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**TRADE LIBERALIZATION AND INDUSTRIAL ADJUSTMENT POLICY
FOR CANADA**

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INTRODUCTION

The extent and nature of Canada's industrial adjustment problems and hence the nature of policies needed to cope with them must be examined against a backdrop of a reviving, but still considerably weak, world trade background, with growth being quite pronounced in the U.S. but weaker in Canada and European countries and NICS burdened with high debt ratios. Canada has just come through two back-to-back recessions and it is our anticipation that it will continue to experience a slowness (slow growth) environment for the remainder of the '80's resulting in weak incentives for business investment and exacerbated adjustment problems. Upward pressure on interest rates, at least until 1986-87, have increased the cost of adjustment and diminished the capacity to adjust. It is expected that an overvalued Canadian dollar will follow the American dollar down when the current extensive capital inflow to the U.S. slows down and European costs are readjusted down. An overvalued dollar is masking comparative advantages which exist in Canada and giving rise to adjustment problems which are more cyclical than structural.

Resistance to change has been one major outcome of continuing high unemployment.

The extent of Canada's adjustment problems is also influenced by a slow, still small but sustained and fundamental trade shift from Europe (which in the 1960's took one-sixth of Canada's exports and accounted for one-tenth of its import shares which have decreased to 4 and 3% respectively by the early '80's) to Japan (which has gone from 3% of our exports and 2% of our imports to more than 5% of both). This trade shift from Europe towards the Pacific Rim must be undertaken in the context of a transitional process of North American rationalization of industry.

By 1987 one-half of Canadian imports will be duty free and there is currently discussion concerning a possible acceleration by one year.

Much of Canada's manufacturing suffers from unit cost disadvantages and the rate of return on investment in manufacturing has declined since the mid-1970's with the result that there is little capacity for adjustment in Canada. A number of Canada's industries are suffering from cyclical and structural over-capacity i.e. food products, metals, industrial chemicals and petrochemicals, auto, rail, and urban transit, and ship building. Significant restructuring is called for in our resources processing industries.

The recently announced discussions re the potential rationalization of industry on a North American basis through further Canada-U.S.A. sectoral arrangements could if they proceed, give rise to significant adjustment problems in Canada.

DRIE's recent analysis of interregional trade flows indicates significant dynamism in trade relations between provinces and adjoining states in the U.S.A. These growing north-south trade flows will give rise to significant potentials and problems for adjustment through the 1980's and '90's.

The GATT tariff cuts, unless offset by significant non-tariff barriers, will probably accelerate the on-going process of North American rationalization of industry in part via the intrafirm mechanism which is very pronounced given the extent of foreign direct investment, primarily American, in Canada.

In addition, as we shall outline below, there is growing interdependence between Canadian development and adjustment potential and problems and domestic and trade policies in the U.S.A. and elsewhere.

DEFINITION AND CONCEPTS

Adjustment is an ongoing process of reallocating resources within firms and industrial sectors, and between firms and industrial sectors. It can happen internally or externally, through market mechanisms, with or without government assistance. Generally, adjustment can occur because of demand side changes i.e. in the geographic distribution of demand, in the arrival of new products and/or services because of market saturation etc.; or because of changes on the supply side i.e. the advent of new suppliers, new processes, etc. The nature of the process of adjustment is also much influenced by the extent of competition and regulatory influences in the market. In addition, the speed of adjustment is a function of the growth context and the slowness period we anticipate provides less incentive for the private sector to proceed with adjustment than would otherwise be the case.

Technological change, changes in the international comparative advantage, and changes in government policies are among the causes of adjustment which we shall examine below. Our concern will primarily be with structural adjustment problems and not cyclical adjustment problems, although the two cannot be neatly separated, for as witnessed in Canada, two back-to-back recessions resulting in low business investments and hence more significant structural adjustment problems have produced situation of aging capital stock.

Adjustment is a global phenomenon for it involves the reallocation of resources from "down-side" to "up-side" sectors. It is a global phenomenon which must be addressed through policies concerned specifically with the down-side sectors but also with the up-side sectors which provides the employment opportunities and incentives to move and reallocate resources through the market or internally from down-side sectors. Establishment of new plants, the expansion and modernization of existing facilities, activities of an innovative nature, penetration of a new market by exports, import penetration, and the nature of the macro context are all relevant to the nature and extent of adjustment and to the policies needed to cope with it.

TRADE LIBERALIZATION AND ADJUSTMENT

We shall later review a number of causes of adjustment problems in Canada, but focus at this stage on trade and adjustment as called for by the conference. The relative importance of trade as a determinant of adjustment problems needs to be identified in order to arrive at a proper mix of policies.

Some analysts¹ have chosen to distinguish between changes in comparative advantage and changes in competitive position as determinants of the nature of trade liberalization impacts on adjustment. By changes in comparative advantage, they mean changes in competitive position of one industry relative to other domestic industries and relative to the same industries in foreign countries. This can be examined by a comparative analysis of cost structures domestically with those in other countries.

By change in competitive position of the economy relative to other economies they mean a change that can be identified by a single comparison of nominal cost or price of the same product offered in a given market. A tariff, for example, does not affect comparative advantage, but improves the competitive position of domestic producers in the domestic market. Modifications in macro policies, exchange rates, and the general level of wages and prices are all factors which will change competitive position.

The distinction is important for change in comparative advantage should be dealt with by the use of micro-industrial policies and a change of competitive position by macro policies.

It is important to attempt to analyze the increase in imports to determine the nature of the adjustment problems and hence arrive at an appropriate policy.

Pearson and Salembier summarize their position with accompanying table.

<u>Reason for Import Increase</u>	<u>Domestic Output and Employment</u>	<u>Nature of Adjustment Problem</u>
General Increase in Imports:		
Increased Aggregate Demand	Increasing	No Labour Adjustment Needed
Demand Switching	Possibly Decreasing	Restore Competitive Position
Increase of Particular Imports:		
Change in Comparative Advantage	Stagnant or Declining	Possible Lay-offs
Other Reasons	Stagnant or Declining	Possible Lay-offs

What their discussion points out is that neither a general increase in imports or deterioration of trade balances is evidence of employment loss and labour adjustment.

Their analysis also indicates that trade measures to protect particular industries are not a correct response to a general loss of international competitive position.

1. C. Pearson and G. Salembier, Trade Employment and Adjustment, Essays and International Economics, The Institute for Research on Public Policy, 1983, pp. 3-4.

Macro-economic Adjustment to External Trade Shocks

In this paper we shall focus primarily on the micro-industrial policy aspects of the adjustment problem. A brief review of macro-economic adjustment to external trade shocks is, however, helpful given the intimate relationship between micro and macro policies.²

Different economies can respond to external trade shocks whether cyclical or structural in origin through four general mechanisms; (1) through trade adjustments which involve either expanding exports or import substitution; (2) through changes in domestic resource allocation which basically imply increasing savings rates and diminishing private and public consumption; (3) through a slow down in investment expenditures and (4) through additional real external financing.

Domestic changes to external trade can be divided into demand side adjustments which involve reduction in consumption expenditures and which principally involves changes in the composition of production to adapt to changes in factor prices.

Mitra reports upon some of the conclusions of a World bank study on adjustment processes in fifty developing countries. Growth after 1973 suffered least in those countries which placed primary reliance on export trade and improved domestic resource mobilization and only, short term recourse to external financing. This suggests that the structure of incentives facing producers is very important and that incentives to export and openness of markets although producing greater vulnerability shocks from the external environment, facilitates the process of adjustment.

World Bank studies also indicate that reliance on external financing decreased growth capability. This suggests that domestic incentives for saving and investment, as influenced by monetary tax and financial market policies, are fundamental in setting the macro context for domestic adjustment activities and policies.

Extent of Structural Change and Adjustment in Canada

Preliminary results of a DRIE examination of historical structural movements in product and factor markets provide little indication of fundamental structural change, at an aggregate level, but some indication of structural adjustment at a more disaggregated level. An examination of the intersectoral composition of constant \$ GDP from 1948 to 1979 indicates little structural change except for the primary sector which has declined in relative importance.

In 1948, the service sector (commercial plus non-commercial) accounted for 60.2% of total GDP, a percentage which had risen to 66.2% by 1982. Manufacturing which accounted for 21.9% of constant \$ GDP in 1948 accounted for 21.6% in 1981 and 19.9% in 1982, a result influenced by cyclical considerations. Structural decline is evident in the primary sector which accounted for 10.1% of constant \$ GDP in 1948 and only 6.1% by 1981.

2. See K.P. Mitra, "World Bank Research on Adjustment to External Thoughts", The World Bank Research News, vol 4, no 3, Fall-Winter 1983, pp. 3-14 for a more detailed discussion of this issue.

An examination of the intersectoral composition of constant \$ value added at a greater level of disaggregation (177 industries) indicates significant but not an extremely pronounced structural change. The commercial service sector percentage of constant \$ value added went from 44.9% in 1961 to 51.2% in 1979; manufacturing share went from 21.4% in 1961 to 21.6% in 1979; and the primary sector went from 11.3% in 1961 to 7.0% in 1979.

An examination of the composition of employment indicates much more substantive adjustment. It would seem that ongoing changes in productivity have produced somewhat more significant change on the input side, particularly on the labour input side.

The service sector (commercial plus non-commercial) which accounted for 44% of total employment in 1946 accounted for 70% of employment in 1982; manufacturing went from 23.7% down to 16.6%, and the primary sector diminished significantly from 30% to 7% of total employment over the same time period.

Preliminary analysis of the question within DRIE makes use of an aggregated summary measure or structural adjustment utilized by the United Nations to measure the extent of structural change³. The structural index is as follows: $I=0.5 \quad A_{i1}-A_{i2}$ where A_{i1} and A_{i2} are percentage shares of output or employment in sector i in periods 1 and 2. These computations have been performed at both the 12 and 177 sector levels.

Use of this index in calculations utilizing successive years to get at the rate of change of structural change at the total economy level indicate no acceleration in the rate of structural change at the 12 sector level but significant modification at the 177 sector level with an acceleration in structural change during the 1970's relative to the 1960's, and an upward trend in the extent of structural change from 1965 on. Computation of the structural index indicates a slight upward turn in the rate of change in the service sector value added structure. It also indicates that the manufacturing sector is changing faster than services with a slight acceleration over the 1970's. This reflects to some extent the 1975 recession period.

A computation of the index in both Canada and the U.S.A. for total output at the 33 sector level over the period 1961-1979 indicates a higher level of structural change in Canada but no growing divergence in the rates of structural change. There was a significant increase in the U.S.A. index from 1973 to 1975. This reflected oil price deregulation and recession and was not felt in Canada given Canada's approach to oil pricing.

There would seem to be no long run trend towards acceleration in structural change in the Canadian or American service sector. A similar conclusion seems to arise from an examination of the index of manufacturing output which increased to 12.7% in Canada and 9.4% in the U.S.A. between 1961 and 1979. Somewhat similar results also obtained from an examination of changes in the total employment structure, with structural changes being more significant in Canada than in the U.S.A. but with both countries displaying an increase in the rate at which the structural distribution of employment is changing.

³Economic Survey of Europe, New York, 1981

Another indication of the extent and pace of change in the trade structure is provided by Pearson and Salembier. They have examined the composition of trade and more particularly computed the sum of the share changes without regard to sign for individual products between an initial and terminal year. A value of zero for the index would indicate no change in production share between initial and terminal years and a value of 2 would indicate maximum change.

COMPARATIVE CHANGES IN TRADE STRUCTURE

1960-1977

	Canada	France	Germany	Japan ^a	UK	US
	Coefficient of Structural Change ^b					
Total Exports	.73	.31	.21	.49	.20	.22
Total Imports	.30	.48	.57	.53	.62	.76
Total Non-Fuel Imports	.32	.55	.51	.25	.67	.65
Manufactures Imports (2-digit SITC)	.27	.29	.23	.10	.31	.32

^a1964-1977.

^bSum of absolute values of share changes of ith commodity group, one- and two-digit SITC levels.

Source, Pearson and Salembier, op cit.

Results indicates that in the U.S.A, France, Germany and the UK, the structure of exports was more stable than the structure of total imports or imports excluding fuel. In Canada and Japan, there was less substantial change in non fuel import structures than in the other countries.

The U.S.A. experienced the greatest change in its total import structure and Canada the least.

Once fuel imports are excluded, the US and the UK suffered the greatest structural change in imports and Japan and Canada the least.

Special Features of Canada's Trade as Determinants of the Nature and Extent of Adjustment Problems

In 1983, two way trade between Canada and the U.S.A. accounted for \$119 billion with Canadian exports at \$65.5 billion (an increase of 13.6% over 1982) and Canadian imports being \$53.8 billion (an increase of 12.3% over 1982). Trade of that magnitude accounts for 20% of Canadian employment and 30% of GNP.

We have referenced above the shift in Canada's export trade from the EEC and the UK particularly to Japan and the Pacific Rim, and pointed to the adjustment problems which it is causing in Canada. In addition, we have mentioned the dynamics of inter-regional Canada-U.S.A. trade which is producing provincial-state trade flows that are stronger than interprovincial trade flows, a result which gives rise in additional adjustment problems in Canada.

Let us examine the import penetration question at a greater level of disaggregation from Table 3 which indicates imports of products from all sources as a percentage of the Canadian market defined as shipments plus imports minus exports. As may be seen from line A, at the total manufacturing level, import penetration increased from 26.07 to 29.8% from all sources, and from 19.1% to 22.3% if one takes into consideration imports from the US only as a percentage of the Canadian market.

The U.S. share of total Canadian imports has also increased as indicated by line B. At the total manufacturing level, it increased from 73.4% to 74.8%.

Data in Table 3 also indicates that the overall measure of export orientation of manufactured products rose from 25.3% in 1971 to 31.4% in 1982. The share of exports destined to the U.S. market has not changed materially (Line B - 73.7% to 74.0%), but the export orientation to the US market increased from 18.6% in 1971 to 23.2% in 1982 (Line C).

Examination of import penetration ratios at a greater level of disaggregation indicates very significant import penetration in selected industries. For example, in 1982 the world share of domestic apparent consumption of transportation equipment was 80% and machinery, 75%. However, the export orientation i.e. exports to the world divided by shipments was equally high in transportation equipment i.e. 82.5%, a bit lower in machinery i.e. 55%. Further examination indicates a significant degree of Canada-U.S.A. integration with the American share of both imports and exports in transportation equipment in the 88% range. What this indicates is specialization in a sector where there are significant joint interests in Canada-U.S.A. rationalization for exports to third countries.

TABLE 3

TRADE ORIENTATION OF CANADIAN MANUFACTURED PRODUCTS
IN THE WORLD AND U.S. MARKETS 1971 - 1982
(Rounded for 1982 values, percent)

MANUFACTURING		Export Orientation ^a		MANUFACTURING		Import Penetration ^{aa}	
		1971	1982			1971	1982
	A	29.3	31.4		A	26.0	29.8
	B	73.7	74.0		B	73.4	74.8
	C	18.6	23.2		C	19.1	22.3
1. Transportation Equipment	A	64.1	81.5	1. Transportation Equipment	A	65.7	80.1
	B	92.1	88.3		B	88.4	87.4
	C	60.9	71.8		C	58.1	70.1
2. Paper and Allied Products	A	51.2	56.8	2. Machinery	A	66.3	74.7
	B	70.4	68.1		B	81.0	82.2
	C	36.0	38.7		C	53.7	61.4
3. Primary Metals	A	45.3	56.8	3. Miscellaneous Manufacturing	A	49.2	59.2
	B	42.2	67.3		B	65.8	66.3
	C	19.1	38.4		C	32.4	39.3
4. Machinery	A	39.5	56.8	4. Leather Products	A	23.5	36.1
	B	75.3	73.5		B	71.9	74.0
	C	29.7	40.3		C	16.9	26.7
5. Wood Products	A	43.2	51.7	5. Electrical Products	A	27.3	39.9
	B	80.1	65.5		B	68.4	65.7
	C	34.6	33.9		C	18.7	26.2
6. Miscellaneous Manufacturing	A	21.1	29.8	6. Chemicals	A	25.0	30.4
	B	66.3	64.9		B	76.3	76.3
	C	14.0	19.3		C	19.1	23.2
7. Chemicals	A	15.5	27.5	7. Primary Metals	A	23.3	34.8
	B	58.8	62.0		B	54.3	63.6
	C	9.1	17.0		C	12.8	22.8
8. Electrical Products	A	13.3	24.7	8. Rubber and Plastics	A	18.1	20.8
	B	64.8	63.2		B	71.9	74.0
	C	8.6	15.6		C	13.0	15.4
9. Rubber and Plastics	A	4.4	12.4	9. Printing and Publishing	A	14.0	15.3
	B	71.6	86.9		B	83.0	88.2
	C	3.1	15.1		C	11.7	13.5
10. Furniture and Fixtures	A	4.5	13.6	10. Textiles	A	22.8	25.9
	B	89.2	86.7		B	42.3	51.5
	C	4.0	11.8		C	9.6	13.3
11. Non-Metallic Mineral Pr.	A	6.6	11.5	11. Non-Metallic Mineral Pr.	A	14.6	17.8
	B	83.8	84.0		B	66.1	64.2
	C	5.5	9.7		C	9.7	11.4
12. Leather Products	A	5.7	9.4	12. Metal Fabricating	A	12.9	14.2
	B	81.4	83.6		B	70.0	70.4
	C	4.6	7.9		C	9.0	10.0
13. Petroleum & Coal Products	A	3.4	7.0	13. Paper and Allied Products	A	6.4	10.6
	B	92.3	91.3		B	93.7	88.2
	C	3.1	6.4		C	6.0	9.4
14. Food and Beverages	A	9.7	12.6	14. Wood Products	A	8.5	8.4
	B	56.9	48.2		B	68.9	86.0
	C	5.5	6.1		C	5.9	7.2
15. Metal Fabricating	A	4.1	7.4	15. Furniture and Fixtures	A	5.8	11.2
	B	66.5	72.9		B	66.2	60.3
	C	2.7	5.4		C	3.8	6.8
16. Clothing	A	5.1	6.2	16. Knitting Mills	A	27.3	28.9
	B	73.3	60.8		B	10.9	22.9
	C	3.7	3.8		C	3.0	6.6
17. Printing and Publishing	A	2.0	3.7	17. Food and Beverages	A	7.0	8.7
	B	85.8	88.9		B	44.7	49.1
	C	1.7	3.3		C	3.1	4.3
18. Textiles	A	5.0	8.5	18. Petroleum and Coal Products	A	9.2	3.1
	B	36.8	36.7		B	34.9	57.3
	C	1.8	3.1		C	3.2	1.8
19. Knitting Mills	A	2.3	1.5	19. Tobacco Products	A	1.2	2.2
	B	66.5	47.5		B	43.2	75.7
	C	1.5	0.7		C	0.5	1.7
20. Tobacco Products	A	0.5	0.8	20. Clothing	A	6.9	15.0
	B	42.8	49.1		B	20.9	5.1
	C	0.02	0.04		C	1.4	1.2

^aExport Orientation equals Exports + Shipments
A = As above
B = Exports to the U.S. + Exports to all countries
C = Exports to the U.S. + Shipments

^{aa}Import Penetration equals Imports + Canadian Market
A = As above
B = Imports from the U.S. + Imports from all countries
C = Imports from the U.S. + Canadian Market

The import penetration ratio in leather products from all sources is 36%; 74% of those products originate from the U.S.A. The ratio for textiles is 26%, 51% of the products originating from the U.S.A.; for knitting mills it is 28.9% with 22% of the products originating from the U.S.A.; and in clothing it is 15% with 8.1% originating in the U.S.A.

The level of import penetration in Canada's small open economy is very significant relative to the United States where openness and interdependence with other countries has, however, been growing. However, a balanced export led-import substitution thrust in industrial regional and commercial policies, would recognize the importance of import penetration as a source of certain selected micro-adjustment problems and develop policies in order to adapt.

Intrafirm Trade

Another particular feature of Canada's trade relations is the preponderance of intrafirm trade, with the U.S.A. in particular.

Table 4

Canada-U.S. Intracorporate Trade, Selected Years, 1965-79¹

Proportions of all import and export trade with the United States that is between foreign-owned Canadian subsidiaries and their parent companies

	1965		1970		1975		1979	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
	(Per cent)							
Mining and primary metals	77.9	82.4	81.3	84.1	71.3	72.8	81.2	70.3
Gas and oil	80.8	82.5	72.9	68.2	87.7	51.6	87.3	53.8
Machinery and metal fabricating	79.3	95.2	79.3	96.1	78.1	70.3	80.3	76.8
Transportation equipment	67.0	59.0	76.0	91.7	78.1	94.4	81.5	93.5
Electrical products	69.7	90.0	64.2	54.5	64.7	75.4	65.0	70.3
Chemical products	55.0	34.4	60.4	64.9	67.2	50.8	68.8	80.6
Food and beverage	46.3	62.5	42.2	66.1	37.1	59.6	27.7	30.8
Pulp and paper	21.9	51.4	28.6	54.5	28.1	59.0	58.0	52.1
Other manufacturing	64.9	67.9	69.8	65.2	72.3	72.5	83.9	81.8
Wholesale trade	80.6	94.8	78.5	90.6	83.1	92.1	76.5	90.6
Other nonmanufacturing	35.0	100.0	60.0	70.0	75.2	100.0	68.9	46.2
Total	66.9	63.0	73.3	81.6	74.5	80.1	78.9	81.3

1. Based on a sample of larger foreign-owned firms accounting for approximately half of the sales volume of all foreign-owned firms in Canada. SOURCE: Department of Industry, Trade and Commerce, *Foreign Owned Subsidiaries in Canada*, Ottawa, various issues.

1. Based on a sample of larger foreign-owned firms accounting for approximately half of the sales volume of all foreign-owned firms in Canada.

SOURCE: Department of Regional Industrial Expansion, *Foreign Owned Subsidiaries in Canada*, Ottawa, various issues.

The data reported in Table 4 is generated from a periodic survey of approximately 300 large foreign owned subsidiaries, with assets over 500 million dollars. The survey indicates intrafirm trade increased from 67% in 1965 to 79% in 1979 on the import side.

The percentage of total trade which is intrafirm varied between 28% in food and beverages and 87% in petroleum and natural gas. On the export side, the situation is approximately the same, the percentage of total exports which represents intrafirm exports was 63% in 1965 and increased to 80% by 1980. These results are much influenced by the Canada-U.S.A. auto pact. The existence of intrafirm trade which is closely related to foreign direct investment links which we shall examine below is quite fundamental to an understanding of the adjustment process and to the development of

appropriate policies to cope with and rationalization from a Canadian perspective. Intrafirm trade allows greater specialization and longer runs in Canada, greater access to marketing facilities and research and development, etc... We shall return to examine the performance of subsidiaries later in the paper.

Foreign Investment in Canada

The nature and extent of adjustment that Canada is and will be experiencing in the post GATT tariff reduction world is very much influenced by foreign investment in Canadian industry; a phenomenon directly related to intrafirm trade and the composition of trade. Table 5 indicates an outflow of foreign direct investment in Canada in recent years. This result reflects the acquisition of U.S.A. subsidiaries by Canadians, the activities of Canadian real estate firms in the U.S.A., and reaction to the Canadianization policies of the Canadian government. Such outflows, if they continue, could give rise to financial intermediation problems as Canada gets out of slowness into a more positive growth and investment context.

Flows of Direct Investment Capital Between Canada and All Countries and Between Canada and the United States, 1974-82

	Foreign investment in Canada		Canadian investment abroad ¹	
	All countries	United States	All countries	United States
	(\$ Millions)			
1974	+845	+684	-810	-524
1975	+725	+588	-915	-542
1976	-300	-559	-590	-257
1977	+475	+417	-740	-508
1978	+85	-300	-2,150	-985
1979	+675	+328	-2,500	-1,210
1980	+585	+118	-3,150	-2,216
1981	-4,600	-3,565	-5,900	-3,110
1982	-1,425	-2,281	+200	+742

¹ A minus sign indicates a positive net outflow from Canada; a plus sign, a reverse net flow into Canada.

SOURCE: Statistics Canada, *Quarterly Estimates of the Canadian Balance of International Payments*, Cat. 87-001, first quarter 1983, pp. 64-5.

Let us examine this question a little further with additional data on long-term foreign investment in Canada. Both direct and portfolio investment refers to equity or long-term debt capital however there is one important difference; direct investment involves an element of control by the investor.

In 1979, manufacturing foreign long-term direct and portfolio investment by all non-residents was \$26,695 million; of that \$22,365 million was American in origin. It is interesting to note that the manufacturing foreign long-term investment as a percentage of total manufacturing plus energy investment has fallen from 51% of the total in 1975 to 46% in 1979.

The stock of the United States long-term foreign investment in Canada is significant and is continuing to increase, contributing to the joint nature of the adjustment problems and potentials facing Canada and the U.S. It should be noted, however, that undistributed profits are a much more significant determinant of the availability of funds for investment. Retained earnings were approximately 40% of total foreign direct investment in the 1965-69 period the figure has now risen to 75%. These sources of funds point to the importance of profitability and other determinants of investment climate as crucial to an understanding of adjustment problems and policies/objectives in Canada.

Adjustment to Trade by Subsidiaries and Canadian Companies

The historically high cost situation and small market in Canada which has given rise to unit cost disadvantages in a significant number of sectors was noted above. That is fortunately not the case for many firms in many sectors as witnessed by the dynamism of Canada's exports to the U.S. as indicated in DRIE's study of interregional trade flows. In 1982, indices of labour costs per unit of output in the manufacturing sector (US = 100) were 125 for Canada; the index of relative hourly compensation for production workers in manufacturing was 93 in Canada (USA = 100), and the index of real output per value in manufacturing 73 in Canada (US = 100).

The response to the high cost-small market situation has been the production of a wider variety of products (horizontal diversification) and a larger number of production activities (vertical diversification). This strategy allowed higher plant utilization and reduced fixed cost of production per unit, but, however, caused product specific diseconomies of scale. A recent study by D.C. McCharles¹ examined how subsidiaries and Canadian firms are adapting to the changing trade environment. McCharles argues that the changing trade environment should give rise to increased specialization and economies of scale with more contracting out of minor product lines and intermediate goods. Such a result would be promising for Canada's small and medium sized industries. In his discussion, McCharles associates scale economies and increasing exports, and scale and specialization and intra-industry trade.

The economics literature suggests that intra-industry trade should make for more efficient adjustment, a phenomenon of fundamental importance to Canada given the extent of intra-industry trade as mentioned above.

The traditional economics models suggests that there will be a movement from industries with increasing import penetration into industries with increasing export success and that this should give rise to increased import and diminished export propensities in industries with relative cost disadvantages (the reverse being true in industries with cost advantages).

McCharles indicates that subsidiaries dominate imports of manufactured goods and that subsidiaries trade primarily with affiliates. He points to a wholesaling role played by subsidiaries to a greater extent than is the case for Canadian firms hence the important role of subsidiaries in imports. He documents that larger subsidiaries dominate Canada's international trade manufacturing goods.

The McCharles results indicate that subsidiaries are slower than their Canadian counterparts in adapting to the freer trade environment. They are not using specialization or world product mandates very significantly and are continuing as small scale diversified import competing firms serving primarily domestic markets (tariff factories). McCharles suggests that U.S. subsidiaries are diversifying rather than specializing and this is the case much more than for Canadian firms.

It is important to pursue research on this question, for an understanding of the dynamics of the adjustment process by subsidiaries in Canada is very important, given the possibility of Canada-U.S.A. sectoral arrangements.

¹D.C. McCharles, "Canadian Domestic and International-Intrafirm Industry Trade in Manufactured Goods", a report for the Department of Regional Industrial Expansion, March 13, 1984.

The Canadian Manufacturers Association presented the Senate Standing Committee on Foreign Affairs with the results of a survey of members concerning the Canada-U.S. Free Trade question at its December 9, 1980 session. The answers to the questions, although formulated within the context of a general free trade agreement rather than a sectoral context are nevertheless of interest.

In response to a question "what would be the net impact on your company of Canada-U.S. Free Trade?", a quarter to a third of the companies felt they would expand, a quarter to a third were of the opinion that they would contract, and a quarter to a third felt there would be no change. Foreign owned companies appear to be somewhat more vulnerable to contraction. Thirty-five percent of the foreign owned companies indicate contraction versus 27.5% of the Canadian controlled corporations. Thirty-five percent Canadian controlled companies indicated expansion while only 29% of foreign owned did so. It is therefore important to study extensively the impact of trade liberalization on a sectoral basis for the results indicate significant restructuring and differentiated response depending upon ownership.

Further disaggregated analysis by McCharles indicates that the foreign owned sector is more extensively involved in importing to serve the domestic market, whereas the Canadian sector specializes in exports. This would seem to indicate that there is a significant burden of adjustment to be borne as a result of Canada-U.S. sectoral trade liberalization.

The Magnitude and Cost of Adjusting the Trade

Attempts to estimate the magnitude and costs of adjusting to trade liberalization usually fall into one of three categories: trade-employment balance studies, decomposition studies, and labour tracking studies.⁴

In trade-employment balance studies, attempts are made to estimate the number of jobs associated with exports and the hypothetical number of jobs that would exist if imports were replaced by domestic production.

Decomposition studies utilize a definitional identity where the growth rate of domestic employment by industry is by definition the sum of the growth rate of demand, labour productivity, and share of domestic output in consumption. These decomposition studies measure the employment levels that would have prevailed if imports or the ratio of imports to domestic consumption had remained constant. These studies are however plagued with methodological problems for productivity growth and domestic demand growth are themselves related to imports and import penetration.

Normally these decomposition studies report that trade related employment changes are small relative to productivity and domestic demand related employment change.

One recent Canadian attempt was presented to a research symposium sponsored by the Royal Commission on Economic Unity and Development Prospects for Canada.⁵

⁴See chapter 3 of Pearson and Salembier, op. cit., for a more detailed discussion and review of different studies.

⁵M. Robertson and M. Grey, Trade-Related Worker Adjustment Policies; The Canadian Experience, January 27, 1984, mimeo.

Robertson and Grey decomposed employment change into change in domestic demand, exports, imports, and productivity change. They chose to examine and estimate the sources of employment change in selected import-competing industries from 1967-81 as may be seen from the accompanying Table 6.

TABLE 6
SOURCES OF EMPLOYMENT GROWTH
IN SELECTED IMPORT-COMPETING INDUSTRIES, 1967-1981
(PERCENT/YEAR)

SIC MAJOR GROUP	(1) GROWTH RATE (TOTAL EMPLOYMENT)	(2) DOMESTIC DEMAND rd (D/SHP)	(3) EXPORTS rx (X/SHP)	(4) IMPORTS -rm (M/SHP)	(5) NET TRADE SUM OF (3) AND (4)	(6) PRODUCTIVITY* (-rp)
9:03 - RUBBER **	0.31	2.67	2.09	-2.82	-0.73	-1.63
5:04 - LEATHER	-1.34	3.05	0.37	-3.18	-2.81	-1.58
5:05 - TEXTILES	-0.78	5.08	0.49	-1.56	-1.08	-4.78
5:06 - KNITTING	-0.83	7.87	0.10	-5.70	-5.10	-3.50
5:07 - CLOTHING	-0.22	2.72	0.52	-1.07	-0.55	-2.40
5:09 - FURNITURE	1.49	3.05	0.89	-1.01	-0.12	-1.45
5:12 - PRIMARY METALS	0.68	2.54	2.57	-1.79	+0.78	-2.64
5:13 - METAL FABRICATING	0.74	2.97	0.54	-0.75	-0.21	-2.02
5:14 - MACHINERY	2.63	11.72	4.22	-9.52	-5.40	-3.69
5:15 - TRANSPORTATION EQUIPMENT	1.44	5.68	7.92	-7.41	+0.50	-4.75
5:16 - ELECTRICAL	0.27	5.40	1.69	-3.66	-1.97	-3.15
5:19 - CHEMICAL	1.41	4.84	1.96	-2.20	-0.24	-3.18
5:20 - MISCELLANEOUS***	0.37	9.04	1.25	-6.25	-5.00	-3.68
TOTAL	2.65	5.62	2.68	-6.09	-1.41	-3.56

*This is a forced figure based on the identity $re = rd (D/SHP) + rx (X/SHP) - rm (M/SHP) - rp$. re , rd , rx , rm , and rp are annual average percentage changes in employment; (E); domestic demand (D); exports (X); imports (M); and productivity (P). The ratios: D/SHP, X/SHP, and M/SHP are averages for 1967-1981. All figures are based on constant \$1971.

**Rubber is used rather than rubber and plastics as the employment series from 1966-1970 for rubber and plastics is not readily available.

***This category includes among others, scientific and professional equipment, instruments and sporting goods and toys.

Source: ITC and REE, Manufacturing Trade and Measures 1966-1982. Ottawa: ITC and REE, 1983. Statistics Canada, Manufacturing Industries of Canada, Catalogue No. 31-203 and Real Domestic Product by Industry, Catalogue No. 61-516 and 61-213. Ottawa: Statistics Canada.

Their results indicate, along with most other such studies that changes in domestic demand and productivity are the major factors which have influenced employment shifts in these industries as may be seen from Table 6. The authors do mention interrelationships between the explanatory factors as a problem. A comparison of their results with similar U.S. studies indicate, however, that employment in Canadian industry is more sensitive to changes in trade.

The third and final method involves labour adjustment cost studies in which a control group of workers is followed and their actual labour force experience is examined. Attempts are made to estimate the private and social adjustment costs. Private adjustment costs are defined as the difference between the income stream the worker could expect if not separated (after tax wage plus after tax unemployment insurance benefits, plus value of leisure when unemployed), minus the income stream expected if separated. (i.e. unemployment insurance benefits plus leisure plus after tax earnings in subsequent employment). Social adjustment costs is the cost to society of displacement prevention. It is equal to the present value of the difference in the social value of labour output prior to and after lay-off. The social value of labour output prior to lay-off is gross compensation and the social value of labour output after lay-off is the social opportunity cost of maintaining workers in their current employment.

We shall not review the results of these numerous studies in this document.

A Brief Discussion of Other Determinants of the Nature and Extent of Adjustment

The openness of Canada's economy points to the importance of trade as a cause of adjustment. This cause of adjustment should not be overdone, for as indicated by previous studies, there are many other causes of adjustments, some of which are independent of trade causes. We shall quickly enumerate these in order to keep trade causes in proper perspective.

Causes of adjustment could be categorized into external versus internal causes, into temporary versus permanent causes and cyclical versus structural adjustment.

The importance and effect of many causes is very much influenced by the macro-economic context; the consensus being that a slow growth context (that envisaged for Canada during the forthcoming period) gives rise to greater adjustment problems and difficulties hence the need for more a proactive involvement by governments to enhance the potential for adjustment.

There exists many trade impacts which are unrelated to tariff reduction and other policy actions. For example, numerous changes in costs, in technology, in resource endowments, in domestic policies, in prices, in taxes, in subsidies, etc. are determinants of the nature and amplitude of adjustment problems to be faced by Canadian firms and workers.

Much has been written about the impact of technological change upon production processes and the nature of products and services. The introduction of micro-electronics, semi-conductors, robotics, CAD/CAM, etc., increase pressure on "downside" sectors i.e. textiles, clothing, footwear, lumber, plastic and rubber products, autos, machinery, and selected services. The substitution of new materials such as fibre optics, for copper, new materials i.e. ceramics and plastics versus steel and autos, the advent of informmediation, telecommunications and biotechnology, etc, are all technologically related factors which are having significant impacts on the nature and extent of adjustment problems faced by Canadian firms.

In addition, shifts in comparative advantage (to be distinguished as we have above from changes in competitiveness) are arising because of the advent of new suppliers (sometimes related to North American head offices). These are impacting upon clothing, footwear, leisure products, electrical products, segments of metalworking, etc. Newly industrialized countries are becoming increasingly involved in exports of these products among others, given the footlooseness possible in localization because of technological transfers and new technologies. Development of new primary offshore resources has increased the need for modernization and rationalization in wood and paper production in primary metals, non-metallic mineral products, wood processing and ship building in Canada.

The dual oil price shocks of the 1970's and the nature of governmental responses to those price shocks have had significant impacts on the nature of adjustment activities and needs in Canada. Petroleum prices quadrupled in 1973-74, fell by a sixth between 1974 and 1978 and then increased by 80% in real terms in 1979-80 period.

Another cause of short term adjustment problems is currency instability which is giving rise, among other reasons, to significant capital inflow to the U.S.A. and in so doing delaying necessary trade adjustment by the U.S.A.

Changes in the terms of trade, with real prices of major products falling in the early '80's to the lowest level since World War II, is another factor which impacts significantly on Canada's primary sector (as we saw above from an examination of shares of real domestic product and value added in Canada).

Pearson and Salembier emphasize another consideration i.e. the growing interdependence and integration of investments, production, distribution, and the internationalization of management systems, transportation and capital markets. They allege this has caused a convergence of industrial capacity with respect to relative factor endowments in different countries. They argue that since capital/labour ratios and wage differentials between countries are narrowing, given the significant mobility of capital and diffusion of technology, rapid changes are occurring in comparative advantage and as a consequence small changes in domestic production costs result in large shifts in trade, production and employment.

The adjustments which follow from these modifications though pronounced in product and factor markets are, to some extent, impeded by non-tariffs barriers, subsidies, piecemeal protectionism, etc.

To the extent that a new round of GATT is forthcoming one can expect continued pressure from these sources.

Other causes of adjustment are very much policy related. The GATT-Geneva tariff cuts which could possibly be accelerated, the multilateral agreements on the use of non-tariff barriers, the changes in the valuation code, are other factors of a policy nature which are giving rise to domestic adjustment problems.

As mentioned above substantive and significant adjustment problems could come from the Canada-U.S. sectoral trade liberalization initiative.

Other causes of adjustment problems are the environmental policies of various governments.

In addition, widespread subsidization of high technology production by OECD countries has increased the possibility of a high technology hardware oversupply situation which increases the potential for significant adjustment by users as well as the potential for significant adjustment problems for producers of these products.

Another policy determined set of adjustment problems which impacts directly upon Canada originates in the LDC's faced with significant indebtedness and incentive to export. That situation increases the difficulty of Canadian export led adjustment mechanisms to deal with adjustment problems, for these LCD's themselves have to face major structural adjustments under IMF's standby and energy lending arrangements.

Among other impediments to the adjustment process are the constraints placed on the utilization of macro, monetary and fiscal policies in Canada. Significant financial intermediation capital flows, and financial stringency are constraining the use of these macro policies and precluding the development of an environment of growth which facilitates the adjustment process.

Brief Overview of Policies and Programs Directly Relevant to Structural Adjustment¹

DRIE programs aimed at aiding industries in the process of adjustment have been developed and modified in the context of the department's overall policy direction as contained in the Corporate Directions paper developed by DRIE Senior Management. In essence, the paper proposes a private sector led approach to deal with the problems of adjustment with government programs acting at the margin. Although highlighting the importance of creating a "climate" for active entrepreneurship, it recognizes some rationale for government involvement in the field of industrial adjustment in high risk, long payoff and large social benefit situations, and others where there is an imperfect knowledge on the part of the private sector firms and for a need to match program support from offshore and U.S. competitors. Rather than directing the industrial adjustment process, the various programs are designed to facilitate the necessary changes by the private sector.

Overall, industry side adjustment assistance measures focus more on the effects that these measures can produce rather than the cause of the adjustment problem, be they trade, technology or otherwise. With regard to adjustment assistance programs aimed at workers, most of the programs operate without distinction as to the cause. There are a few programs, however, that do discriminate in favor of workers affected by trade related difficulties and possess, as well, geographic and/or age restrictions.

More specifically, few programs, industry or labour oriented have been tied to tariff changes, and those that have, such as the General Adjustment Assistance Program (GAAP) were eventually broadened. Under the original GAAP program in 1968, firms, in order to be eligible had to manufacture a commodity on which tariffs had been lowered as result of the Kennedy Round and be engaged in restructuring. By 1975, however, eligibility was broadened to include any manufacturing firm that was exposed to international competition. Presently there are no adjustment assistance programs in Canada that are linked to tariff changes.

¹A more detailed and complete presentation is available upon request from DRIE's Office of Industrial Adjustment.

Although only a small number of DRIE programs were initiated solely for the purpose of industrial adjustment, most of the programs impact on adjustment. Some are universal while others are quite specific, being limited to certain sectors, regions or communities.

The following is a break-down of existing programs which are considered to have significant adjustment program elements.

A. All Industry Sectors

- Industrial and Regional Development Program (IRDP)

To enhance the flexibility, effectiveness and regional sensitivity of government assistance, most of the major programs of the former DREE and ITC have been replaced by the Industrial and Regional Development Program (IRDP) introduced in June 1982. The IRDP, intended to respond to economic development priorities established by the government without creating additional new programs or perpetuating less relevant ones, differs from former programs in several respects. It is based on a philosophy of selectivity and value for money to reduce the tendency of some sectors and companies to develop a dependence on program assistance. Projects are subject to prioritization and negotiation.

The program is the means whereby the Department of Regional Industrial Expansion provides financial assistance to commercial operations for industrial development in all regions based on need (through Tier Group designation) and on the specific purpose for which the assistance is used (program elements). It has subsumed seven earlier programs, some of which were sector and community specific, they include: the Enterprise Development Program, Regional Development Incentives Program, the Institutional Assistance Program, Support for Technology Enhanced Productivity, Cooperative Overseas Market Development Program, and the special area programs for Montreal and the Magdalen Islands.

A Development Index classifies census divisions into one of the Tier Groups according to economic disparity; the index is based on employment, income and revenue (fiscal capacity of the province) over the most recent three years for which data exist. Tier Group IV comprises the most disadvantaged 5% of the population, Tier Group III the next 15%, Tier Group II the next 30%, and Tier Group I the remaining 50% of the population. The level and type of assistance varies according to Tier Group being higher in Tier IV than in Tier I.

Assistance is provided for viable projects at various stages of development from inception of the idea through innovation, plant establishment, modernization/expansion, marketing, and restructuring; industrial development climate is the sixth program element. Assistance is in the form of contributions (repayable or not), participation loans, loan guarantees, and grants (for studies/scholarships or course development related to industrial adjustment).

The program provides for the first time, a regionally sensitized, multi-faceted program of industrial financial assistance in all parts of Canada. Another feature of the program is its flexibility to provide the type of assistance appropriate to a given industry, area or community at a given time. The IRDP addresses the needs related to industrial development and the opportunities afforded, opportunities to apply the benefits of technology and other innovations to existing industries in all

parts of Canada to ensure long-term viability and growth. The program provides for effective regional development by instituting a strong incentive to Canadian firms to invest in those areas in Canada which are in the greatest need of that investment. Program delivery will be local, aiming at a one-stop shopping approach to government industrial assistance.

- Industry and Labour Adjustment Program (ILAP)

The program was initiated in order "to promote industrial restructuring and manpower training and mobility in areas of particular need". It is administered by DRIE and CEIC.

The legislation under ILAP will expire on March 31, 1984. It is expected that the IRDP will provide adequate replacement for most aspects of ILAP. The Canadian Employment and Immigration Commission and Labour Canada are preparing a successor program to enable them to continue delivery of the labour adjustment aspects in areas of particular need.

- Company Specific Restructurings (e.g. Chrysler)

Assistance for adjustment related problems is available in the form of loan guarantees, guarantees of preferred share issue and repayable grants and contributions.

DRIE is giving thought to the pros and cons of multiyear Memoranda of Understanding (MOU's) with firms. These could serve as an interesting vehicle for attaining adjustment objectives.

B. Specific Industry Sectors

- Shipbuilding Industry Assistance Program (SIAP).

The objective of the program is to maintain and improve the industry's viability and competitiveness in bidding for new domestic and foreign orders in face of foreign competition. Assistance include subsidies of the approved cost of a vessel built or converted in Canada as well as productivity improvement grants.

- Canadian Industrial Renewal Board (CIRB)

CIRB, created in 1981, administers programs to provide assistance for the restructuring, rationalization and modernization of domestic textile and clothing industries while ensuring adequate levels of protection during the adjustment period. It also provides assistance to communities and workers affected by the foreign competition in these industries. CIRB assistance includes contributions, loans and loan guarantees to viable companies and projects, as well as, portable wage subsidies, mobility assistance, enhanced training allowance incentives and early retirement benefits for laid off workers (administered by the Canadian Employment and Information Commission).

CIRB also administers a financial assistance program for Canadian footwear and tanning industries.

- Pulp and Paper Modernization

The purpose of the program is to stimulate investments to improve the viability and efficiency of the industry. Assistance takes the form of incentive grants for modernization, efficient utilization of energy resources and pollution abatement of pulp and paper facilities. The federal funds are distributed through various cost sharing subsidiary agreements with the provinces of Newfoundland, Nova Scotia, New Brunswick, Quebec and Ontario.

- Task Forces have also been established by DRIE to deal with development and adjustment related problems in forestry, automobile, petrochemical and textile and clothing sectors.

The following programs are considered to also have some impact on adjustment.

- Industrial Energy R & D Program (IERDP)

The IERD program, through the provision of contributions, encourages research and development of new and improved processes and equipment that will reduce energy consumption in industry and ensure the widest possible use of this technology. This program is now administered by the Department of Energy, Mines and Resources.

- Small Business Loans Acts (SBLA)

Under the provision of the SBLA all chartered banks and other approved lenders are authorized to make guaranteed loans to small business enterprises for the purchase or modernization of equipment or premises and the purchase of land. The loan rate is set at 1% above prime. Loans can be used to finance the cost of fixed or movable equipment, and the cost of the purchase or construction of new premises, renovation and the purchase of land.

- General Development Agreements (GDA's) and Economic and Regional Development Agreements (ERDA's)

GDA'S provided flexible mechanisms for federal-provincial coordination of developmental programming; they were in force in each province except Prince Edward Island, where a Comprehensive Development Plan is in place. GDA's will continue until their 1984 expiry date, and the Ministry of State for Economic Development will negotiate new Economic Regional Development Agreements. (ERDA's) Both GDA's and ERDA's are a vehicle for joint federal provincial agreement of development objectives, constraints and policies in different provinces.

- Defence Industry Productivity Program (DIPP)

The objectives of the DIPP program are: the promotion of economically viable defence exports and related civil exports; the maintenance of a defence industrial base in Canada; and the development and sustaining of an advanced technological capability in the industry.

DIPP provides assistance for R & D projects, capital assistance projects, source establishment projects and market feasibility studies.

A number of duty remission (or waiver) programs exist, covering the following items:

- | | |
|---------------------------|--------------------------|
| - Machinery | - Televisions |
| - Power Cruisers | - Singer Sewing Machines |
| - Front End Wheel Loaders | - Automotive Components |
| - Shirting Fabric | - Off-Highway Vehicles |

Trade Related Worker Adjustment Programs

In addition there are three major programs now in place which are designed to alleviate adjustment difficulties experienced by workers: the Canadian Industrial Renewal Program, the Industry and Labour Adjustment Program (both as already mentioned are co-administered by DRIE and CEIC) and the Labour Adjustment Benefits Program (LAB).

Both ILAP and CIRP provide assistance in the area of worker training, mobility, wage subsidies, job creation, and manpower consulting services. LAB provides last resort income maintenance for displaced older workers.

I have not dwelt on domestic trade policies as a vehicle for adjustment in this section although there has been significant use of voluntary export restraints and quotas in certain sectors such as textile and clothing, footwear and automobiles.

A variety of trade policy instruments affecting industrial adjustment has been introduced over the last two decades, including use of safeguards permitted under GATT (the imposition of anti-dumping and countervail duties against export subsidies), the renegotiation of tariff concessions, the use of safeguards as provided for in the General Preferential Tariff, and the decision to phase-in gradually during the 1980's the tariff reductions resulting from the MTN (in addition to the use of partial or full exemptions from the formula tariff cuts as permitted). To deal with industrial adjustment problems, Canada has imposed selective import controls such as introducing quotas on certain items (acrylic and worsted yarns), negotiating import levels for selected goods with other countries, or requesting import licences for specific products (e.g. worsted fabrics) as well as the use of voluntary export restraints.

Other examples include a three year global quota on all imports of non-leather footwear in effect from December 1981 to November 1984, and the Automotive Adjustment Program (AAA) which was introduced as a result of the Canada - United States Agreement on Automotive products.

Concluding observations and topics for further analysis

Briefly stated, one might say that the objectives of adjustment policy are to facilitate the transfer of resources to more

productive uses and to cushion social problems which arise in the process.

The aim is to reinforce and improve market effectiveness in advance by removing obstacles to structural changes and facilitating restructuring. What is called for is a medium term growth strategy oriented to higher investment innovative applications of new technologies and exports as means to attain adjustment.

A proper policy stance calls for an estimation of the private and social cost and benefits involved during that process, especially since costs are often concentrated in particular communities and borne by a relatively small number of workers while benefits are widespread.

Our examination of the situation has indicated that significant adjustment needs have not been addressed in the last few years given two back-to-back recessions. It is suggested that it will be difficult to address these needs in the forthcoming environment of slow growth which has and will stunt business incentives to invest.

DRIE's approach is to rely to the fullest extent possible on private sector initiatives by encouraging strategic planning, innovation, modernization, expansion, market research, product design and engineering and a shift in the utilization of resources to higher value added activities but it is realized that the slow context is making that activity less than might be considered desirable.

It is suggested that the adjustment process should be viewed as a total phenomenon involving utilization of many government policies to achieve expansion, modernization, establishment, innovation, and adoption of new technologies and that the amount of activity in these areas depends very much on the macro context with adjustment activity being directly related to growth. It is suggested that the facilitation and flexibility needed for adjustment requires harmonization of a whole range of policies and that they be made available to all industries, primary, secondary and tertiary, whether they be upside or downside for there is potential for growth in all industries. Relative price stability much influenced by macro-policies is necessary for clearer market signals for adjustment.

The proper policy approach will require determining the emphasis to be placed on internal i.e. within industry and within firm adjustment mechanisms versus market adjustment mechanisms. The latter suggests significant emphasis on policies to abolish impediments to interregional, interoccupational interindustrial mobility and possibly the use of instruments such as portable wage subsidies, relocation grants, etc... The former suggest examining the role of closure compensation, the desirability of an adjustment insurance program with premiums, etc...

Developing country experience seem to indicate that an export oriented thrust facilitates adjustment. The proper policy posture from a Canadian perspective will have to determine the modalities of attaining and maintaining this export orientation in a slow growth protectionist context particularly in the EEC but also in the US. This will necessitate addressing questions such as the extent to which domestic policies are subject to countervail and other constraints. The proper policy stance will also call for addressing questions such as the mix of domestic and trade policies in the attainment of adjustment objectives.

As indicated above research results would seem to indicate that ownership (domestic vs foreign) is related to the extent and nature adjustment. The impact of government policies on

modernization, innovation, marketing, intrafirm trade and on product differentiation and specialization should undoubtedly be dealt with in more depth.

Another policy question should be to determine how far and how fast to go in the Canada-USA sectoral trade liberalization exercise if Canada seeks to maintain its option of diversifying its trade relations especially towards Pacific Rim countries.

More macro policy leverage and the promotion of faster growth rates without giving rise to undue inflation pressure are essential to an effective sectoral and micro policy package consistent with the macro policy context.

In Canada, the distributional and regional impacts and constraints and the tradeoffs between development and adjustment objectives and regional development objectives are very real. The proper diagnosis of the adjustment problem and the development of an appropriate policy stance requires significant attention to its regional aspects. Some adjustment situations which have been identified include: in the Western provinces, wheat and paper products and some secondary manufacturing; in Ontario, the manufacturing sector particularly those industries which are labour intensive; in Quebec, traditional labour-intensity industries such as clothing, furniture, footwear and forest products, in the Atlantic provinces, mineral, oil and gas offshore industries, and the forest industries.

This list indicates that the sectors identified for discussion in international forums i.e. textile and clothing, steel, autos and agriculture are in the Canadian adjustment agenda. As requested this paper has not focussed on international mechanisms to prompt adjustment.

In addition, the adjustment problem must cope with the political nature of adjustment i.e. the impact on one industry communities many of which are concentrated in Quebec and Ontario.

The development of the policy approach to adjustment must determine the relative importance of temporary protection (phased and declining) versus permanent protection; the emphasis on trade protection which assists all the resources in the industry versus adjustment assistance aimed more directly at firms and/or workers; the relative emphasis on adjustment going to firms as against workers; etc.

Also called for are more methods to enhance labour/management cooperation to facilitate the adjustment process. This will call for measures in addition to the recent provision for profit sharing introduced in the last federal budget and the establishment of the Canadian Labour Market and Productivity Centre.

A harmonization of labour market and industrial adjustment policies is also in order. Policies and programs to help the private adjustment process through new competition policy, bankruptcy policy, approaches to mergers, acquisitions, leasing, the use of tax policies to allow the development of pools of money for adjustment purposes, plant and equipment writeoffs and buybacks, etc... are to be reexamined.

Research to help determine clear indicators of market failure, the role of turnover (firm entry and exit) in adjustment and a system to allow an early identification of firms, industries and communities in difficulty in order to enhance government involvement is also high on the research agenda. Monitoring of the extent and nature of structural change should also be considered.

As may be seen from the above summary discussion of the nature causes and policy approaches to the adjustment problem, the attainment of an equitable, efficient and politically efficacious policy package is no easy task.