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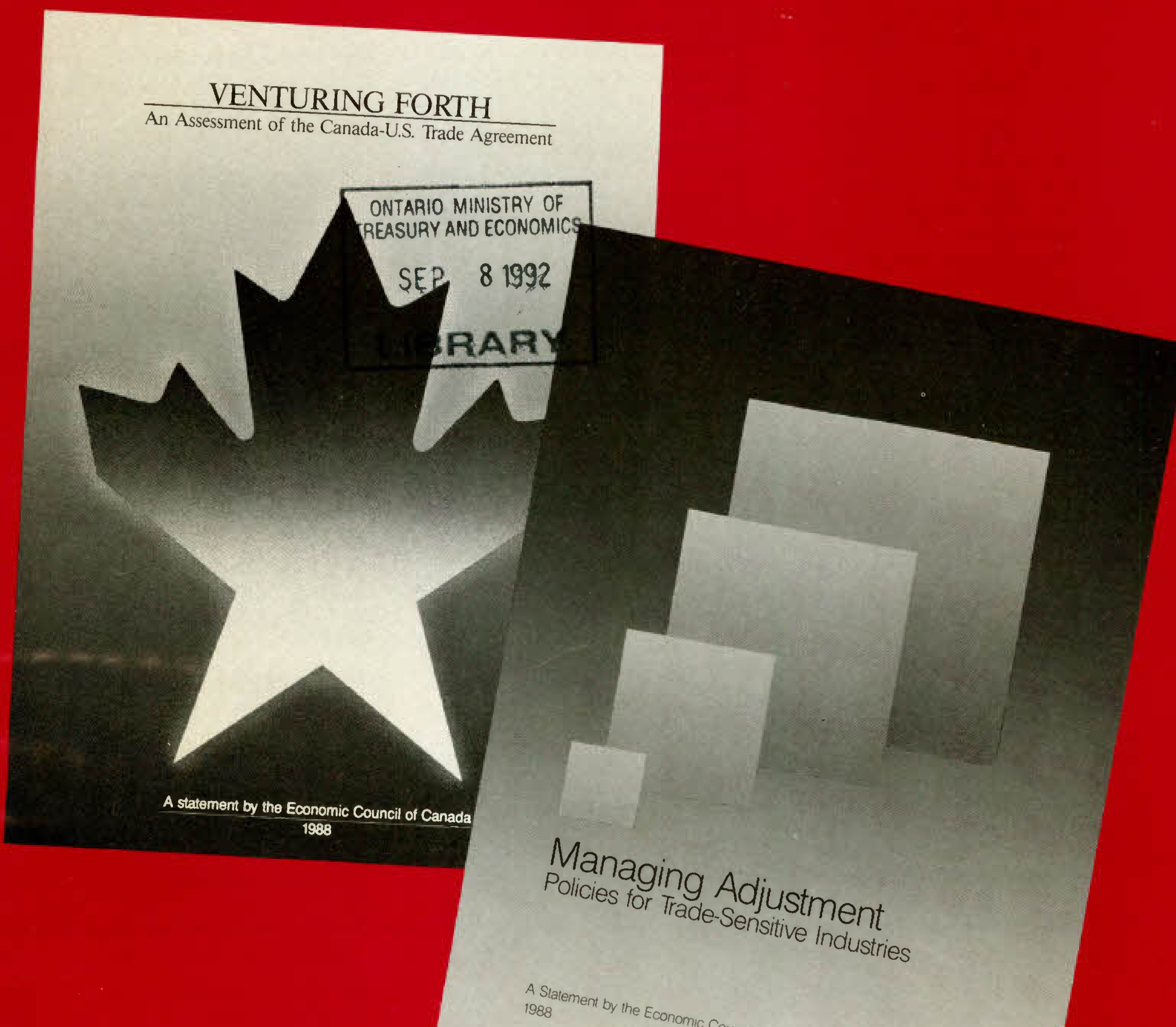
# au courant

Economic Council of Canada

Volume 8, No. 4, 1988






- The free-trade deal
- The record of adjustment

# PUBLICATIONS

## New Council Statements

***Managing Adjustment: Policies for Trade-Sensitive Industries*** (EC22-150/1988E; $4.95 in Canada, $5.95 elsewhere).

In this Statement, the Council looks at the adjustment of manufacturing firms and workers to changes in the marketplace, particularly the impact of growing international competition and trade liberalization. The Council presents considerable new evidence on the adjustment responses of Canadian and foreign-owned firms; on the mobility of workers; and on the impact of change in "trade-sensitive industries" – those that have received sector-specific government assistance because of the pressures of international competition. The Council also puts forward recommendations for governments on how best to help workers and industries manage the adjustment process.

***Venturing Forth: An Assessment of the Canada-U.S. Trade Agreement*** (ECC22-151/1988E; $4.95 in Canada, $5.95 elsewhere).

In this Statement, the Council assesses the impact of the proposed Canada-U.S. Free-Trade Agreement. In particular, it looks at the extent to which Canada achieved its objectives in the trade agreement; the impact of the agreement on economic growth and job creation in the economy as a whole and in various industries and regions; and some of the concerns that Canadians have about the deal. In addition, the Council puts forward some suggestions for helping workers adjust to changes in the economy as a result of the agreement.

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**No. 337** "The impact of tax reform on the taxation of corporate investment income," by *M. J. Daly* and *P. Mercier.*

**No. 338** "Collective bargaining over technological change in Canada: A quantitative and historical analysis," by *Jonathan C. Peirce.*

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Volume 8, No. 4, 1988

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## Contents



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**Editor: Jonathan Massey-Smith**

ISSN-0226-224X

# *Managing Adjustment*

Some workers and industries in Canada have failed to adjust to increased foreign competition because of protectionist government policies that prevent rather than promote adjustment, the Economic Council says.

In particular, import quotas and subsidies have tended to delay workers and industries from making the appropriate choices indicated by competitive pressures, the Council says in a new Statement examining the adjustment experience of Canada's manufacturing sector. The research also indicates that, by and large, special industry policies "have had a low payoff."

The Council believes that special sectoral measures should be used sparingly and only after careful consideration and evaluation. It calls for a number of "corrective steps" to ensure that such policies have the intended impact of promoting positive adjustment. The conclusions and recommendations contained in *Managing Adjustment: Policies for Trade-Sensitive Industries* are the culmination of an 18-month research program. A more detailed report on the project's findings will be published shortly as well.

## *An overview*

The Council points out that Canada's prosperity depends on trade and that its manufacturing sector produces two-thirds of Canada's exports. Because of the constant challenge to renew its products and production systems in response to international competition, "Canada must manage the adjustment to change by manufacturing firms and workers wisely," it says. "In managing adjustment, Canadians are trying to channel capital investment, managerial talent, and workers' skills into activities where they will be most productive."

Canadian manufacturing firms have faced a number of competitive challenges over the past two decades. The newly industrialized countries have undercut traditional industries – textiles, clothing, and footwear, in particular. The dynamic Japanese economy has displaced some Canadian production of goods such as automobiles, ships, and electrical appliances. As well, there have been rapid technological innovations; changes in transportation (including deregulation); fluctuations in exchange rates and the world price of oil; and increased import competition from the fall in tariff barriers.

In the past, the debate on adjustment policy in Canada has tended to focus on the particular problems of a specific industry. But two recent developments call for a broader perspective in examining this issue, the Council says. First, the negotiation of a Canada-U.S. trade agreement has awakened Canadians to the scope of the adjustment challenge facing all sectors that engage in international trade. Second, the economic success of Japan and the newly industrialized countries has forced Canadian firms to recognize that their competitors can replicate the production of many of the goods and services now produced in Canada. "In short, the adjustment challenge is pervasive and unending," the Council explains.

## *The research*

To manage adjustment, it is not sufficient merely to identify the competitive pressures on the horizon. There is a need as well to understand the responses of industries, firms, and employees to the pressures of a changing environment and to assess how their responses influence policy makers. On the next few pages *Au Courant* presents considerable new research to describe the actual adjustment that is taking place in the manufacturing sector. Because the impact of structural change on unemployment is of critical concern, the Council concentrates on examining the turnover of jobs (initiated by firms) and the mobility of workers. Since foreign-owned corporations may react to the pressures for change differently than Canadian-owned firms, the Council looks at whether firm-initiated responses differ according to country of ownership. It also examines the impact of change on "trade-sensitive industries" – those that have received sector-specific government assistance because of the pressures of international competition. The analysis in this respect focuses on the use of three policy instruments: special import measures, particularly quantitative restraints on imports (quotas); capital subsidies to firms and industries; and special labour market policies. The Council examines the way in which these instruments have been applied in the shipbuilding, automobile, footwear, textile, clothing, and pulp and paper industries.

Finally, the Council sounds a note of caution over the increasing involvement of governments in adjustment policy, reflected in part by the growth in the number of trade-sensitive industries. "This is important because our work suggests that if change is delayed for too long as a result of sector-specific assistance by governments, the adjustment that must eventually take place will be far more difficult . . . for people in the affected industries," it concludes. Hence the Council puts forward recommendations for governments on how best to manage the adjustment process.

# *Adjustment in manufacturing*

Will free trade with the United States lead to an exodus of foreign-owned branch plants – U.S. multinationals in particular?

New Council research suggests that a mass exodus is unlikely. Contrary to public perception, in fact, recent experience shows that many U.S. multinationals have maintained or expanded their Canadian presence as trade barriers between the two countries have fallen. Furthermore, while in many industries Canadian employment in U.S. branch plants has tended to decline relative to that in U.S. parent corporations, the losses tended to be smaller in those industries where Canadian trade barriers had been lowered the most.

It is often suggested that Canadian affiliates of multinational enterprises will respond to competitive pressures in ways that are less favourable to the domestic economy than are the responses of Canadian-owned firms. Proponents of this view argue that some forms of production may not be economically feasible in Canada in the absence of trade barriers.

To discover if ownership makes a difference in the way in which firms react to change, the Council examined the responses of multinationals to several types of pressures (including tariff reductions and differences in national cost levels). Specifically, it examined evidence on the inclination of U.S. and Australian, as well as Canadian, multinationals to shift production from country to country, to rationalize (by improving production or lowering costs, for example), or to cease operations in the face of import competition.

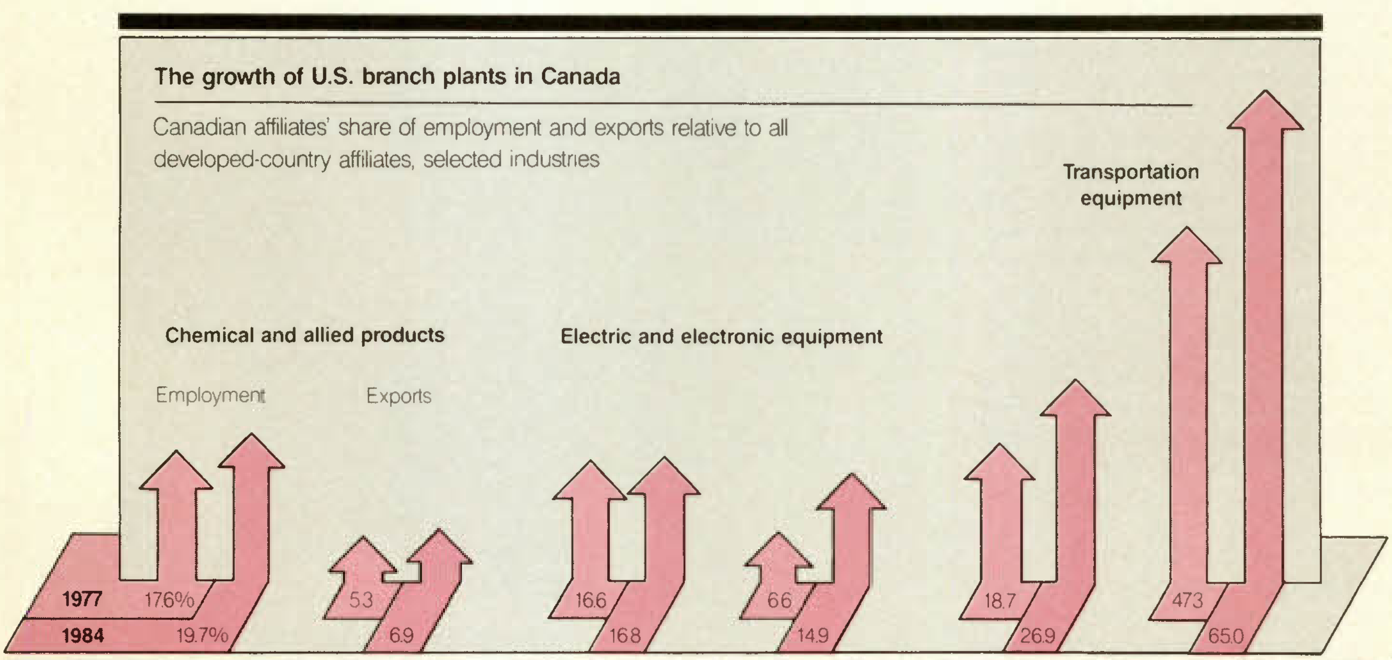
## *The results*

The Council uncovered a number of interesting results. First, multinationals do not appear more inclined than other firms to shift their operations to low-cost foreign sources of inputs. They may even be less footloose than domestic firms: when there are short-term changes in the prices of competing imports (caused by variations in exchange rates, for example), multinationals show more stability in employment. That means domestic firms are more likely, for example, to buy cheaper foreign inputs and to lay off workers as a result of short-term price reductions in competing imports. (Conversely, they are more likely to hire workers in response to rising import prices.) Multinationals, on the other hand, respond much more strongly to longer-term changes in import prices. Consequently, the Council maintains that multinationals would appear to be "particularly well placed to distinguish between permanent (or structural) and temporary (or cyclical) changes."

Second, multinationals do not appear more inclined than domestic firms to close or sell plants when faced with declining domestic demand. "Thus the picture that is frequently painted of foreign-owned branch plants ready to leave Canada as soon as conditions take a turn for the worse is not borne out by the evidence," the Council finds.

Third, although there is some disagreement on this issue, foreign-owned firms in Canada appear to have rationalized their production facilities in response to trade liberalization and market growth in much the same manner and to much the same extent as Canadian-owned firms.

Fourth, in industries experiencing rapid trade growth (such as electrical machinery and transportation equipment), the affiliates of U.S. multinationals in Canada have grown in terms of exports and employment relative to those in other developed countries (see chart). Often, these are industries that involve a high intensity of research and development (R&D) and that "many hope will provide the high-quality jobs desired by Canadians," the Council points out. At the same time, Canadian affiliates of U.S.-owned firms have become less important in industries experiencing slower trade growth. This is particularly the case in



such industries as wood, paper products, and textiles. Canada's total share of developed-country exports in these industries also fell between 1977 and 1983, reflecting a decline in the attractiveness of Canadian production overall. In other instances, such as the food and beverage industry, while U.S. ownership of Canadian production became less attractive, Canada's share of developed-country exports increased.

In total, the evidence suggests that Canadian- and foreign-owned firms often respond to the pressures for change in much the same way.

In light of this evidence, the Council says that a separate adjustment policy based on the country of ownership of firms is not warranted.

## *Labour market turnover*

The rationale for government intervention to help workers facing adjustment is much stronger than it is for firms, the Council believes. Workers may not have the resources necessary to undergo retraining, for example, while firms can more easily finance new investment opportunities. The Council looks at labour market adjustment in the manufacturing sector from two perspectives – "job turnover" (the creation and destruction of jobs) and "worker turnover" (the flows of workers into and out of jobs).

Job turnover is viewed as being firm-initiated, since it reflects the changes in employment that result from the creation, expansion, contraction, or closing down of firms. Each year, a large and relatively constant proportion of jobs in manufacturing disappear as a result of the decline or closing of firms – more than 8 per cent, on average, during the 1970s. When calculated over a five-year period – to eliminate the effect of short-run fluctuations – the average job-loss rate exceeds 4 per cent annually; over a 10-year period it is 3.6 per cent. "The latter figure reflects the fact that at least 30 per cent of the jobs that existed in 1971 had disappeared a decade later," the Council points out. Yet, as the accompanying chart shows, employment in the manufacturing sector has increased over time.

Worker turnover can be either firm-initiated (layoffs or hirings, for example) or worker-initiated (workers finding new jobs, for instance). Both are equally important on an annual basis. Together, the number of permanent layoffs and attritions (people quitting, taking early retirement, or extended leave for illness) amounts to more than 20 per cent of employment in the manufacturing sector each year.

## *Labour force mobility*

While many people change jobs in the manufacturing sector each year, either for personal reasons or because of changing economic conditions, the large turnover does not necessarily mean that workers adapt easily. If workers leave one employer to do similar work for another in the same industry, it may be difficult for them to adjust should that industry undergo a long-term decline in activity. On the other hand, if workers move to other industries, occupations, or regions relatively frequently, "we can expect adjustment to be less painful," the Council explains.

The degree of labour mobility across occupations and employers was investigated by tracking individual workers over time. That evidence indicates that workers show "considerable mobility" between employers, industries, and occupations when they leave one job for another, the Council concludes. Still, adjustment problems are likely to be more acute in cases where the industrial base is narrow (such as in one-industry towns, for example) or where older workers in particular are affected, it adds.

## *Trade-sensitive industries*

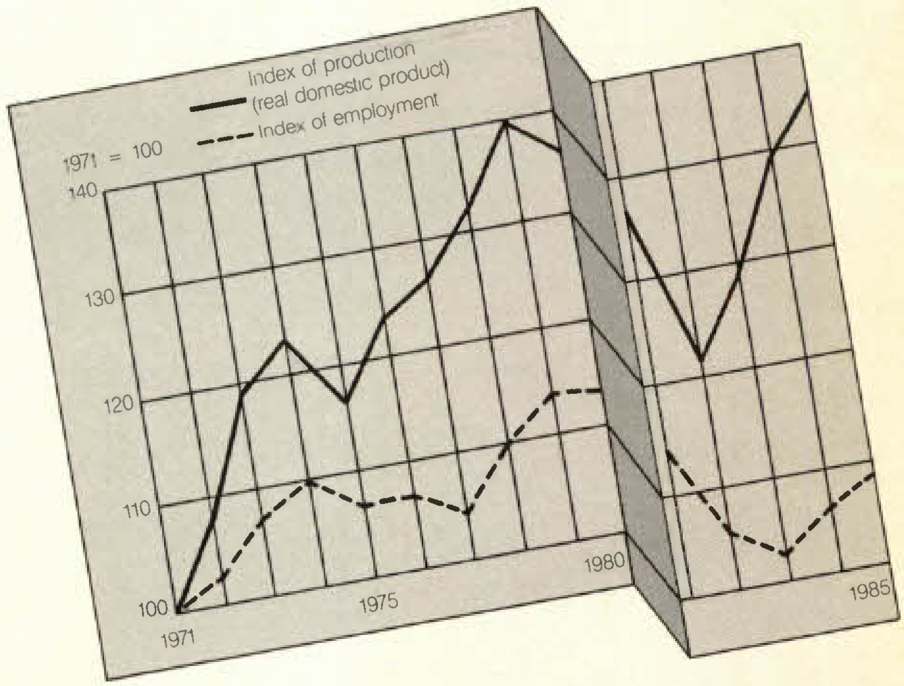
Some industries are likely to be more affected than others as a result of trade pressures. Adjustment problems are most acute for industries facing strong competition from imports. But the number of plant closures in these industries corresponds closely to those registered in other industries where there was less import competition, the Council discloses. Indicators of job and worker turnover also reveal little difference between the two groups of industries. In particular, the Council singled out for careful examination workers in four industries that are widely regarded as being among the most trade-sensitive: leather, textiles, knitting mills, and clothing. The mobility, and hence the adaptability, of workers in three of those industries turned out to be "remarkably similar to the average for all manufacturing," the Council found. Only the leather industry showed lower rates of layoff and attrition.

## *Trade adjustment*

In industries that are experiencing declining sales, about half the adjustment takes place through a reduction in the number of new firms entering the industry. The other half occurs in the form of increased firm closures. In addition, industries grow not so much through lower firm-closure rates as through higher firm-entry rates. For workers, part of the adaptation takes place as those who would normally lose their jobs because of firm decline find new employment in businesses that are starting up.

**The manufacturing sector has grown**

Growth in production and employment; 1971 as the base year



# A look at government policies

When the pressures for change are judged to be an intolerable burden on industries, regions, or workers, governments intervene with specific policies to manage that change.

Instead of promoting adjustment, however, many of the policies examined by the Council have retarded it. The Council analyses the impact of special import measures, subsidies, and labour adjustment measures on those industries in which they have been used most widely over the past 10 to 15 years: textiles and clothing; footwear; automobiles; shipbuilding; and pulp and paper.

## *Quotas*

Special import measures were intended to provide a "breathing space" so that industries could adjust to increased foreign competition. When temporary quotas are introduced, for example, the industry is given time to adjust. In practice, however, special import measures have typically been of considerable duration, the Council finds. For example, at no time has an appropriate termination date been specified with respect to Japan's voluntary export restraints on automobiles. Under the General Agreement on Tariffs and Trade, the Multifibre Arrangement was basically supposed to encourage trade in textile products and to reduce trade barriers in that area in an orderly fashion. But it has become progressively more restrictive and has been renewed three times.

## *Subsidies*

Subsidy programs have also fallen well short of encouraging positive adjustment, the Council says. Under the Shipbuilding Industry Assistance Program, the value of the subsidy was supposed to be reduced gradually over the life of the program. Instead, it was increased several times. In the case of textiles and clothing, although the subsidy program ended in 1986, the promised reduction in quantitative restraints has not taken place. Finally, although the Pulp and Paper Modernization Program was discontinued in 1984, the federal government continues to subsidize the industry under other programs.

Because import restraints and subsidies had tended to delay rather than promote adjustment, labour policies were given limited opportunity to demonstrate their usefulness, the Council explains.

The only bright spot in its analysis of policy implementation was the use of quantitative restraints in the footwear industry. Here, the quotas were announced as temporary and were indeed phased out.

## *Defining the problem*

With the exception of the footwear industry, the Council finds that governments have failed to ask the right questions when considering adjustment assistance. Governments also have a serious credibility problem because of their failure to phase out or terminate assistance as originally intended. As a result, individuals and producers set their expectations accordingly, and adjustment is retarded.

Import quotas suffer from several problems in particular. Quotas generally restrict the level of imports, which causes higher import prices in Canada. In the case of selective quotas (targeted at a particular country or group of countries), foreign producers can realize a higher return on their exports than they would otherwise. Japanese auto companies are estimated to have garnered an additional U.S. $1 billion in profits in 1984 because of voluntary export restraints on sales to the United States, for example. Foreign producers that receive higher prices because of import restraints will be in a better position to maintain and improve their competitive advantage over domestic producers. This widening gap may discourage Canadian producers from using the breathing space to revitalize their operations.

## *Other shortcomings*

The Council prefers global over selective quotas for other reasons as well. For example, because selective quotas usually target low-cost producers in a small number of countries, they may create an incentive for potential producers in other countries to manufacture those goods and ship them to Canada. If that happens, selective quotas can lead to requests for bilateral restraint agreements with the new suppliers. (This happened with automobiles and with textiles and clothing.) Global quotas that set a ceiling on imports from all sources do not suffer from those shortcomings, the Council notes.

Whether global or selective, however, when the size of the quota is set in volume terms (as it usually is), there is an incentive for exporters to shift to those categories of the restricted good where they can earn the highest profit margins. Such upgrading can occur in sectors of the market where domestic producers previously had an advantage. For example, Japan's voluntary export restraints on automobiles are believed to have accelerated the movement of Japanese manufacturers into the mid-size category, in which North American manufacturers had traditionally held a dominant market share.

Employment and Immigration Canada

The pulp and paper industry receives government support.

# Directions for government

When industries or firms are in trouble because of competitive pressures, governments should help workers adapt rather than give subsidies to businesses to help them modernize, the Council concludes.

The subsidy programs examined by the Council have not promoted adjustment, despite their aims. Primarily, they did not encourage firms to undertake extra investment to modernize their capital equipment. "In contrast, there is a strong argument for government intervention to help workers adjust," the Council believes. Workers may need retraining, for example, and they may not have the necessary resources to adapt. So far, special sectoral labour adjustment policies have had a limited opportunity to demonstrate their usefulness because subsidies and other measures have retarded the adjustment process. But the design of such policies is consistent with the objective of encouraging workers to make the appropriate choices indicated by competitive pressures.

The Council's recommendation in this area is one of nine principles it puts forward to guide governments in managing adjustment and in dealing with the demand for intervention generated by competitive pressures. Overall, the Council sees an important and legitimate role for governments in the adjustment process at two distinct levels: the provision of general or framework adjustment policies in such areas as labour markets (unemployment insurance and training programs, for example), taxation, and competition policy; and the design of selected sectoral policies to help specific industries cope with adjustment.

In particular, governments should maintain and strengthen framework policies that encourage the most productive use of resources in ways that are least costly to society. While sector-specific policies should respect that principle as well, the Council recommends that they be considered exceptions, to be introduced only under particular conditions and subject to clear evaluation.

## Quotas

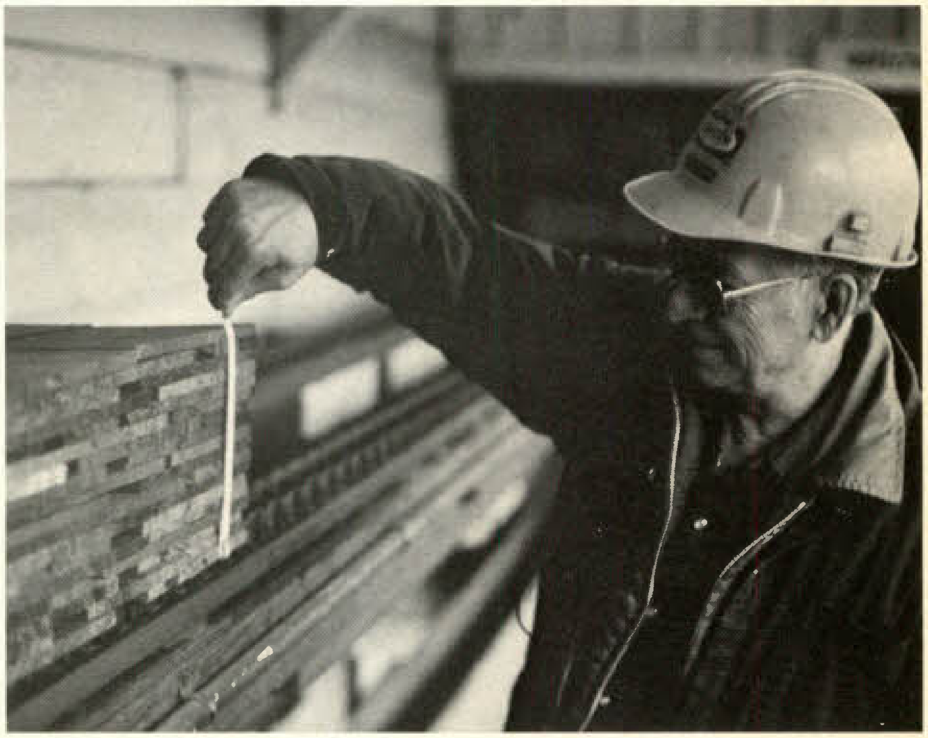
The Council supports the use of quotas to assist industries adversely affected by international competition, provided that Canada corrects the mistakes of the past. Where quotas are used, they should be global, not bilateral; temporary, not permanent; gradually phased out, not constant; and subject to a preset termination date.

To ensure the proper application of import quotas, the Council issues several guidelines. (Some of these principles could be applied to the adoption of other sectoral policies, such as subsidy programs, should the government persevere in using them.) When governments introduce sectoral policies (in particular, import quotas), they should first undertake a thorough evaluation of the problem, as well as of the costs and benefits of alternative policy options, including their duration, necessity, visibility, and impact on firm-adjustment options. The preferred policy should be implemented in such a way as to generate the information necessary for a retrospective evaluation. The public and interested parties should have access to both the initial assessment and subsequent evaluation process. If the urgency of the situation requires a quick reaction by government, the initial assessment may be undertaken after the policy is introduced.

## Independent review

In considering the nature of the evaluation process, the Council is guided by four values that were laid down in its report on the regulatory process (*Responsible Regulation*, published in 1979): informed decision making; accountability; procedural fairness; and openness. One of the problems that regulatory boards experience in respecting those values is that they frequently become captured by the very industry they are regulating. "Agencies that confine themselves to one industry are more likely to be overwhelmed by its concerns," the Council explains. Hence it recommends that policy evaluation be undertaken by an independent arm's-length tribunal whose mandate is not confined to one industry or a small number of industries. The tribunal would hold hearings and issue written reports.

Because the Council is impressed by the mandate given to the Canadian Import Tribunal and the manner in which it undertook its various inquiries into the footwear industry in the early 1980s, it recommends that the tribunal be given responsibility in this area. The question of continuing the quotas should be referred to the tribunal within three years. The tribunal should also hold hearings



Employment and Immigration Canada

Governments should assist workers, not firms.

and issue written reports both before and after the quotas are imposed. In case of emergency, the policy evaluation may take place while some temporary import restraint is in place.

## *Distributing the benefits*

In restricting imports through quotas, the government creates valuable commercial rights, since the price of the restricted goods in the Canadian market is higher than the world price. Sometimes Canadian importers benefit because the quota is allocated among them. (They import the restricted goods at the world price and resell them at a higher price.) In those cases the quota is divided up on the basis of historical import patterns. Other times the quota is allocated among foreign producers by their government, and hence they subsequently benefit.

The Council favours a system under which quotas are divided into standard lot sizes and then auctioned off. It sees a number of advantages to this method. Among other things, import restraint policies would be much more visible, because quotas would be given a dollar value – $3 for a pair of shoes, or $1,000 per automobile, for example. This would give voters and elected representatives a clear idea of their cost. If quotas are auctioned off, the windfall gain would accrue to the government, which could use the funds to respond to adjustment needs. Under this system, the quota holder could not use it as a competitive advantage to shut out new entrants and potentially reduce competition in the industry. Setting up auctions would also provide a clear indication of their tariff equivalent. This would raise the possibility of converting the quota to a tariff – generally considered to be a more efficient instrument of trade policy. While there are some perceived problems with quota auctions, the Council does not consider them insuperable. Hence it recommends that quota rights be auctioned off by the government in conformity with rules under the General Agreement on Tariffs and Trade (GATT), and that the results of such auctions be published. It also endorses the suggestion that auctioned quotas be used as an element in the proposed phase-out of the Multifibre Arrangement (which has restricted trade in textile products) under the GATT.

Governments may follow the recommendations concerning quotas but continue to protect the industry using other policy instruments once the quota expires. So the Council recommends that the Canadian Import Tribunal publish annually, on an industry-by-industry basis, a list of the instruments currently being used to protect an industry from international competition, as well as an estimate of the effect of each instrument by calculating the tariff that would be required to replace it with the same degree of protection. Because this is likely to be a major undertaking, the tribunal should initially confine itself to a narrow range of instruments (firm and industry subsidies, tariffs, government procurement, Canadian-content rules, and quantitative restrictions). Because such information can be collected relatively easily by foreign governments, its publication would not put Canada at a disadvantage in international trade negotiations, the Council points out.

> ***Because of the difficulty in isolating trade-related job losses, assistance to workers should be part of general policies.***

## *Framework policies*

Over the past few years the Council has recommended major changes to government policies in the fields of research and development, technological change, tax reform, and financial markets. General or framework policies in these and other areas must constantly be reviewed to make sure that they support rather than thwart adjustment.

In the case of labour adjustment policies, the Council believes it would be difficult to target special assistance to workers in trade-sensitive industries who are displaced as a result of changes in trade policy. One reason is the difficulty in isolating trade-related dislocation from that caused by other changes. Accordingly, it recommends that such assistance be part of framework policies designed to facilitate the adjustment of workers to changing economic times and conditions.

The Council's work on a number of programs aimed at workers adversely affected by changes in the marketplace leads it to make several suggestions as to how these programs might be modified or improved.

## *Preretirement programs*

Income maintenance for older workers, in the form of preretirement benefits, has been one of the main elements in labour adjustment policies for trade-sensitive industries. Changes to these programs in the early 1980s enabled older workers to volunteer to be laid off without losing their eligibility for such benefits. As a result, younger workers are encouraged to enter and to stay in industries adversely affected by international competition, even though it might be more useful to encourage them to go elsewhere. Under the new Program for Older Worker Adjustment, the Council suggests a return to the eligibility criteria where workers are laid off according to their seniority.

In the past, the designation of industries and communities eligible for benefits under preretirement programs has been made by Cabinet. In the Council's view, consideration should be given to granting that responsibility to an independent tribunal such as the Labour Adjustment Review Board, since the board has labour and employer representation.

## *Re-employment programs*

The Council notes that future job growth in Canada is likely to be in sectors requiring highly skilled labour. Hence it is important that workers be given the opportunity to upgrade their skills and education. In *Making Technology Work* (see *Au Courant*, vol. 8, no. 1), the Council made a number of suggestions for achieving a well-trained, flexible, and committed labour force. These included support for employer-based training in selected highly skilled occupations, the creation of conditions conducive to continuous learning on the job, and the provision of funds and leave for training. Rather than an increase in government funding in this area, the Council suggested a reallocation of resources, with a view to providing "an environment within which employers and workers can make informed decisions about necessary retooling and can then carry out the required training." It reiterates this suggestion, as well as calling for stronger support for the Industrial Adjustment Service (which encourages labour and management to work together when economic change causes labour market adjustments).

# Bargaining over tech change

As the pace of change increases in the workplace, many Canadians become fearful that such change could cost them their jobs or lead to a reduction in their earnings. Many others fear that the introduction of new technology could make their work less interesting.

Because of those concerns, the Council undertook some research to discover what sort of protection Canadian workers enjoy against the adverse effects of technological change. As one measure of that protection, Council researcher Jonathan Peirce examined about 1,000 collective agreements on file in the Collective Bargaining Division of Labour Canada. The agreements covered workers in unionized establishments that employ 500 or more individuals. Peirce examined two things in particular: how frequently certain key tech-change clauses, such as the right to advance notification prior to the introduction of a workplace change, occur in Canadian agreements, and whether the incidence of any of these clauses has significantly increased over time.

The research was carried out as part of the Council's project on the labour market impacts of tech change, which led earlier to a Council policy statement entitled *Making Technology Work* (see *Au Courant*, vol. 8, no. 1).

## The findings

Since tech-change legislation is in force in four Canadian jurisdictions (federally, in Manitoba, Saskatchewan, and British Columbia), Peirce studied whether tech-change clauses were appreciably more frequent in those areas. His findings were recently published in a new discussion paper. They indicate that, on the whole, tech-change clauses are not very frequent in Canadian agreements and that, furthermore, they are not all that much more common now than they were before the passage of federal and provincial tech-change legislation in the early 1970s.

The most common tech-change clause (that requiring advance notice and/or consultation prior to the introduction of a workplace change) occurs in fewer than two-fifths of the agreements in the sample. Other tech-change clauses, such as the right to retraining or relocation assistance, are still less frequent. And while tech-change clauses are somewhat more frequent in British Columbia and the federal jurisdiction than in Canada as a whole, they are relatively less common in Saskatchewan, and evidence suggests that, in general, the existence of tech-change legislation within a particular jurisdiction hasn't been much help to workers seeking to negotiate protective clauses.

## Additional analysis

Workers under collective agreements covering 500 or more employees are not necessarily representative of the Canadian work force as a whole, since many people work in smaller establishments. Accordingly, Peirce supplemented his analysis of large agreements with a sample of about 200 small agreements (covering fewer than 500 workers). As might be expected, he found that bargaining unit size was a distinct advantage in obtaining protective agreement provisions. Every single tech change clause under study was relatively more common in the large agreement pool than in the small one. On average, workers covered by large agreements enjoyed an advantage of about three-to-two over their counterparts covered by small agreements.

In those jurisdictions that have tech change legislation in force, workers or their unions may request that the labour board enforce that legislation in cases where workers feel employers have violated it. But labour boards are not required to open bargaining over tech change when an application is brought before them; rather, it is an option that they may exercise at their discretion. To see how effective the legislation has been, Peirce looked at how often labour boards have granted leave to bargain and in what way they have interpreted that legislation. His review of the relevant labour board cases suggests that, except to a certain extent in B.C., workers and their unions have not been successful in bringing tech change cases before labour boards. The main reason, says Peirce, is the tendency of labour boards to adopt a highly restrictive definition of tech change.

## New approaches

Peirce argues that, taken together, the results suggest that the Canadian collective-bargaining system generally hasn't accommodated itself very well to tech-change issues. Another observation is that more than half of Canadian workers are not unionized and thus do not enjoy any formalized tech-change protection, while many unionized public-sector workers do not have the right to bargain over this issue.

> ***The collective bargaining system generally hasn't accommodated itself very well to technological change issues.***

Peirce concludes, therefore, that formal collective bargaining will need to be supplemented by policy approaches covering all workers if Canada is to create an industrial relations climate in which workplace change is more readily accepted by all parties. To this end, he suggests that joint labour/management committees be established in all workplaces employing 50 or more people. These committees should be given the mandate to address skills-related issues, such as job reclassification and tech-change-related retraining, in addition to bread-and-butter issues such as wages and job security. In unionized establishments, these committees would have to select their representatives from among active union members, in order to prevent them from usurping the unions' rightful business.

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"Collective bargaining over technological change in Canada: A quantitative and historical analysis," by Jonathan C. Peirce. Discussion Paper No. 338.

# Venturing Forth

The Canada-U.S. Free-Trade Agreement is basically a good agreement, the Economic Council concludes in a new Statement assessing the deal.

The Council believes that Canadians will be well served by the trade agreement. While acknowledging that Canada did not get everything it wanted from the deal, the agreement "is an important step forward," the Council says in Venturing Forth: An Evaluation of the Canada-U.S. Trade Agreement. Not only will trade barrier reductions boost growth in incomes, output, and productivity over the longer term, but also "the real (but not easily measured) gains to be derived from more-*secure* access may well match the measured economic benefits that flow from an *increase* in access." The Council's assessment of the deal is part of an ongoing project examining Canada's trade policy options (see *Au Courant*, vol. 7, no. 2).

From the beginning of the trade talks, Canada had four objectives: more-open access to the U.S. market for Canadian exports; more-secure access; special provision for sensitive sectors; and an example to the world of reciprocal trade liberalization and a model for the multilateral trade negotiations under the Uruguay Round of the General Agreement on Tariffs and Trade (GATT).

On tariff issues, access was achieved. (All tariffs between the two countries would be eliminated by 1998.) Since Canadian tariffs are generally higher than those of the United States, Canadian producers face certain adjustment pressures and costs, the Council notes. Canadian consumers, on the other hand, as well as Canadian producers who import parts, equipment, and raw materials subject to tariffs, will on average benefit more than their U.S. counterparts. On nontariff barriers, the gains were disappointing (about three-quarters of these barriers remain). In addition, while both countries are committed to liberalize government procurement policies, Canada was unable to obtain full access to nonmilitary defence, transportation, and telecommunications contracts. This is unfortunate, the Council says, because the U.S. Defence Department spends billions of dollars on research and development through university and other contracts not available to Canada.

As for more-secure access, new rules have been introduced to improve the security of access in such areas as services, investment, and energy. More-general rules to govern the conduct of trade and to help settle disputes have been developed as well.

Particular sectors have been singled out for special treatment, including agriculture, energy, automotive trade, services, and investment. In agriculture, the effect of the agreement on Canada's exports to and imports from the United States is not expected to be either significant or disruptive, although vegetable and fruit growers and some Canadian food processors will face adjustment pressures.

In energy trade, almost all bilateral barriers are eliminated. In this area, some Canadians are concerned because of provisions to maintain the traditional proportion of Canadian energy supplies to the United States in the event of world shortages. But Canada is already committed to an emergency oil-sharing system as a member of the International Energy Agency, the Council notes, and the new commitments with respect to natural gas and electricity correspond with the kind of support that Canadian suppliers would normally give to important customers. Furthermore, secure access to the U.S. market will reduce some of the market risks that tend to impede large-scale energy developments.

The bulk of the automotive industry will be relatively unaffected by free trade. Some small-parts manufacturing firms will likely have to restructure, and several of Canada's heavy-truck facilities may shift to the United States. In the service sector, the agreement is likely to have a minor impact on the flow of business services between the two countries. As for investment practices, Canadian negotiators managed to retain a screening mechanism for U.S. acquisitions of large Canadian businesses while securing exemption from any restraints on foreign investment in the United States. The issue of Canadian culture was not part of the agreement, apart from a few minor trade irritants that were resolved.

The agreement breaks new ground in spheres not yet covered by GATT, including trade in services, investment, and in particular the establishment of a bilateral tribunal with powers to override U.S. and Canadian administrative rulings in trade disputes. A mutually acceptable system of North American trade rules for dealing with unfair pricing, subsidies, antidumping and countervailing duties is to be negotiated over the next five to seven years.

Overall, the Council says the agreement does three things: it eliminates all tariff and some nontariff barriers; it establishes trade rules that will ensure a more predictable climate for commercial decisions on both sides of the border; and it will provide a forum for the more orderly handling of trade disputes, particularly when the new set of rules governing antidumping and countervailing duty cases has been worked out.

On the next few pages *Au Courant* examines the Council's assessment of the trade agreement.

# *The impact of free trade*

Free trade with the United States will have a modest but positive impact on economic growth and job creation in Canada, according to new Council research.

By 1998 the trade agreement will have resulted in a 1.8 per cent increase in employment (about 250,000 jobs) and boosted real output by 2.5 per cent over the base case (where there is no change in Canada-U.S. trade relations), according to the most likely scenario in a series of simulations conducted by the Council as part of its assessment of the agreement. "While these numbers by themselves are impressive, they appear quite moderate when averaged over 10 years," the Council points out.

The Council bases its analysis on the expectation that the trade agreement will have two major consequences. First, the removal of tariff and nontariff barriers will lower prices and production costs, stimulate consumer expenditure and investment, and subsequently increase output and employment. Second, increased U.S. competition and more-open and -secure access to the American market will encourage Canadian manufacturing industries to rationalize production. By modernizing their facilities, attuning plant size to expanded sales, and finding appropriate specialized product niches, Canadian firms can substantially increase their productivity.

The Council says that the gains in output and employment under the free-trade deal are likely to be more modest than it had predicted earlier (see *Au Courant*, vol. 8, no. 2), because the actual agreement is not as all-embracing as the hypothetical deal it had simulated. As well, in the new simulations the Council distinguishes between two types of investment that lead to increased productivity – induced investment (that which normally occurs as a result of market growth) and autonomous investment (that which occurs in response to new markets and often from new discoveries and innovations).

## *The simulations*

The Council undertook five simulations with these principles in mind. In Simulation 1, it simply removes the tariff and nontariff barriers to trade that are identified in the agreement. In Simulation 2, which the Council believes to be the most likely scenario, the removal of trade barriers is accompanied by induced investment that leads to growth in manufacturing productivity of 3.6 per cent a year (such growth normally averages 3 per cent a year). The results of Simulation 2 are summarized in the accompanying chart.

Over the long term, the benefits flowing from the security of access to the U.S. market and the new rules relating to commercial conduct could be higher than indicated by Simulation 2. For example, the provision of national treatment to investors who establish or acquire business enterprises, the new regulations governing services, as well as the commitment to remove disguised barriers to trade, will greatly reduce the economic and commercial risk of undertaking a new venture. In an attempt to capture the effects of additional autonomous investment that may take place as a result of the agreement, the Council performs two additional simulations in which total investment in the economy is increased in stages by 5 per cent overall. In Simulation 3, the additional investment is financed entirely from abroad; in Simulation 4, entirely from domestic savings. The Council says that its choice of a 5-per-cent increase in investment is based partly on a survey of major multinational firms, many of which indicated that their investment in Canada would likely increase by 10 to 20 per cent as a result of the trade agreement. Many small and medium-sized firms expect to increase their sales and invest in Canada in response to the agreement as well.

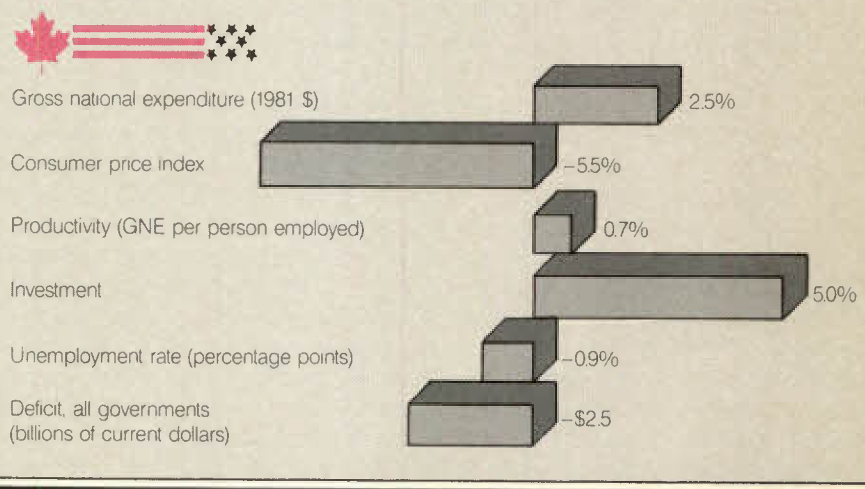
Finally, in Simulation 5 the Council looks at the impact of failure to ratify the agreement by measuring the effects on Canadian exports of U.S. trade actions that could be expected to follow if the agreement is rejected. This scenario also assumes that failure of the agreement would increase capital outflows from Canada by half a billion dollars annually. The result would be a decrease in Canadian output and a loss of some 22,000 jobs by 1998.

The Council also tests the sensitivity of its results to changes in the exchange rate caused by factors other than the agreement (such as an anticipated rise in commodity prices). A strong appreciation of the Canadian dollar would put a competitive strain on Canada's export industries. But by lowering the price of imports, it would also increase real incomes. The result would be a reduction in manufacturing activity and employment that would be more or less offset by growth in the service sector. The reverse would occur in the event of a strong depreciation of the dollar.

While the Council sounds a note of caution with respect to the accuracy of

**The free-trade impact by 1988**

Percentage and level changes over the Council's base-case projections (Simulation 2)



econometric projections in general, it points out that the simulation results "tell a consistent story." Ratification of the agreement will encourage increased economic growth and employment in Canada, it says. Conversely, failure to ratify the agreement would have a dampening effect on the economy.

## *Industry implications*

To examine the effects of the agreement on various industries, the Council relies on what it describes as the most likely outcome, derived from Simulation 2. In this case, out of the 36 industries it examined, 29 would benefit from bilateral free trade. The service sector, primary industries, and construction account for close to 90 per cent of the gains in employment.

Within the manufacturing sector, 13 out of 20 industries would benefit, the most prominent being wood, primary metals, and printing and publishing. Those that could be adversely affected (primarily because they are highly protected by prevailing tariffs) are rubber and plastics products, leather products, textiles, knitting mills, chemical and chemical products, electrical products, and miscellaneous manufacturing. Within many industries, however, there will be winners and losers, the Council notes. Canadian high-fashion textile and wool producers are expected to benefit from free trade, for example, whereas producers of man-made fibres and cotton are likely at risk. In a similar vein, there are potential losers within some industries that are expected to benefit from free trade. While the food and beverage industry as a whole should benefit, for instance, wineries and some segments of the food processing industry are expected to face tough competitive pressures as trade barriers are eliminated.

To determine which industries will have to adapt in response to the trade deal, the Council looks at what would happen in the absence of productivity improvements under Simulation 1. In this case, increased U.S. competition could result in a net decline in output and employment in 17 of the 36 industries studied, virtually all of them in the manufacturing sector. Indeed, output for the entire sector could decline by 2.4 per cent relative to the base case if industries fail to improve their productivity performance. The Council concludes that "if Canadian manufacturing firms are to prosper in a free-trade environment, they must be prepared to modernize their plants and to upgrade the skills of their work force."

## *Provincial impacts*

The impact of free trade on each province is largely shaped by its profile of industrial activities. According to the most likely outcome, all provincial economies will experience increases in output and employment. Western and eastern provinces will gain the most in relative terms, mainly because of the importance of primary industries that benefit from the removal of U.S. trade barriers. The gains for Ontario and Quebec, on the other hand, are slightly below the national average. That's because the picture for manufacturing, while positive overall, is mixed, owing in part to the failure to get broad access to U.S. government procurement.

## *Employment*

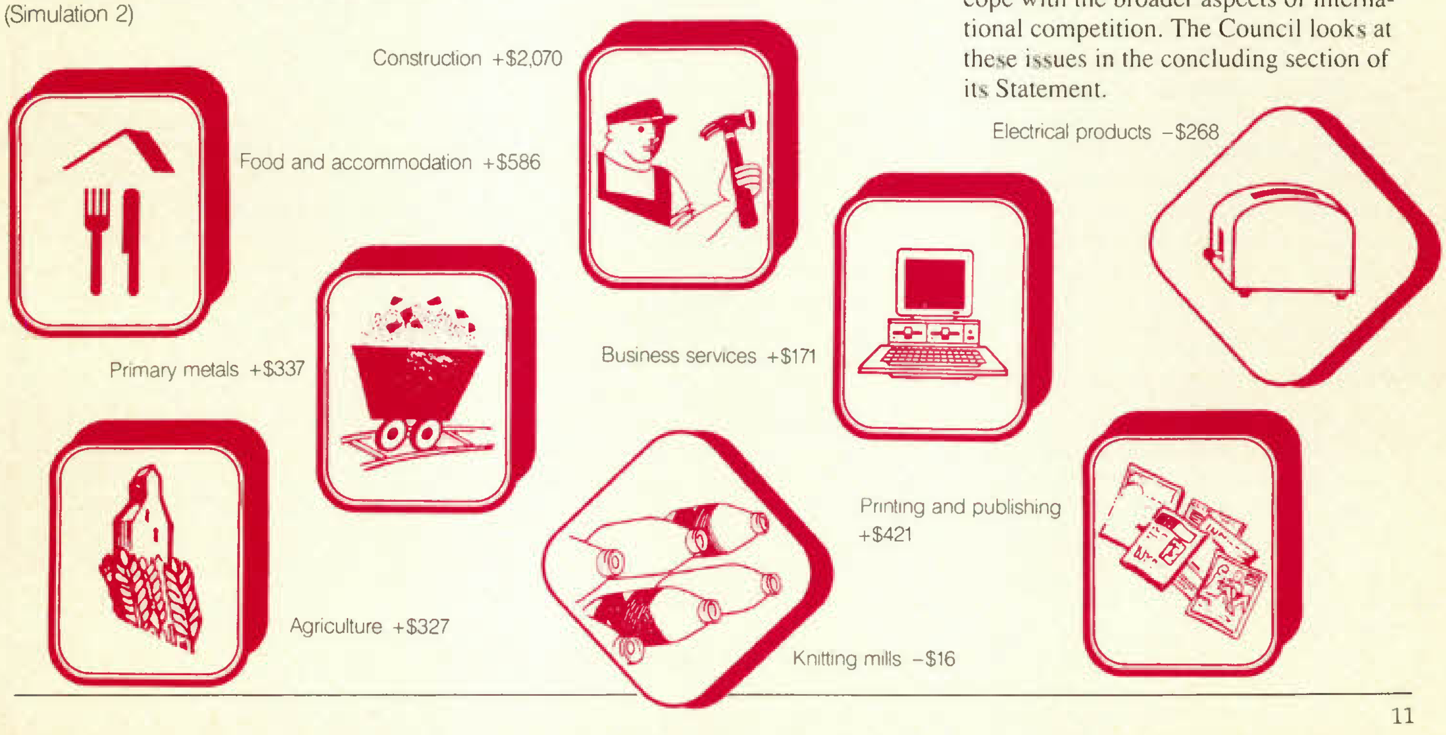
Of the 250,000 new jobs that would be created by free trade under the most likely scenario, service sector occupations – clerical, sales and services, managerial and administrative – dominate, accounting for close to 148,000 new jobs. Free trade will add about 37,500 new jobs to the construction industry, with the rest split mainly between manufacturing and primary industries. It appears that the job gains would be divided between men and women roughly in the same 60/40 ratio that is found in today's labour force. But the Council cautions against making definitive estimates in this respect, since they apply today's job gender split to the future.

The Council notes that the number of jobs created and destroyed over the 10-year span is not large in comparison to those that appear and disappear each year. The net gain in employment under free trade amounts to 25,000 jobs each year, for example, compared to increases of 250,000 to 350,000 jobs that normally occur annually.

The Council adds, however, that some of the people displaced by free trade will be those with years of experience, with families, homes, pension entitlements, and skills that may or may not be easily transferable. As well, many Canadians are concerned about the impact of the agreement on Canada's unique institutions, its trade laws, and on its ability to cope with the broader aspects of international competition. The Council looks at these issues in the concluding section of its Statement.

**Some free-trade winners and losers**

Increase or decrease in output (millions 1981 $)
(Simulation 2)



# Assessing the deal

Canada will become a stronger and more cohesive nation as a result of its trade agreement with the United States, the Council concludes.

In its view, the two countries have negotiated "a historic and mutually beneficial treaty." But, while both countries will be well served by the agreement, the Council recognizes that many Canadians have deep reservations about it.

First, some Canadians have expressed concerns that the agreement could lead to an exodus of many U.S.-owned subsidiaries that, in the absence of trade barriers, may find it more profitable to supply the Canadian market from the United States. But there is little evidence to support this contention, the Council argues. For one thing, employment by U.S. multinationals in Canada has been strongest in industries where trade barriers between the two countries have been falling (see story on page 3).

On the other hand, some Canadians are concerned that easing Investment Canada's threshold review powers could unleash a wave of American takeovers and U.S. investment in Canada that could undermine Canadian sovereignty. (Under the agreement, the agency would generally be limited to reviewing U.S. takeovers of businesses with more than $150 million, as opposed to the current $5-million level.) Consequently, even with the new thresholds, it is estimated that Investment Canada will still have right of review over about two-thirds of Canadian-controlled assets. Under the trade agreement, with the exception of certain performance requirements, the existing criteria for evaluating large acquisitions can still be used. In addition, Investment Canada retains its existing full rights of review over acquisitions in the sensitive investment areas of energy, transportation, and culture.

## Pressures to harmonize

A third area of concern is that the agreement will give rise to pressures that eventually reduce or alter Canada's social and regional development policies to bring them in line with U.S. practices. Both countries were at pains to remove their social programs from the negotiations, however, and Canada resisted efforts to bring culture, regional incentives or intellectual property into the negotiations. Furthermore, as Canada-U.S. trade interdependency has grown over the last four decades, the differences between Canadian and American social programs have, if anything, increased. Countries within the European Economic Community and the European Free Trade Association have not harmonized their social policies either. Furthermore, the rules under the General Agreement on Tariffs and Trade (GATT) are explicit in stating that trade laws cannot legitimately be invoked against social or industrial policies that are designed solely to cross-subsidize or redistribute income and employment among regions and citizens.

> ***Governments must be willing to work out ways to ease the adjustment and to facilitate the retraining and re-employment of workers.***

Finally, a major concern among many Canadians is the possibility of being displaced by the trade agreement and the prospects for them finding more satisfying, more remunerative alternative jobs. While such fears are understandable, the Council points out that as tariff levels have dropped significantly over the past 40 years, Canada has enjoyed the most rapid rate of employment growth of any developed country.

## Adjustment programs

Governments must be willing to work out ways to ease the adjustment and to facilitate the retraining and re-employment of workers whose jobs are at risk, the Council says. It reiterates suggestions made in its other reports that adjustment programs should focus on workers. In particular, governments should review or, if necessary, consider new programs to ensure adequate access to income support and to alternative training opportunities for workers who are adversely affected. The Council also believes that strengthened or new adjustment programs should apply to workers who are displaced, not only as a result of the agreement, but also for other reasons – for instance, new technology. In other words, labour market programs should be general in their application and designed to meet the needs of workers who face the most difficulty in finding and holding a new job. In this vein, older workers, people with low education, and those who live in small remote communities should be the main targets of government assistance, the Council concludes.

As a small trading nation, Canada's external commercial policy should focus on trade liberalization and ways to strengthen the multilateral trading system to ensure the best possible access to all markets. The Canada-U.S. trade agreement is consistent with the general aims of both countries in multilateral negotiations under the GATT, and in certain areas it breaks new ground, the Council points out.

The negotiations that follow the agreement are particularly crucial for Canada. Clear, mutually accepted rules of trade will help to reduce uncertainty and unnecessary litigation, for example. The Council believes that a top priority for Canada in future negotiations is to obtain greatly increased access to U.S. government expenditures on research and development. As well, the Council agrees that unless Canada is exempted from the application of the U.S. omnibus trade bill, it should withdraw its consent to the free-trade agreement.

(One Council member dissented from the Statement, questioning many of the Council's assumptions and arguing that the free-trade deal as currently structured is not in Canada's best interests. Two Council members also commented on the Statement; in their opinion the Council did not adequately examine the potentially negative impacts of the free-trade deal.)

# S·P·E·A·K·I·N·G · O·U·T

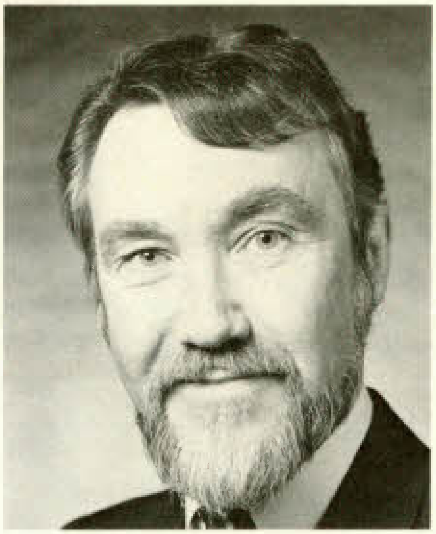
The Canadian and world economies are likely to undergo massive changes in the 1990s and beyond, in response to developments in such fields as science and technology. To find out what these changes mean for Canada's policy agenda, the Economic Council is undertaking a new project entitled Visions of Canada in the Year 2000. *Au Courant* spoke with project director Keith Newton to learn more about it.

***Au Courant***: How did this project come about?

**Newton**: To mark the 25th anniversary of the Council, the Chairman urged a departure from our traditional work. In fact, we are doing something out of the ordinary in this project, in three respects. First, rather than concentrate on purely economic questions, we are looking at some trends and prospects in such disciplines as political science and in areas such as science and technology, the environment, and demography. In that sense the project has a much broader focus than that of the work we traditionally do. Second, rather than dealing strictly with Canadian issues, we are trying to look at the prospects for Canada in the context of global trends and developments. Third, while the emphasis of the Council's research has traditionally been on the medium term – say, five to eight years from now – this time we are looking a little further ahead. In particular, we hope to identify the public-policy issues that this country will face as it enters the next millennium. From the Council's point of view, the attraction of this project is that the results should help us to develop the research agenda that this organization will need to address in the years ahead.

***Au Courant***: How will you go about doing this?

**Newton**: We are going to get the help of some of the very best minds in their respective fields. We expect contributions from scholars with international reputations, which is what makes this project a particularly exciting one. Some of our authors include Jacques Lesourne of the Conservatoire des arts et métiers in Paris and John Helliwell of the University of British Columbia,



Keith Newton

both specialists in international economics; Richard Freeman of Harvard University, who has done extensive work in the field of human resources; and Thomas Kochan of the Massachussetts Institute of Technology, who specializes in industrial relations.

***Au Courant***: How will the work be organized?

**Newton**: The project will be divided into four parts or blocks. In the first block, we shall be looking at international trends, not only from the point of view of economics but also in light of the shifting political alliances that may shape the face of the globe in the year 2000. We shall also be examining some of the world's environmental issues, population pressures, and trends and developments in science and technology.

In the second block, we shall be asking what these influences mean for Canada and its place in the world economy and what impact these developments will have on income distribution and social welfare policies in Canada.

The third part focuses on human resource development, including an examination of such issues as the education and training needs of the work force, the future of industrial relations, and the impact of changing technologies.

In the final block, we shall take a look at some of the recent trends and developments in the discipline of economics – in particular, at the process of economic decision making and the role of consensus in that process. Is there evidence, for example, that economies perform better when there is a consensus approach to economic decision making? We shall be doing some soul-searching as to whether the discipline of economics is too isolated, in the sense that we often analyse public-policy issues from a narrowly economic perspective only.

***Au Courant***: What do you foresee as the results of this project?

**Newton**: I think the most important output will be the intellectual capital that we shall get from bringing together leading scholars to discuss issues and ideas, and to raise questions about developments in their particular fields of expertise. Undoubtedly this will provide us with some directions for the future work of this organization. In early April we held a workshop in Ottawa to discuss the outlines of the papers that these scholars are working on. The papers will form the basis of a chapter in the Council's Twenty-Fifth Annual Review of the economy. Then, in late 1988, we shall be holding a major conference to discuss the papers and obtain feedback. Finally, we shall publish conference proceedings based on the presentations of the principal authors and the discussions that ensue.

***Au Courant***: Is it really possible to look into the future like this and come up with some meaningful conclusions, considering how quickly things change?

**Newton**: Most economists consider the range of uncertainty very great at the moment. Nevertheless, this exercise should complement the work we usually do, which involves engaging in very sophisticated modeling to look at some possible future trends and their implications for the future performance of the economy. This project is somewhat different in that we are not relying on an explicit modeling exercise; rather, we are relying on the views of people whom we believe to be particularly sage in their respective fields – people whose collective wisdom will help to shape our future.

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