TEN YEARS AFTER:

Cross-Border Export/Import Trends Since the Canada-United States Free Trade Agreement

Over 10 years ago, on January 2, 1989, after one of the most emotional debates in Canadian history, the Canada-U.S. Free Trade Agreement (FTA) became operational. Critics viewed the FTA as an assault on Canadian sovereignty, and argued that it would result in large losses in manufacturing and increased economic dependence on resources. Supporters countered that the FTA was necessary to secure access to Canada's major market and would mean significant gains in jobs and investment.

The Canada West Foundation (CWF) has taken an active role in researching Canada-U.S. free trade since negotiations began in 1985, and has produced ten reports on the features and anticipated effects of the FTA. As CWF predicted in the late 1980s, the Canada-U.S. Free Trade Agreement has been neither nirvana nor doomsday.

This report re-visits the FTA and focuses on the changes to Canada-U.S. trade flows over the first ten years following the FTA (1989-1998) compared to the year prior to the FTA (1988). Export and import data by sector and by province are analyzed in detail to present the "results by the trade numbers." Trade information presented in the report is largely derived from Statistics Canada data for merchandise trade on a customs basis, analyzed over the years 1988 to 1998. (Statistics Canada trade data are subject to minor adjustments and 1998 data are preliminary.)

Trade data are the best indicator of significant changes resulting from freer trade. Although it is recognized that the impacts of the FTA extend beyond trade numbers, and that other factors influence economic activity, these issues are beyond the objectives and scope of this report.

The Canada-U.S. Trade Boom

Canada-U.S. trade has grown substantially over the past ten years (see **Figure 1**). Two-way trade today is nearly 2.5 times the level before the Canada-U.S. Free Trade Agreement! Average annual increases in both Canadian exports to the U.S. (near 16%) and imports from the U.S. (near 14%) have been very high, and at levels well above growth trends in gross domestic product and most economic indicators.

This report was written by Stuart Duncan, Principal, KPMG Corporate Finance Inc. in Calgary. Mr. Duncan has written ten reports on Canada-U.S. trade and free trade issues while associated with the Canada West Foundation. This report re-visits the free trade agreement and trade patterns occurring since its implementation. Because of the independence given the author in writing this report, the opinions and recommendations within it are those of the author only and do not necessarily reflect the opinions of the Canada West Foundation Council, its members, or contributors. Additional copies are available from the Canada West Foundation, or may be downloaded free-of-charge via the CWF web site (www.cwf.ca).

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In the early years of the FTA (1989-1991), export and import activity were relatively flat, affected by a sluggish and then recessionary economy in both countries. Following the recession in the early 1990s, Canada-U.S. trade exploded, doubling within five years. During this five-year period, Canadian exports significantly outpaced import growth. This was partially fuelled by a decline in the Canadian dollar relative to the U.S. dollar from 87 cents in 1991 to 73 cents in 1994, which widened Canada's trade surplus with its largest trading partner. Canada-U.S. trade continued to expand at a solid, but less dramatic rate from 1995 to 1997 and surged again in 1998 with another decline in the Canadian dollar. In 1998, Canada enjoyed a surplus of nearly $50 billion in merchandise trade with the U.S.

A depreciating dollar has certainly been one factor in Canada's strong export performance, but many other factors also affect trade performance. Since the recession of the early 1990s, the economies of both Canada and the U.S. have enjoyed generally favorable macroeconomic conditions – eight years of economic growth (although Canada has lagged behind U.S. growth), very low inflation and low interest rates, and a shift from large government deficits to surpluses in recent years.

As Canada-U.S. trade rapidly expanded during the past decade, Canada's trade with the rest of the world grew at a rather slow pace. From 1988 to 1998, Canada's growth in exports to the U.S. grew at about seven times the rate of its 2% average annual export growth with the rest of the world. Canada, as well as most countries, has experienced a decline in offshore exports since 1997, largely due to the economic slowdowns in Asian and Latin American markets (except Mexico). For example, Canada's exports to key Asian trading partners such as Japan and China dropped 24% and 10% respectively in 1998, while imports from Asia increased. Canada's 1997-1998 trade grew because of Canada's success in the U.S., which offset the adverse impact of world trade with Asia.

As a result of the increased trade integration in North America, an expected trend which usually results from regional trade agreements, the United States now accounts for approximately 85% of Canada's merchandise trade exports, up from approximately 73% prior to the FTA.

The Canada-U.S. trade boom has been a bright light for the Canadian economy in the 1990s. Overall, Canada-U.S. free trade appears to have been positive in terms of Canadian trade performance. The sharp rise in two-way trade is over-and-above what could have been expected.

In terms of investment between Canada and the U.S., inward and outward flows have experienced strong growth over the 1990s. However, Canada's share of total inward foreign direct investment within North American and world markets has declined. Canadian direct investment in the U.S. grew by nearly two and one-half times since the FTA, to $126 billion in 1998. U.S. direct investment in Canada has risen steadily and nearly doubled since the FTA, reaching $147 billion in 1998. As Canadian firms continue to expand abroad, Canadian direct investment around the world has grown significantly faster than investment into Canada. Since 1996, Canada has been a net exporter of foreign direct investment. In addition, Canadian levels of capital investment in machinery and equipment have been relatively steady.

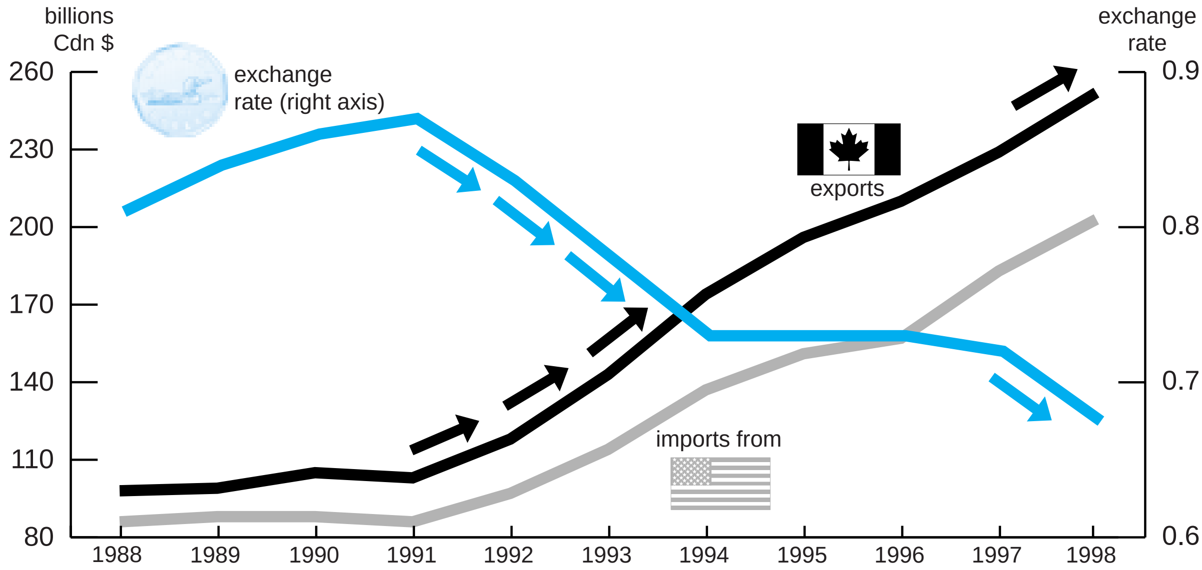
NAFTA

A number of key trade-related agreements and events have occurred since the implementation of the FTA. In particular, the North American Free Trade Agreement (NAFTA) was negotiated in 1992 and went into effect on January 1, 1994, replacing the FTA. NAFTA was basically an extension of the Canada-U.S. Free Trade Agreement to Mexico, and includes a tariff elimination schedule to be completed by 2003. The tariff elimination schedule between Canada and the U.S. under the FTA remained intact, and on January 1, 1998, the final tariffs were removed on goods traded between Canada and the U.S. (with the exception of certain supply managed agricultural goods).

Since NAFTA, Canada's exports have increased by about 80% to the U.S. and 65% to Mexico. Investment flows between the three partners have also grown substantially.

A key feature of NAFTA is its dispute settlement mechanism and procedures. With over $500 billion of two-way trade in goods and services between Canada and the U.S., disputes are bound to emerge. Nonetheless, the number and size of trade disputes have been very small in

FIGURE 1
Canada-U.S. Trade and Exchange Rate Levels Since the Free Trade Agreement



Source: Trade data derived from Statistics Canada, merchandise goods, customs basis.
Exchange rate data from Bank of Canada Annual Review.

the context of the trading relationship. Disputes have tended to deal with resource-based products such as agricultural commodities, lumber, and steel as well as cultural industries. These areas are a traditional source of dispute, and were so prior to the FTA.

The results of the dispute settlement mechanism have been mixed, but overall the process represents an improvement over world trade procedures. Most disputes are settled in North America by North Americans, and decisions are generally rendered in a more transparent and quicker time frame. Over 50 disputes have been resolved under the NAFTA procedures.

Other Trade Agreements

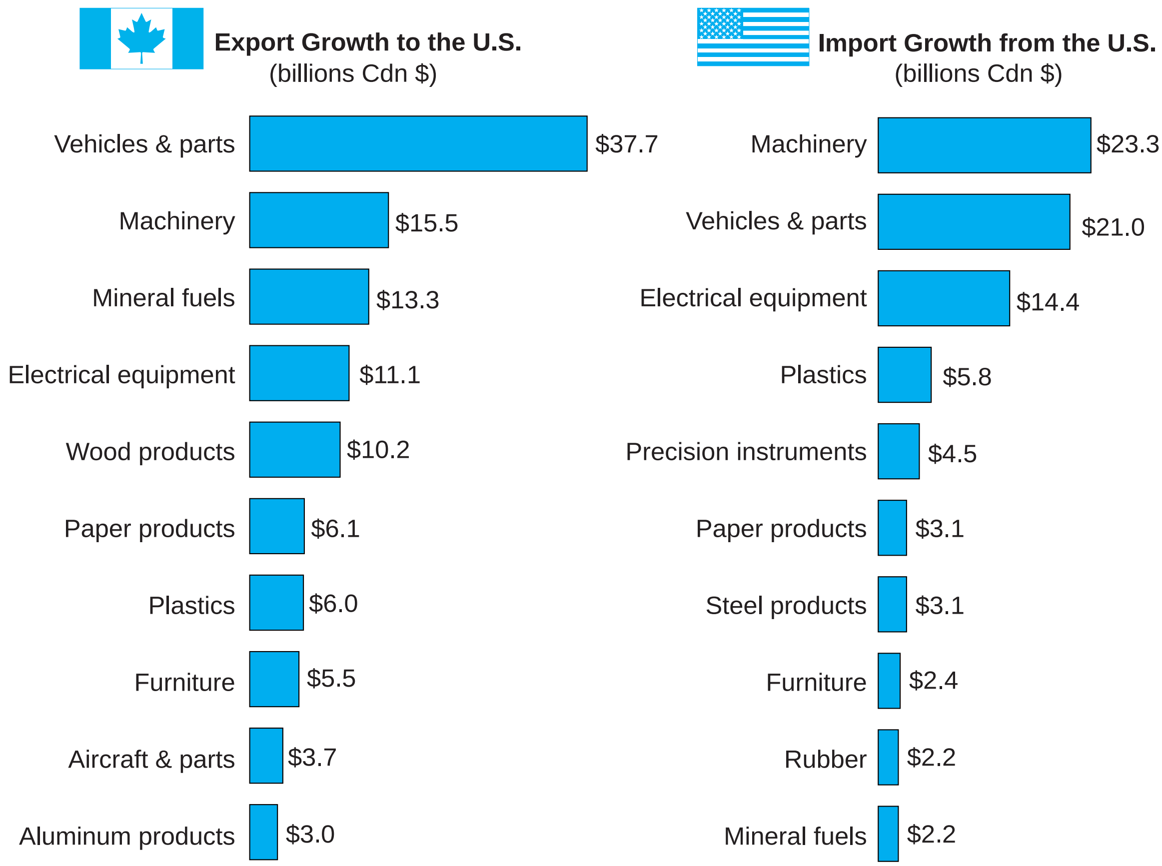
In 1994 - and long overdue - Canada's First Ministers signed the Agreement on Internal Trade to reduce trade barriers between the provinces.

The long-negotiated (1986-1994) Uruguay Round of the GATT world trade talks took effect in 1995. The new GATT agreement resulted in significant phased-in tariff reductions and the elimination of tariffs on many products. Other liberalizing features included the extension of tariff reduction principles to some services and the limited inclusion of agricultural goods. GATT was subsequently replaced by the new World Trade Organization (WTO), representing over 130 member countries accounting for over 90% of world trade. The WTO has focused on sector-specific trade agreements, including 1997 agreements covering telecommunication equipment, information technology products and financial services. The WTO is gearing up for major negotiations covering agriculture, services, and other areas starting in 2000.

In 1997, Canada implemented bilateral free trade agreements with Israel and Chile. Negotiations for a Free Trade Agreement of the Americas, potentially joining the Western Hemisphere, commenced in 1998. The target date for a comprehensive agreement is 2005.

In 1998, Canada entered negotiations with the European Free Trade Area (Norway, Switzerland, Iceland, and Liechtenstein) which could lead to the first transatlantic free trade agreement.

FIGURE 2
Top Ten Industries in Canada-U.S. Trade Growth in the Last Ten Years



Source: Derived from Statistics Canada 65-003 and 65-006, customs basis. Based on absolute growth of two-digit Harmonized System industry groups, 1998 less 1988 trade figures.

So, the North American and world trade scenes have changed considerably since the Canada-U.S. Free Trade Agreement. The historic agreement has been a catalyst for other successful trade negotiations.

Driven by substantial growth in Canada-U.S. trade, Canada is the most trade-oriented G-7 nation with exports now accounting for nearly 40% of GDP and approximately one in every three jobs.

The Shift Away From Resources Toward Manufactured and Value-Added Products

Figure 2 indicates the top ten industries (by Harmonized System groups – the world trade standard) in actual dollar gains in both Canadian exports to the U.S. and imports from the U.S. since the FTA. Canada's export gains to the U.S. have been led by vehicles and parts, which were already operating relatively duty-free prior to the FTA under the Canada-U.S. Auto Pact. Similarly, vehicles and parts, and machinery and equipment, have been the major sources of import increases from the U.S. Like motor vehicles, the aerospace and mineral fuels industries experienced strong gains in exports despite being relatively duty-free prior to the FTA.

Most of the export gains have been in manufactured and high-tech goods as opposed to resource-based goods. Of the top ten export gains for Canada, only four were in resource-based sectors, while in terms of U.S. export gains in Canada, four were also in resource-based sectors.

Without question, a number of key resource sectors are a major source of Canada's trade surplus with the U.S. (and the world) because of our abundance of resources and comparative advantages. However, as **Figure 3** illustrates, in terms of relative growth trends, imports of resource products from the U.S. such as forestry products, metals, mineral fuels, ores and fish have grown at a faster pace (albeit from a smaller base) than Canadian exports of these products. Further analysis indicates that within a number of these sectors, Canadian exports of resources have grown slowly, while sub-sectors of value-added products such as remanufactured wood products, paper products and finished metal products have grown faster.

As illustrated in **Figure 4** and discussed in the next section, the dramatic export growth for Canada has been in manufacturing, high-tech, and value-added industries. This is a positive trend hoped for by supporters of the FTA. Industries such as apparel, furniture, sporting goods and toys which were subject to high tariffs and duties prior to the FTA (and, as a result, accounted for little trade between the two countries) have experienced extraordinary growth in exports (and to a lesser extent imports) since the agreement. High-tech products such as electrical equipment, electronics, telecommunication equipment, aircraft parts, and speciality chemicals and pharmaceuticals have experienced tremendous export gains. Value-added processed foods such as canola oil, potato products, and prepared cereal products have grown over four-fold.

Several industries have experienced fast two-way growth with modest changes in offshore trade, such as food products, chemicals, apparel, furniture, paper products and office equipment, suggesting an increasing degree of intra-industry specialization within North America.

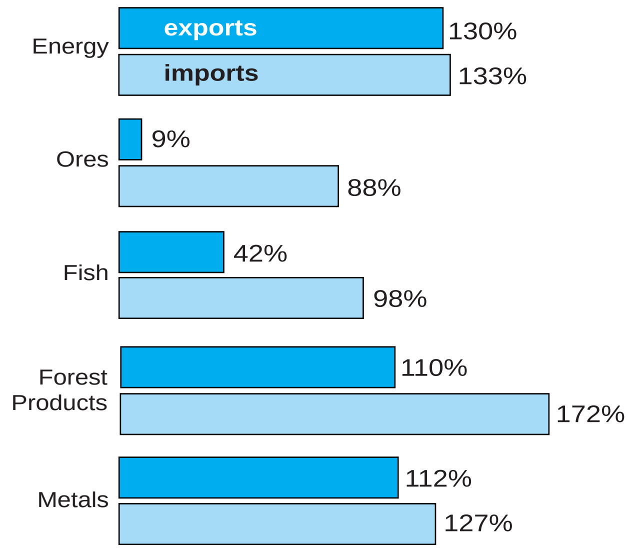
The shift in Canada-U.S. trade towards more manufactured and value-added goods and less dependence on resources stands out as the most fundamental structural trend in Canada-U.S. trade since the Free Trade Agreement.

Key Sector Highlights

The following analysis briefly highlights FTA developments within four major sectors – agri-food, resources, manufacturing, and services. The results point

FIGURE 3
Change in Canada-U.S. Merchandise Trade Since 1988 - Resources

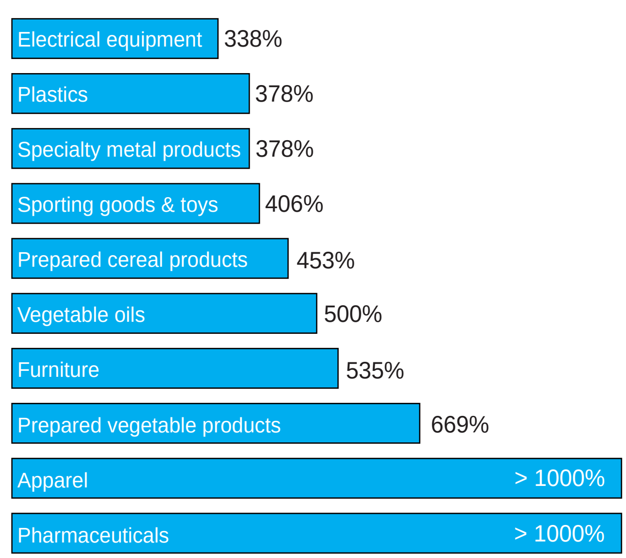
Although Canada has significant trade surpluses in resources, growth has been slower...



Source: Derived from Statistics Canada 65-003 and 65-006, customs basis.

FIGURE 4
Change in Canadian Merchandise Exports to the U.S. Since 1988 - Select Manufacturing

...the dramatic export (and import) growth has been in several manufacturing and value-added industries.



Source: Derived from Statistics Canada 65-003, customs basis.

to key trends within industry groups, but there can be considerable shifts in trade and investment patterns in sub-industries within these industry groups.

Agri-Food: Solid Trade Growth with Wide Differences by Product

While the FTA phased-out tariffs on most agricultural and food products over a ten year period, a number of agricultural commodities remain protected on both sides of the border. Canada's supply managed commodities such as dairy, poultry and eggs, and U.S. commodities such as dairy, sugar, cotton, and peanuts were only slightly opened under the FTA and remain largely protected by quotas and other trade restrictive policies. Grain and grain products were also liberalized subject to certain conditions and restrictions. Agriculture is trade-sensitive within GATT and most countries. Consistent with this sensitivity, agri-food has been the main sector of trade irritants between the two countries. Thus, while the FTA liberalized agri-food sector trade to a degree, the sector still resembles managed trade more than free trade.

Despite these agri-food realities, trade in agricultural and food products has more than doubled on both sides of the border since the FTA. On an average annual basis, Canada's total agri-food exports have grown by over 20% while imports from the U.S. have grown by approximately 15%. As a result, Canada's trade surplus with the U.S. on agri-food products rose to over $4 billion last year.

Net export and import trends have generally been consistent prior to and after the FTA. Key sources of Canada's agri-food trade surpluses with the U.S. are in hogs, cattle, meat, fish, beverages (distilled spirits, bottled water), canola oil, and grains. Canada has a trade deficit in fruits and nuts, vegetables, prepared fruits, wine, snacks, and animal fodder. Nevertheless, the FTA has enabled more trade to occur in these industries.

Canada's food exports in value-added processing such as milled cereal products, canola oil, cocoa preparations, prepared cereals and flour, and frozen potato products have experienced dramatic gains. Beef sales have doubled since NAFTA to both the U.S. and the rest of the world while pork sales have expanded more rapidly in other parts of the world than in the U.S.

There was particular concern during the FTA debate with respect to the competitiveness of Canadian food processors. For the most part, according to bilateral trade flows, Canadian processed food exporters have held their own. However, significant parts of Canada-U.S. agri-trade is limited by protective policies. Certain food processing industries such as wine, beer, poultry and miscellaneous processed foods such as snacks and sauces, appear to have been negatively affected by the FTA as U.S. imports have outpaced Canadian exports.

Resources: Accounting for Large Trade Surpluses But Imports Outpacing Exports

In many primary resources, trade was already duty-free prior to the FTA. The FTA was most important to Canadian resource exporters in assuring secure market access. This is particularly important because of the volatility of the resource sector and commodity prices. Canadian exports and investments in oil, gas and electricity were expected to rise under the FTA, coupled with deregulation. In further downstream industries such as petrochemicals, remanufactured wood products, paper products, and fabricated metal products, the FTA presented an opportunity to open up trade.

Canada's major export gains in resource trade in terms of absolute dollars were in oil, natural gas, lumber, paper products, and aluminum products. While Canadian exports of natural gas and oil have doubled, U.S. imports of mineral fuels have also grown at similar rate. While Canadian exports of forestry products to the U.S. are over $30 billion compared to imports from the U.S. of over $7 billion, the growth of U.S. forestry product imports have significantly outpaced Canadian export growth, (see **Figure 3**) led by strong gains in paper products. Within the forestry sector, Canada experienced strong gains in remanufactured wood products such as door and window frames, and value-added paper products. Canadian exports of pulp and newsprint have been up and down but generally sluggish.

Canadian exports of metals and metal products as a group have grown by over 100% since the FTA, while U.S.

imports have increased by over 160%. Canada's fastest export growth in the metals sector has been in fabricated metal industries such as tools and specialty metal products where exports have more than quadrupled since the FTA. While Canadian imports of aluminum products are double U.S. imports, aluminum product imports from the U.S. have grown at twice the rate Canadian exports since the FTA. Bilateral trade in most base metals is relatively small. The steel industry has experienced significant two-way growth in trade, which reached over $9 billion in 1998, assisted by healthy demand for automobiles and construction materials. This industry continues to be subject from to trade disputes, U.S. trade policy restrictions, and allegations of dumping by U.S. interests from time-to-time which tend to dampen trade levels.

Manufacturing: Dynamic Activity and Major Source of Canada's Export Growth

Under the FTA, the main action has been found in the manufacturing sector. Prior to the FTA, manufacturing industries were subject to a wide range of duties from zero for automobiles, aircraft and tractors, to around 10% for pharmaceuticals, industrial machinery, hardware and appliances, to 15% for sporting goods and furniture, and to around 20% for clothing and textile products. Manufacturing was the sector expected to encounter the most change and developments under the FTA, and it did not disappoint.

Overall, Canadian manufacturing exports have significantly outpaced imports from the U.S. Approximately 30% of all bilateral trade is in the auto sector, facilitated by the 1965 Auto Pact. The FTA strengthened North American safeguards within the Auto Pact. Since the FTA, Canadian auto exports have more than doubled, primarily due to strong U.S. demand. With faster growth in exports over imports, Canada has widened its trade surplus in the auto sector with the U.S.

Other major sources of Canadian export gains in manufacturing since the FTA have been in high-tech sectors. Average annual increases from 1988 to 1998 in high-tech sectors were dramatic including industrial machinery and equipment (approximately 19%), electrical machinery such as electronics and telecommunications equipment (33%), aerospace (28%), scientific and precision instruments (23%), and pharmaceuticals (>100%). Canadian demand for imports of U.S. machinery and equipment and high-tech goods remained strong as industries made significant investments and adjustments.

Somewhat surprising has been the even more dramatic export growth in previously high-tariff, protected sectors such as furniture, textiles, and clothing. As a group, these industries experienced more than a five-fold increase in exports compared to three-fold increase in imports. Results were expected to be mixed within these groups. Canadian export growth was particularly strong in high fashion apparel (over 100% average annual increase), man-made textiles, and metal and wooden furniture. U.S. import penetration was particularly strong in textile products, carpets, and apparel (over 70% average annual increase). Although bilateral trade in apparel has exploded, most of the import pressure for the apparel industry in North America is from offshore competitors. Other noteworthy industries with strong gains in Canadian exports to the U.S. include plastics (quadrupled from 1988 to $7.5 billion in 1998), rubber (tripled), and sporting goods, toys and games (five-fold).

Services: Significant Gains But Limited Trade Activity Compared to Goods

The FTA rules on trade in services are built upon the principle of "national treatment" which provides a framework for further liberalization but essentially means a standstill on discriminatory laws and regulations. A number of services in sensitive areas were not covered by the agreement; these include cultural, telephone, legal, transportation, social and government services. NAFTA subsequently expanded the services provision to include land transportation, and the Open Skies policy opened up airline services. Cross-border customs procedures and temporary access for business personnel have been improved since the FTA.

The FTA resulted in the first international agreement on services but because of its limited coverage and lack of specific provisions, the FTA has had relatively minor impact on services trade between Canada and the U.S.

Furthermore, much of the economy operates in non-tradable services.

Services trade is still of significance and bilateral services trade has doubled in the last decade to nearly $59 billion in 1998. Canada has consistently run a trade deficit in services, but Canada's growth in service exports, led by commercial services, has outpaced imports in the 1990s. As a result, Canada has narrowed its services trade deficit with the U.S. from nearly $10 billion in 1993 to $5.5 billion in 1998. Canada's service exports of $26.7 billion to the U.S. in 1998 represented approximately 10% of Canada's total exports to the U.S. The U.S. accounts for approximately 60% of Canada's service exports.

Commercial services now account for nearly one-half of service exports, followed by travel and transportation. Financial services, computer and information services, and engineering and technical services have been the main source of export growth in commercial services. Management services, advertising, and royalties and licensing continue to be a major source of U.S. commercial service imports. The depreciating dollar and recent increases in U.S. tourism have helped narrow the deficit in tourism to levels of $3 billion in 1997-1998 compared to the $5 billion range in much of the 1990s.

Provincial-U.S. Trade: Strongest Export Surge from Alberta, Manitoba, Quebec and Prince Edward Island

Figure 5 compares provincial export growth to the U.S. by averaging annual export growth over the past ten years. Since 1988, the year prior to the implementation of Canada-U.S. free trade, P.E.I., Manitoba, Alberta, Quebec and Saskatchewan have experienced the best export performance, all above the national average.

Growth of imports from the U.S. has been strongest in Saskatchewan, Manitoba, Alberta and New Brunswick. In B.C., Saskatchewan, and New Brunswick, imports from the U.S. have grown slightly faster on average than have exports to the U.S.

Ontario, which dominates Canada's two-way trade with the U.S. (64%), generally mirrors the Canadian average in both export and import growth, with a slight decrease in its share of Canadian exports. Ontario runs a slight deficit in trade with the U.S.

Quebec and Alberta generate large surpluses in trade with the U.S. - surpluses which have significantly increased since the FTA. Quebec experienced the greatest net increase of all provinces in terms of export growth over import growth.

Consistent with the general trend toward increased trade dependence with the U.S., all provinces have significantly increased their share of world trade with the U.S.

This increase ranges from 59% of Saskatchewan exports destined to the U.S. to 92% of Ontario exports. The western provinces have experienced a substantial increase in share of exports to the U.S., from 52% in 1988 to 72% in 1998, but this is still the lowest share among Canada's regions.

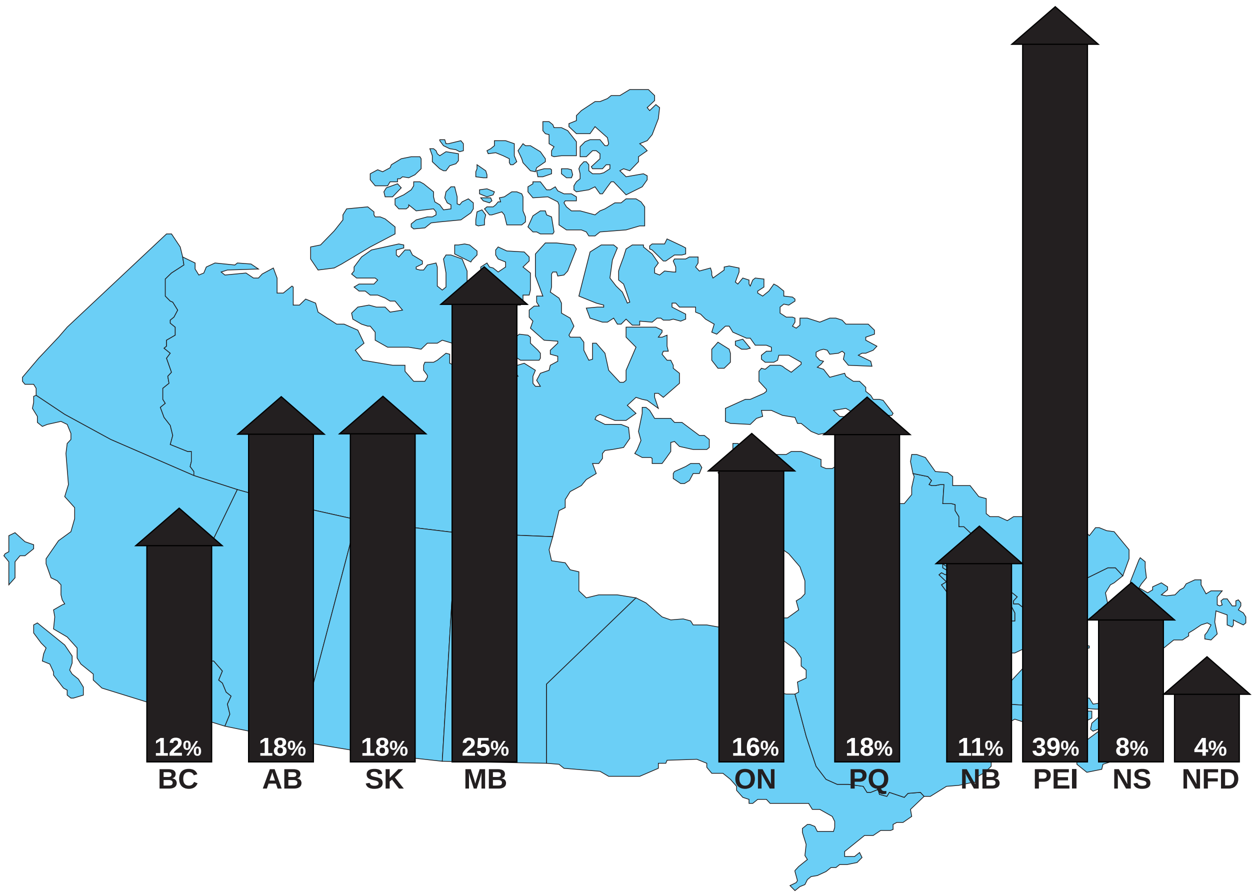
The dramatic increase in north-south trade, particularly in the Prairies and Quebec, has come at the relative expense of east-west trade, which has been growing comparatively slowly over the last decade.

Atlantic Provinces

Atlantic Canada's trade growth with the U.S. - both exports and imports - has been slower than other regions in Canada. The exception in export growth is P.E.I. which has experienced the largest increase in exports to the U.S. because of a boom in sales of potato products (frozen french fries, table potatoes), along with smaller gains in fish products, and machinery and equipment.

Other main areas of export growth to the U.S. have been mineral fuels from Newfoundland and New Brunswick, prepared fish from Newfoundland and New Brunswick, fish from Nova Scotia and New Brunswick, rubber products from Nova Scotia, wood products from New Brunswick and Nova Scotia, paper products from Newfoundland and New Brunswick, potato products from New Brunswick, and steel from Nova Scotia and New Brunswick. Fish exports from Newfoundland, pulp from Nova Scotia and New Brunswick, paper from Nova Scotia, and fertilizers from New Brunswick are all down from pre-FTA levels.

FIGURE 5
Provincial Exports to the U.S. Since Free Trade
(Average Annual Export Growth)



Source: Derived from Statistics Canada 65-003, customs basis. Based on annual average of 1998 exports less 1988 exports.

Quebec

After a slow start in the early years of the FTA, Quebec exports to the U.S. have grown rapidly since the recession in the early 1990s. The U.S. now accounts for 84% of Quebec's merchandise exports, up from around three-quarters before free trade. In 1998, Quebec's exports to the U.S. exceeded imports to the province from the U.S. by over $26 billion.

Key Quebec industries which have experienced dramatic export gains include several high tech manufacturers – aircraft and parts, electrical machinery, industrial machinery, telecommunications equipment, and pharmaceuticals. Other sources of high growth included electricity sales to the U.S. northeast, beverages, confectionery food products, plastics, wood products, furniture, apparel, sporting goods and toys, steel and aluminum products.

Ontario

The auto sector represents close to one-half of all Ontario-U.S. trade. As indicated, Canada has enjoyed a large and growing surplus in the motor vehicle trade, commensurate with economic growth. Similar to Quebec, Ontario-U.S. trade was sluggish from 1989 - 1991 followed by very high growth from 1992 - 1995. In 1998, Ontario led all provinces in export growth to the U.S. (up over 13% from the previous year).

Outside of vehicles and parts, Ontario's largest export gains have been in manufacturing, namely industrial machinery, electrical equipment, plastics, specialty chemical products, precious metals, aluminum products, sugar and cocoa preparations, miscellaneous food products, specialty metal products, rolling stock, furniture and scientific instruments.

Within the forestry sector, lumber and newsprint exports have been down or flat while remanufactured wood products and paper products have grown significantly. While significant gains have been made in food processing, certain food processing industries such as prepared meats, prepared vegetable products, cereal preparations, wine, beer and snacks have been subject to import pressures.

Manitoba

Manitoba has experienced tremendous growth in exports to the U.S. since the FTA, averaging 24% annually, the best of the provinces except for P.E.I. Exports to the U.S. today are well over triple what they were a decade ago. Manitoba has the most diversified economy in western Canada and its strong manufacturing base has benefited from free trade. Import growth has also been exceptional, partially reflective of a relatively stronger economy and strong demand for machinery, equipment, and components for secondary manufacturing.

Major manufacturing industries of export growth include: vehicle parts, buses, electrical machinery, industrial machinery, agricultural equipment, aircraft parts, steel, furniture, apparel, wood products, plastics, and pharmaceuticals. Electricity and copper exports have also risen significantly. A number of agri-food industries have done well including hogs, grains, oil seeds, canola oil and frozen potato products.

Saskatchewan

Saskatchewan is the least dependent of the provinces in terms of U.S. trade, and is more dependent on resources than other western provinces. Growth in both exports and imports with the U.S. was strong in the 1990s until last year when Saskatchewan's U.S. trade declined.

Saskatchewan's main source of export growth has been oil, followed by fertilizers (potash) and grains. Other sources of resource-based export growth have been oil seeds, canola oil, cattle, meat products, wood and paper. Manufacturing export gains were made in machinery and equipment, steel products and specialty chemicals.

Alberta

Alberta accounts for approximately 45% of western Canada's exports to the U.S. Alberta is one of the provinces most dependent on bilateral trade as the U.S. represents 83% of Alberta's merchandise exports. Oil and gas account for over 60% of Alberta's exports to the U.S., down significantly from a decade ago. Alberta's manufacturing exports have grown substantially in the 1990s, indicating greater diversity in the economy. Alberta experienced steady, strong growth in exports to the U.S. until last year when sharp declines in energy prices led to a 7% fall in exports to U.S. Imports from the U.S. have risen sharply in the last two years. Despite the recent drop in exports and surge in imports, Alberta has a large surplus of over $16 billion in trade with the U.S.

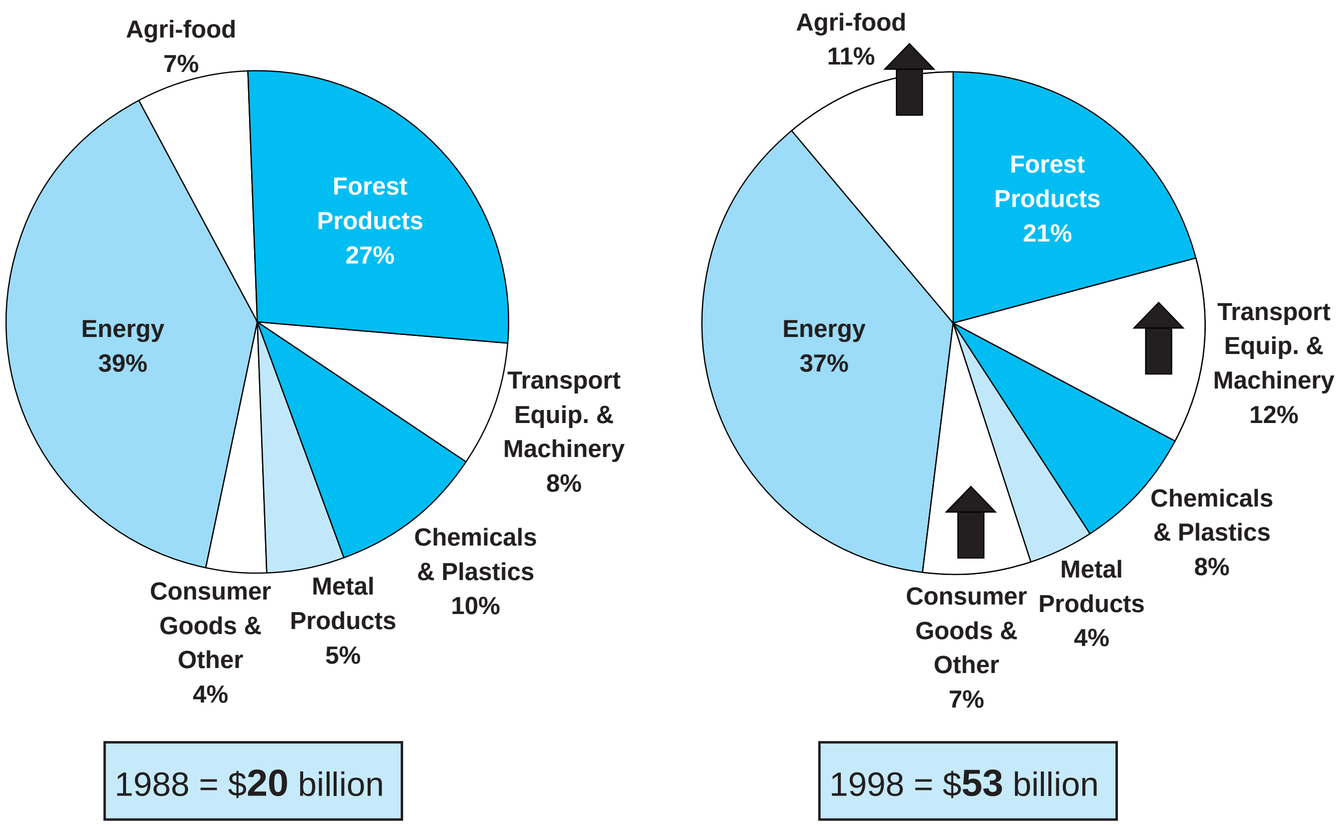
Oil and gas have been the main source of export gains in absolute dollars, benefiting from investments in natural gas and pipelines. Other key sources of export growth for Alberta have included: petrochemicals, plastics, fertilizers, wood products, paper, steel products, industrial machinery, telecommunications equipment, and furniture. Export growth in agri-food has also been strong led by cattle and beef, followed by animal fodder, canola oil, grains and oil seeds.

British Columbia

Prior to the FTA, the U.S. only represented 43% of B.C.'s exports; today, the U.S. accounts for 63%. B.C.'s export growth to the U.S. has been slower than the other western provinces, but still is at a solid level on an average annual basis following three years of decline after the initial implementation of the FTA.

Forestry products account for slightly over one-half of B.C. exports to the U.S., down significantly from pre-FTA levels. Exports of wood pulp have actually declined since 1988 and newsprint sales have been flat. Lumber and wood products have been the main source of export growth. In other sectors, B.C. experienced significant export gains in fish products, beverages, vegetables, inorganic chemicals, electricity, natural gas, plastics, steel products, aluminum, industrial machinery, telecommunication equipment and electronics, boats and trucks and parts.

FIGURE 6
Change in Western Canada's Exports to the U.S. Since Free Trade



Source: Derived from Statistics Canada 65-003, customs basis.

Western Canada: Key Structural Changes in Canada-U.S. Trade and a Look Back on Free Trade Expectations

Figure 6 illustrates the composition of western Canada's exports to the U.S. in 1988 (pre-free trade) and today. As a result of western Canada's growth of some $33 billion in exports to the U.S. in just the last ten years, western Canada has increased its share of Canada-U.S. trade. western Canada accounts for one-quarter of Canada-U.S. trade, and approximately 46% of Canada's trade with the rest of the world.

Some significant and positive shifts have occurred in western Canada's trade. Because of rapid growth in exports to the U.S. from manufacturing and value-added industries, the three sector groups in **Figure 6** of transportation equipment, machinery and equipment, consumer goods, and agri-food have significantly increased their presence in western Canada's trade economy. While western Canada is still much more resource dependent than Ontario or Quebec, there have clearly been marked shifts to more manufacturing and processed products and away from primary resources.

Industry patterns of trade have been in roughly the direction of pre-FTA expectations. As CWF predicted, based on extensive interviews with industry leaders and associations in the late 1980s, for most of the economy, free trade has largely been business as usual.

For certain resource sectors such as primary forestry products, energy, mines and steel, the main benefit of the FTA was export security. For many manufacturing and processing industries, the FTA was expected to have a positive impact and this has largely happened in western Canada. Some industries were expected to be negatively affected by the FTA. This has generally occurred for poultry products, fine papers, canned fruits and vegetables, wine and miscellaneous food processing (snacks, sauces). However, some industries that were expected to be negatively affected turned out to do fairly well, namely the furniture, door and millwork, and apparel industries.

Some Closing Comments

As discussed at the outset, trade is driven by many macroeconomic factors (e.g., GDP growth, inflation, interest rates, exchange rates, commodity prices) and other factors (e.g., stock markets, technology, and transportation and communication costs). The implementation of a regional or world trade agreement is only one factor among many which influences trade activity.

NAFTA is not a cure for competitiveness and job performance problems and should not be purported as such. Canada's cost competitiveness has been partially assisted by a depreciating currency.

A fundamental concern is the fact that Canada's productivity growth continues to be slow and lags behind the U.S. Addressing this problem may require, among other things, new investments in innovation, technology and training, and more competitive tax rates.

The extent to which the FTA/NAFTA has changed economic activity is questionable, but the evidence of trade flows certainly indicates that since the FTA, Canada-U.S. trade has experienced tremendous growth, at much higher rates than other economic indicators and higher than anticipated. Canada's exports are also increasingly more knowledge-intensive and less resource-intensive.

Many will continue to argue who the winners and losers are. A good argument may be made that consumers are the biggest winners, as they benefit from a better choice of products and better prices than otherwise would have been the case. Remember it was only ten years ago when Canadian consumers paid duties of around 20% for U.S. clothing and footwear, 15% for U.S. furniture and fixtures, and near 10% for U.S. machinery, hardware and motorcycles. These duties are now eliminated on U.S. products. Similarly, U.S. industrial and retail customers no longer pay duties on Canadian-made products.

Canada and the United States have benefited from predictable and transparent rules under FTA and NAFTA which have resulted in greater stability and security in trade and access to our major market.

Canada must continue to build on the trading relationship it is fortunate to have with the largest economy in the world. Signs of U.S. protectionism, which have flared from time to time, will remain a priority concern of Canada. Make no mistake, trade disputes will continue to surface when some $500 billion in two-way trade is involved, but the vast majority of cases are resolvable.

Improvements to NAFTA are needed in areas such as procurement, subsidies, trade law application, agriculture, environment, and services, but overall, NAFTA is working fairly well.

In parallel with our trade attention in North America, Canada must focus on the WTO and regional trade agreements outside North America in order to capture emerging markets in Asia, Europe, and Latin America as these economies rebound.

While Canada has done well in international trade, Industry Canada noted that the top 50 exporters represent approximately 48% of Canada's world exports. The number of exporters and entrepreneurs needs to be widened. Most importantly, changes with respect to trade are the cumulative results of the responses of individual firms and people.

Finally, it is worth recapping the impact of ten years of free trade on western Canada. The trade effects have been generally favourable, but for the majority of the economy it has been business as usual with relatively minor impact. Free trade has not fundamentally altered the internal structure of the western Canadian economy, nor has it fundamentally transformed the West's economic position within Canada. Many economic factors - including free trade - have helped spur a directional shift in western Canada's trade with the U.S. toward more manufactured and processed goods, and less reliance on primary resources. ■