguing about free trade," remembers Allan Gotlieb, who was Canadian ambassador to the United States at the time, and one of the key negotiators of the agreement. "People were pinning up editorials or articles on their refrigerators. It was an issue that grabbed hold of the country in a way no other foreign policy issue has since conscription. To me, it was a phenomenon."

Polls surged for the Liberals after Mr. Turner kicked butt during the leaders' debate. And the party put out what may be the most effective attack ad in Canadian history:

A Canadian and an American negotiator sit over a table discussing the accord.

"There's just one line I'd like to change," the American proposes.

"What line is that?" asks the Canadian.

"This one here. It's just getting in the way." On a map placed between them, the American takes an eraser to the Canada-U.S. border.

But with opposition split between the Liberals and NDP, the Progressive Conservatives won a second majority government, and the FTA became law.

Two years later, Canada fell into a deep recession – with free trade part of the

reason. With tariffs removed, American firms closed their Canadian branch plants and shut down their Canadian head offices.

"We lost 200,000 manufacturing jobs in the first two years," Mr. Peterson recalls. "We were the province with the most to lose, and we predicted we'd lose it, and we did."

But then things started to take off. Bilateral exports, which totalled about \$100-billion a year in the late 1980s (all figures are in Canadian dollars), shot up to \$350-billion a year by 2000, according to a new study by Douglas Porter, deputy chief economist of BMO Nesbitt Burns. The study is part of the Inside Policy issue on free trade.

Little of the gloom turned to doom. Public health care remained intact. Water stayed in Canadian rivers and lakes.

Yes, total American investment in Canada increased, to \$326-billion in 2011 from \$76-billion in 1988. But Canadian investment into the United States also grew, to \$276 billion today from \$55 billion before free trade.

Free trade with the United States, and the subsequent North American free trade agreement that brought Mexico into the tent, were "critical ingredients in helping modernize the Canadian economy ... transforming Canada from a relative underachiever among industrial world economies to a relative overachiever," Mr. Porter concludes.

Except there's a catch. Actually, there are several catches.

Since 2000, growth in Canada-U.S. trade has not only flattened, but declined. After almost a decade of little or no growth, from 2000 to 2008, bilateral export values plunged with the arrival of the 2009 recession, and are still struggling to return to 2000 levels.

Taking an even longer view, Mr. Porter notes that just before free trade, exports to the United States represented 17 per cent of Canada's nominal gross domestic product, in current Canadian dollar terms. By 2000, they had reached 33 per cent of Canada's GDP. Today the number is all the way down to 19 per cent. By that measure, we're practically back to where we started.

Different yardsticks produce a better result. But by any measure, the wild trade gains of the 1990s were at least partly clawed back in the past decade. Trade between Canada and the U.S. is stronger today than it was before free trade, but not that much stronger.

There are many reasons for the swoon. Mr. Porter points to the rising Canadian dollar - which appreciated by 75 per cent between 2002 and 2007 - as the

principal culprit. As well, there was also the thickening of the border that followed the attacks of Sept. 11, the bursting of the tech bubble in 2000-02, the last recession, which hit the United States harder than it hit Canada, and growing competition from other exporters, especially China.

There is a bigger catch. If the Canada-U.S. free-trade agreement was a critical opening act in the story of globalization – signalling to the world that two G7 countries were ready to open their markets to each other – the most recent chapters of that story make for grim reading.

Ed Broadbent, who was leader of the NDP during the free-trade debate, thought it was a rotten deal then, "and I do to this day."

Free trade brought deregulation, privatization of state-owned companies, weakened protection for labour and the great sloshing of capital from one national market to another – all of it part of the race to the bottom, he believes.

"This approach became ideologically dominant in the Anglo-American world," Mr. Broadbent maintains. "The trade deal was part of the kickoff of this kind of thinking, and I think it was a mistake."

Then there were the intended consequences that were never realized. Open competition with the Americans should have forced Canadian firms to become more productive. And spending on research and development should have taken off, as Canadian entrepreneurs plowed profits into product development.

But Mr. Lynch observes that Canadian productivity is only 72 per cent of its American counterparts, and Canada ranks 20th among OECD nations in spending on research.

Nonetheless, he is convinced that the free-trade agreement had a more important, and more lasting, legacy than any number can record.

"It caused a sea change in attitudes," he believes. The courage needed to take that free-trade leap of faith equipped governments to tackle other seemingly insurmountable challenges: Establishing the goods and services tax, eliminating the deficit, reducing corporate taxes.

Most important, FTA convinced Canadian governments, Canadian businesses and Canadians generally that this country had the knowledge and confidence to compete in any market.

Since the original free-trade deal, Canada has not only joined the North American free trade agreement, it has signed bilateral deals with Israel, Chile, Costa Rica, Columbia, Jordan and the non-European Union states of the European Free Trade Association. An agreement with Panama is before

Parliament.

But the real news should come before the end of the year, with the signing of a Canada-European Union free-trade agreement, which will be the largest since the Canada-U.S. deal. Next year, Canada and India hope to conclude a free-trade agreement.

And Canada recently joined the Trans-Pacific Partnership, a set of negotiations that, if successfully concluded, will create the largest trading bloc in the world.

As globalization continues to break down barriers and promote the free flow of capital across borders, for better or worse, Canada stands well positioned to tap the potential of the rising Asian and Pacific economies.

So was it worth it in the end? Twenty-five years later, David Peterson – who lost an election as free trade and a recession reshaped Canada in 1990 – still isn't sure.

"What you've asked me is a totally reasonable question. And I don't think there's a clear and easy answer to it," he confesses. "It helped the resource side of our economy. It has not helped the innovation side, particularly. There was good and bad in it."

John Turner has advice for Stephen Harper as he works through these negotiations.

"Be very careful in drafting these agreements with Europe or India or wherever that we don't lock ourselves into a situation where we don't win," he warns. "And read the agreement first."

But Mr. Gotlieb has a far more positive view. He believes competing freely and successfully in the American market helped cure Canada of its insular, fearful anti-Americanism. "We were a frightened nation," he maintains. "We were frightened by this U.S. embrace." The free-trade debate marked the high tide of that anti-American fear.

But after the agreement passed, "the waters slowly began to pull back from the shore. And they have never returned."

Competing successfully in the U.S. market has given a new generation of entrepreneurs the confidence to compete in other big markets.

Mr. Lynch recently met with the leaders of several new startup firms based in the high-tech hub of Waterloo, Ont. "Their view is they're going to sell their goods and services globally; they can compete with anybody," he reports.

"They're flying from Waterloo to Silicon Valley to Israel to Singapore." They are using their experiences in Canada and North America to sell Canadian business to the world. "And that," Mr. Lynch believes, "is how we should think about the future."

Let Mr. Mulroney, who more than anyone was responsible for the deal, have the last word:

"There is a new generation of Canadians with a new attitude," he believes. "They are confident, they are outward looking. These are the happy warriors of Canada who are out there fighting the good fight and winning most of the time. And they've established that they can win because if they can win in the United States they can win anywhere."

"I look back at it now, and I'm pleased with what I see."

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A trade deal's hopes and fears

By BARRIE McKENNA

When the FTA was signed by the U.S. and Canada, there were positive predictions and cries of doom. In 2012, the result has mostly been mundane

THE PROMISE

Trade Nirvana

Trade exploded in the first 15 years after the Canada-U.S. free-trade deal went into effect in 1989. Exports more than tripled. Imports from the U.S. also rose rapidly.

But it's been a different story since. Trade with the U.S. has pretty much stagnated as a series of events unwound the progress of the early years, including the crash of the tech bubble, the post 9/11 border crackdown, the rapid rise of the loonie and the global financial crisis.

The result: Exports to the U.S. are now lower than they were in 2000, and account for roughly the same share of Canada's gross domestic product now as before the deal (19 per cent vs. 17 per cent). And Canadian exporters have steadily lost market share in the U.S. market.

End bickeringThe FTA created a new model for impartial dispute resolution that was supposed to end chronic border bickering. It didn't quite work out that way. The nastiest post-FTA fight – softwood lumber – ended with a managed trade deal in 2006 after several rounds of inconclusive litigation before FTA panels.

And yet disputes have become less frequent in recent years. But that's mainly because the economies of the two countries are much more integrated. Companies and their suppliers operate on both sides of the border, blurring the lines of national self-interest.

Fix Canada's economic woesMany proponents boldly sold the FTA as a cure-all for problems that had long plagued the economy, including the large current account deficit, wild currency swings and hefty sovereign debts.

The results are mixed. Currency fluctuation is still a problem (witness the ascent of the loonie in 2006 and 2007). And after running large trade surpluses in the first decades after the FTA, Canada has a deficit again. Sovereign debts aren't a big problem after Ottawa cleaned up its finances in the 1990s. The country also has many new problems, including lagging productivity and underinvestment in

research and development.

Boost investmentIt's one of the forgotten outcomes of the deal. Two-way foreign direct investment has soared. Americans are still more invested here than the other way around (\$326-billion versus \$276-million). But the flows are way up in both directions. Canadian banks, for example, have expanded massively south of the border.

THE FEAR

Loss of sovereigntyPerhaps the greatest fear of Canadians about free trade was that the country would lose its autonomy. There almost no evidence of this happening. The country has continued to take an independent course, both inside Canada and on the world stage.

A flashpoint was the FTA's chapter 11, which allowed companies to sue governments. But the clause is sporadically used, and no major government programs have been affected in Canada.

Loss of identity

The feared Americanization of Canadian culture hasn't happened. Canada continues to enjoy a vibrant media industry, filled with a mix of homegrown music, theatre, film and books, as well as foreign material. Canadian content rules and foreign ownership restrictions for sensitive industries remain firmly in place.

Canada remains a major cultural exporter, with success stories such as Justin Bieber and Cirque du Soleil.

Undermine MedicareThe two countries' public and private health care models remain distinct. Private health care is gaining ground in Canada, but that's largely a response to cost pressures and wait times. Meanwhile, elements of public health care have crept into the U.S. system, including increased drug coverage for seniors and Obamacare for the uninsured.

Death of industry

Some industries have clearly suffered, including lumber, cattle, textiles, autos and clothing. But it hasn't been the disaster many critics warned. And many of the challenges these industries face – including the high dollar, low-cost offshore competition and the recession – would have happened anyway.

Even some of the most unlikely survivors, such as clothing makers, continue to thrive in Canada, exporting items such as jeans and suits.

NAFTA REVISED: Canada agreed to a revamped free trade deal with the United States and Mexico late Sunday after weeks of negotiations. The deal reached just before a U.S.-imposed midnight deadline will be called the United States-Mexico-Canada Agreement, or USMCA. It replaces the 24-year-old North American Free Trade Agreement. The agreement gives U.S. farmers greater access to the Canadian dairy market, but keeps a NAFTA dispute-resolution process the U.S. opposed. It also offers Canada protection if Trump imposes tariffs on cars, trucks and auto parts imported into the United States. President Global Trade. Productivity in the UK fell at its fastest annual pace in five years in the April-to-June quarter, according to the Office for National Statistics. The figure - measured by output per hour - fell by 0.5%, after two previous quarters of zero growth. Both services and manufacturing saw a fall from April to June, the ONS said. The period of weak productivity growth after the financial crisis has been a time when the economy has, for most of the time, been growing but not strongly. The one rather brighter spot has been the other element in the productivity calculation, employment. Britain now has the highest percentage of the population in employment since at least 1971 (that's how far back this particular data series goes). "Whatever free trade was about it hasn't helped Canada in the modern era," says Canadian Auto Workers economist Jim Stanford. For evidence, he rhymes off the Canadian hopes for FTA and the results so far. FTA was supposed to have bought Canadian exporters special access into the lucrative U.S. market, but Canada's share of total American imports is now lower than it was in 1988. How's that for "special access," he says. "I think free trade has contributed to the de-industrialization of Canada and the growing, and I would say precarious, reliance on resource extraction and export," he concludes. Economist Erin Weir of the Progressive Economics Forum adds another negative, as he sees it.