

# Should Canadian Labor Be Concerned About NAFTA?

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Many Canadians have expressed concerns over the implementation of the North American Free Trade Agreement (NAFTA).<sup>1</sup> Canadian critics of NAFTA argue that the Agreement will result in a mass exodus of employers to Mexico to take advantage of its pool of cheap labor. This predicted exodus will deliver a one-two punch to

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<sup>1</sup> The North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 296-456, 612-799, 33 I.L.M. 649-57, 663-64, 671-80 [hereafter NAFTA]. Canada's NAFTA obligations were implemented by the *North American Free Trade Implementation Act*, Bill C-115, 3rd Session, 34th Parliament, 40-41-42 Eliz. II, 1991-92-93, which came into force on January 1, 1994, pursuant to Order-in-Council P.C. 1993-2183. The view of one NAFTA critic, though somewhat over-zealously stated, is characteristic of these concerns:

The average hourly wage in the maquiladora free-trade zones is forty to sixty cents. That is where U.S., Japanese and Canadian corporations are going — more than 1500 of them since 1978. Half a million Mexicans work in the maquiladoras, many living in tar-paper shacks without electricity, drinking water or sewage facilities. Given a choice of setting up a plant in Canada and paying wages of eight, ten or fifteen dollars an hour, vacation pay, social benefits, and health and education taxes, or going to Mexico, paying 60 cents an hour with virtually no benefits or union protection, and simply shipping product north, its [sic.] not hard to see where business will go. Some 70 percent of the television sets sold in the United States now come from the Maquiladoras. One U.S. company promoting the Maquiladoras explains that by relocating from Canada or the United States, a corporation can cut its production costs in half and save up to \$25,000 per year per employee.

DAVID ORCHARD, *THE FIGHT FOR CANADA* 229-30 (1993). Mr. Orchard provides no references for the information he relies on in this paragraph, so it is not possible to determine its source.

Canadian labor through, first, a wave of plant closures as manufacturers close in Canada to relocate in Mexico, followed by a flood of cheap imports. The end result of implementing NAFTA is predicted to be massive Canadian job losses.

The purpose of this Article is to advance a personal view of NAFTA's likely effect on Canadian labor. This Article concludes that, in spite of the dire predictions, NAFTA will be mildly beneficial for Canada and Canadian employment. The Agreement is unlikely to result in a substantial exodus of Canadian companies, a flood of cheap Mexican products, or significant labor dislocation. Moreover, the alternative (of Canada abrogating NAFTA) could cause much more significant labor dislocation affecting many more Canadian workers. While NAFTA will be mildly positive for the Canadian economy as a whole, the Agreement, like any trade agreement, will require some labor adjustment as resources are reallocated. However, Canada should address these negative effects through properly directed government education and retraining programs, not through restrictive trade policies.

#### I. DOES MEXICO REALLY ENJOY A LABOR-COST ADVANTAGE?

The first point of concern for many Canadians is Mexico's wage rates. How can Canadian workers compete with Mexicans reputedly earning only \$0.40 (CDN)<sup>2</sup> an hour? The first part of the answer is that Mexico does not, in fact, enjoy such a substantial labor-cost advantage. Mexican hourly compensation levels are much higher than \$0.40. The second and perhaps more important part of the answer is that focusing on per hour wage rates fails to account for total production costs. When total production costs are accounted for, the manufacturing of most goods may be more expensive in Mexico than in Canada.

##### A. *Mexico's Labor-Cost Advantage Not as Significant as Is Commonly Suggested*

What are Mexico's wage rates? Precise information on Mexican wage rates can be difficult to obtain and is often conflicting. One thing is certain: The average Mexican wage is not \$0.40 per hour. The statutory minimum wage is approximately \$0.60 per hour. There are at least two problems with relying on this statutory minimum as a basis of comparison. First, it is an absolute minimum, not

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<sup>2</sup> \$1.00 CDN is approximately equal to \$0.74 U.S. as of Feb. 9, 1994. All subsequent dollar figures are in Canadian funds unless otherwise indicated.

an average. As in Canada, average wages are much higher than the statutory minimum wage. Comparing Mexico's statutory minimum wage to the average manufacturing wage in Canada is comparing apples and oranges. The minimum Mexican wage should not be relied on as a basis of comparison (unless, of course, one wishes to compare minimum wages in the two countries). If one looks at the average wage rates offered in the maquiladora industries alone, approximately \$2.00 per hour, the wage rate is far above the statutory minimum.<sup>3</sup>

Second, looking only at per hour wages tends to underestimate total compensation. It is total compensation that employers consider to be important, not simply per hour wages. Benefits to Mexican employees are substantial. Employers in Mexico are required by law to provide employees with a number of benefits that would be considered unusual in Canada, such as mandatory ten-percent profit sharing; mandatory Christmas bonus of fifteen days wages; and transportation, housing, and food allowances. In the maquiladoras, employers often pay considerable bonuses to workers who stay with the firm.<sup>4</sup> Furthermore, the Mexican social security system is comparable to Canada's, providing for paid holidays and mandatory medical, workers' compensation, disability, and old-age security coverage. These benefits are all in addition to per hour wages.

The consulting firm of Price Waterhouse estimates that the loading factor on wages in Mexico (that is, the additional employee benefit costs imposed on employers) is approximately 100 percent.<sup>5</sup> Consequently, actual Mexican per hour wage rates are much higher than is often stated, and more importantly, the gap between total compensation in Mexico and Canada is much less than the gap between per hour wages.

An additional problem with simple cross-border per-hour wage comparisons is that they do not account for the relative purchasing power of the different wages. Alan Reynolds, Director of Economic

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<sup>3</sup> DAVID HUSBAND ET AL., *THE OPPORTUNITIES AND CHALLENGES OF NORTH AMERICAN FREE TRADE: A CANADIAN PERSPECTIVE* 6 (1991). It should also be noted that average hourly wages for maquiladora workers are lower than the average for the entire Mexican manufacturing sector. See BANK OF MONTREAL ECONOMICS DEPARTMENT, *THE SEARCH FOR COMPETITIVE ADVANTAGE: A NEW NORTH AMERICAN FREE TRADE ZONE* 7 (April 1991).

<sup>4</sup> These bonuses are apparently an attempt to overcome high turnover rates and training costs. See HUSBAND ET AL., *supra* note 3, at 7.

<sup>5</sup> PRICE WATERHOUSE, *DOING BUSINESS IN MEXICO* 107 (1989).

Research at the Hudson Institute, relying on an International Monetary Fund study that reviewed the actual purchasing power parity of Mexico's per capita gross domestic product (GDP) estimates that a Mexican wage of \$2.35 (U.S.) an hour is comparable to a U.S. wage of approximately \$5 (U.S.) per hour.<sup>6</sup> Reynolds also quotes from a World Bank study that, employing Mexican statistics, concluded that 1991 U.S. manufacturing compensation was only 4.7 times higher than Mexican manufacturing compensation.<sup>7</sup>

*B. Wage Rates Are Only One of Many Manufacturing Cost Factors*

While total compensation in Mexico is well above \$0.40 per hour, simply comparing employee compensation levels across borders still looks at only one side of the equation. If compensation rates were the only relevant factor in locational decisions of investors, countries with wage rates much lower than Mexico's (such as Bangladesh or many African countries) would attract enormous amounts of foreign investment and would be exporting powerhouses. This has not happened because investors make locational decisions on the basis of total production or unit costs, not simply individual employee compensation.<sup>8</sup> A proper calculation of unit costs must take labor productivity into account. Most estimates place Mexican manufacturing productivity at approximately twenty percent of U.S. and Canadian productivity, meaning that, on average, it will take five Mexican employees to do the work of one Canadian or American.<sup>9</sup> It is not surprising, therefore, that with

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<sup>6</sup> Alan Reynolds, *Ross, Get a New Brain Trust*, INT'L ECON., July/Aug. 1993, at 6, 7.

<sup>7</sup> *Id.*

<sup>8</sup> In fact, wage rates have been found to be a relatively unimportant factor in investment planning. For example, in a survey of small- to medium-sized Canadian, Mexican, and U.S. businesses, the accounting firm of Arthur Andersen concluded that, in making investment decisions in North America, taxes and the regulatory environment were more important considerations than wage rates. ARTHUR ANDERSEN, *NAFTA SURVEY REPORT 10* (1993). In another survey of Canada's largest 100 companies conducted by KPMG Peat Marwick Thorne, Canadian managers ranked labor costs as ninth in importance out of the fourteen factors listed, behind considerations such as taxes (ranked first), skill level of available employees, exchange rates, quality of communications and transportation facilities, market proximity, and proximity of educational institutions. See *Lower Tax Rates Not Lower Wages Top NAFTA Lure Survey Shows*, TORONTO STAR, May 3, 1993, at C1.

<sup>9</sup> Reynolds, for example, states that in 1991 U.S. manufacturing productivity was 4.6 times higher than Mexican manufacturing productivity. Reynolds, *supra* note 6, at 7. Robert Lawrence, the Albert L. Williams

Mexican productivity averaging about one-fifth that of Canada and the United States, total compensation per Mexican employee also averages about one-fifth.<sup>10</sup>

To return to the central question, can Canadian labor compete with low-wage Mexican labor? Once properly accounted total compensation costs are multiplied by labor productivity, the alleged Mexican labor-cost advantage substantially evaporates.<sup>11</sup> Canadian labor can compete because it is much more productive.

## II. MEXICO'S COMPARATIVE ADVANTAGE MEANS IT MUST COMPETE WITH OTHER LOW WAGE COUNTRIES, NOT CANADA AND THE UNITED STATES

While Mexico's labor-cost advantage is not as significant as commonly believed, its pool of unskilled, low-wage workers is where its one comparative advantage lies. This one advantage will be attractive to those industries where unskilled labor costs are a significant

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Professor of International Trade and Investment at the John F. Kennedy School of Government, Harvard University, estimates that 1990 output (profits plus wages) in the maquiladoras was \$7,700 (U.S.) per worker, while average U.S. manufacturing output was \$45,600 (U.S.) per worker. This would make average U.S. manufacturing productivity almost six times that of the maquiladoras; thus, based on productivity alone, it may be more costly to manufacture in the maquiladoras than in the United States. Robert Z. Lawrence, *The Real Wage/Productivity Story*, 16 INT'L ECON., July/Aug. 1993, at 16, 18.

<sup>10</sup> It is also not surprising that with so many other considerations being more important to investors than wage rates, over 75% of U.S. foreign direct investment in 1990 was invested in developed countries, not low-wage countries. Japan and Germany have similar foreign investment patterns. THE STERN GROUP, INVESTMENT, TRADE, AND U.S. GAINS IN THE NAFTA (1992). If low wage rates were of fundamental importance to investors, these percentages would of course be reversed.

Wages (and incomes) are high in Canada and the United States because overall productivity is the highest in the world; in sharp contrast, wages (and incomes) are low in Mexico because the productivity of Mexican workers is low. Their low productivity is the result of a combination of factors, including low skill levels, poor plant and machinery with which to work, and poor social infrastructure such as roads, telecommunications, etc.

HUSBAND ET AL., *supra* note 3, at 7.

<sup>11</sup> See HUSBAND ET AL., *supra* note 3, at 7 ("At the going exchange rates between the Mexican peso and the Canadian and U.S. dollars, unit labor costs (which are the product of hourly wage rates and the number of hours of labor needed to produce a unit of output) are more or less comparable among the three countries.").

component of total costs and where labor productivity is relatively unimportant or can be improved rapidly through relatively basic training. But these labor-intensive, unskilled manufacturing industries are not likely to be lured away from Canada or the United States because, for the most part, these industries have already departed Canada and the United States for lower-wage countries.

As labor costs increased in Canada and the United States following the Second World War, labor-intensive industries found it cheaper to produce in lower-wage countries and gradually began to relocate manufacturing facilities to locations such as the Far East. Today, with the possible exception of textiles and clothing, only a minimal amount of labor-intensive manufacturing occurs in Canada and the United States.<sup>12</sup> And, again with the exception of clothing and textiles, the economies of Canada and the United States have become increasingly open to imports of labor-intensive products from these countries, meaning that imports already account for a significant percentage of domestic consumption in these sectors. If, as expected, Mexico does attract investment in the labor-intensive manufacturing industries, it is not likely to be Canadian or American products that Mexican producers will have to compete with, but those of other low labor-cost countries.

Mexico's preferred access to Canadian and U.S. markets may also mean that some of the labor-intensive manufacturing facilities that had once relocated to Asia may again relocate, this time to Mexico. This could result in a realignment of Canadian and American import patterns, with total Canadian and American imports of labor-intensive products remaining the same while imports from Asian countries decrease and imports from Mexico correspondingly increase. However, the overall effect on Canadian labor of any such trade diversion would be minimal, as trading patterns will simply

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<sup>12</sup> As an aside, it is interesting to note that as a percentage of total employment in Canada, manufacturing employment peaked as far back as 1951, at only about 35% of all employment, and has experienced an almost continual decline since that time. In 1970, manufacturing accounted for 22% of all employment in Canada; in 1992 only 14.5%. The United States has experienced a parallel development. In 1970, manufacturing accounted for 24.6% of employment; in 1992, only 15.4%. Michael Walker, *Behind the North American Free Trade Agreement*, FRASER FORUM, Jan. 1993, at 5, 6-8. See also *Minutes of Proceedings and Evidence of the Sub-Committee on International Trade of the Standing Committee on External Affairs and International Trade*, 34th Parliament, 3d Session, Issue 21, at 5-24 (Nov. 30, 1992) (statement of Michael Walker).

shift. Overall import penetration is not likely to increase significantly.

### III. MEXICO'S SIGNIFICANT MARKET ACCESS TO CANADA PRIOR TO NAFTA

Canadian workers are concerned that NAFTA will result in a flood of cheap Mexican imports into Canada. The underlying (and often unstated) premise of this concern is that, prior to the Agreement, Canada effectively precluded the entry of these low-priced Mexican imports through a high tariff wall and other nontariff barriers. NAFTA's presumed elimination of these protective barriers will result in the flood.

In fact, there were very few barriers to the entry of Mexican goods into Canada prior to NAFTA. Over eighty percent of Mexico's exports to Canada entered duty-free.<sup>13</sup> Those products that did attract duty were subject to Canada's most-favored-nation (MFN) rate—the same tariff rate applied to all other parties contracting to the General Agreement on Tariffs and Trade (GATT) (except the United States). Estimates place the average Canadian tariff on all Mexican products at 2.4 percent.<sup>14</sup> One study determined that the pre-NAFTA duties on Mexican products marginally narrowed the wage-rate differential between the two countries by only \$0.02 to \$0.05.<sup>15</sup> Any nontariff barriers that had been applied to Mexican products were also applied on an MFN basis.<sup>16</sup> Thus,

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<sup>13</sup> Duty-free access to Canada was granted to Mexican exports under both the Most-Favored-Nation (MFN) Tariff and the General Preferential Tariff (GPT), depending upon the product. The GPT is a Canadian program of preferential tariff treatment extended to developing countries, similar in form and substance to the U.S. Generalized System of Preferences, or GSP tariff.

<sup>14</sup> RICHARD LIPSEY ET AL., *INSIDE OR OUTSIDE THE NAFTA? THE CONSEQUENCES OF CANADA'S CHOICE* 7-8 (1993); see HUSBAND ET AL., *supra* note 3, at 7.

<sup>15</sup> HUSBAND ET AL., *supra* note 3, at 7.

<sup>16</sup> For example, Canadian quota restrictions on dairy, egg and poultry products applied to Mexican goods as it did to the same goods of all other GATT contracting parties. However, Canada has never had to negotiate export restraint agreements with Mexico in the clothing and textiles sector under the GATT Multifibre Arrangement, as it has been required to do with many Asian countries. Therefore, prior to NAFTA Mexico already enjoyed better access to the Canadian market in clothing and textiles than did many other countries. Mexican clothing and textiles were not flooding into the country.

prior to NAFTA, with very low tariffs and very few nontariff barriers, Mexico had relatively unimpaired market access to Canada.

In spite of this open market access, Mexico's exports to Canada have historically been insignificant, totalling only \$2.8 billion in 1992.<sup>17</sup> Canadian imports from the United States in the same year totalled almost \$97 billion. The low level of Mexican imports even in the face of virtually unimpeded access to the Canadian market leads to an obvious conclusion concerning the potential for a post-NAFTA flood of cheap Mexican imports into Canada: "If the low wages of Mexican workers were a decisive factor in the location decision for most industries, Canada would already be flooded with Mexican products, since existing tariffs cover only a tiny fraction of the wage differential."<sup>18</sup>

#### IV. CANADIAN ACCESS TO MEXICAN MARKET, BEFORE AND AFTER NAFTA

Critics look at the increasing investment in Mexico by Canadian companies and conclude that the prime motivation for this investment is, and will continue to be, the avoidance of Canada's high wage rates. In their view, NAFTA will result in increased Canadian investment in Mexico as products can be manufactured more cheaply there and can now be exported duty-free back into Canada. However, sales statistics of U.S. companies operating in Mexico tend to display a more important motivation for investing and manufacturing in that country. Recent statistics show local-market sales accounting for a full seventy percent of total sales made by majority-owned Mexican affiliates of U.S. firms. Only twenty-five percent of all sales were for export to the United States.<sup>19</sup>

With easy access to the U.S. market from Mexico, if U.S. companies invested in Mexico to take advantage of low labor costs, a much higher percentage of total sales should have been in the U.S. market. The high percentage of local-market sales leads to the conclusion that, prior to NAFTA, many companies had been investing in Mexico not to take advantage of cheap labor and to re-export back

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<sup>17</sup> External Affairs and International Trade Canada, *NAFTA—What's It All About* (Ottawa: Government of Canada, 1993) at 3. By way of contrast, Mexico's exports to the United States totalled over \$42 billion in 1992.

<sup>18</sup> LIPSEY ET AL., *supra* note 14, at 8.

<sup>19</sup> THE STERN GROUP, *supra* note 10, at 37. The Stern Group relied on information from the U.S. Department of Commerce's National Trade Data Bank.

to their home markets, but to leap trade barriers and access the growing Mexican market. Nothing suggests that Canadian companies were motivated by any different considerations.

In contrast to Mexico's relatively open access to the Canadian market, Canadian products were virtually excluded from the Mexican market until 1986, when Mexico became a contracting party to the GATT. Prior to its GATT accession, Mexico practiced a comprehensive policy of import substitution, whereby it almost completely prohibited imports, and, to the greatest extent possible, met domestic needs from government-encouraged domestic production. While Mexico's GATT accession greatly improved Canada's market access, that access remained limited. In spite of some GATT-negotiated tariff reductions, Mexican tariffs remained high. At GATT accession, Mexico bound its tariffs at fifty percent.<sup>20</sup> Its maximum applied tariff rate was twenty percent, with numerous products subject to tariffs in the ten to fifteen percent range.<sup>21</sup>

While Mexico's GATT accession did require it to phase out some nontariff barriers, many significant barriers remained. For example, the 1989 Mexican Auto Decree imposed export performance and domestic production and content requirements on any auto producer wishing to sell into the Mexican market.<sup>22</sup> Auto producers had to be manufacturing in Mexico in order to sell automobiles there. This domestic production requirement significantly limited export opportunities in Mexico for Canadian and American production plants and their employees.

As a result of Canada's limited market access, its total exports to Mexico were only about \$400 million in 1986, increasing to only \$771 million in 1992.<sup>23</sup> Mexico ranked seventeenth on Canada's list of export markets. In contrast, Canadian exports to its number one export market, the United States, were \$93 billion in 1986, increasing to over \$125 billion by 1992.

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<sup>20</sup> MICHAEL HART, *A NORTH AMERICAN FREE TRADE AGREEMENT: THE STRATEGIC IMPLICATIONS FOR CANADA* 108 (1990). A tariff binding at 50% meant that Mexico remained free to increase any tariff up to that rate without requiring prior GATT authorization and without having to offer compensation to its trading partners in return.

<sup>21</sup> *Id.*

<sup>22</sup> For a concise historical description of Mexico's regulation of the automobile industry, see GARY HUFBAUER & JEFFREY SCHOTT, *NORTH AMERICAN FREE TRADE: ISSUES AND RECOMMENDATIONS* 209-41 (1992).

<sup>23</sup> PROSPECTUS PUBLICATIONS LTD., *MEXICO - CANADA: PARTNERING FOR SUCCESS* 40 (1992); External Affairs and International Trade Canada, *supra* note 17, at 3.

An asymmetry of market access between Canada and Mexico existed prior to NAFTA. What has occurred under the Agreement is an equalization of that access, meaning a relatively small improvement in Mexico's access to the Canadian market, but a significant improvement in Canadian access to the Mexican market. NAFTA also eliminates many of Mexico's trade-restricting domestic production requirements, such as those imposed under the 1989 Auto Decree. Canadian companies will no longer be required to invest and produce in Mexico in order to sell there. Companies will now be able to supply the Mexican market from their existing production facilities located in Canada and the United States. Domestic production requirements and trade barriers were two of the primary reasons Canadian companies had been locating production facilities in Mexico. Removal of these restrictions under NAFTA should mean fewer Canadian companies locating manufacturing facilities in Mexico, not more. In relative terms, Mexican imports to Canada will increase only slightly, but Canadian exports to Mexico should increase significantly, increasing Canadian export opportunities and export-supported employment.<sup>24</sup>

#### V. THE CONSEQUENCES OF CANADA ABROGATING NAFTA

Canadian workers have little to fear from NAFTA. They should have no difficulty competing with Mexican low-wage labor. Moreover, the Agreement will result in increased employment as a result of increasing exports. What, then, would be the consequences of not remaining a party to NAFTA? Would such a move be more beneficial or more costly to Canadian labor? The answer to this depends on the trading relationship that would develop absent NAFTA.

By June of 1990, Mexico and the United States had resolved to negotiate a comprehensive bilateral free trade agreement, similar in form and substance to the bilateral trade agreement that Canada

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<sup>24</sup> This potentially significant increase in Canadian exports must be placed into proper perspective. In absolute terms, even if Canadian exports experience an unheard of increase of 100% over the short term (say, one to five years), total exports to Mexico would only reach a level of about \$1.5 billion, still less than 1% of Canada's total exports. By way of contrast, under the Canada-U.S. Free Trade Agreement, in the three year period 1989-92, Canadian exports to the United States experienced an unprecedented increase of about 24%, or about 8% per year. DANIEL SCHWANEN, *A GROWING SUCCESS: CANADA'S PERFORMANCE UNDER FREE TRADE* 5 (1993).

and the United States had implemented only one year earlier.<sup>25</sup> Moreover, the express policy of the United States was to seek a series of similar trade agreements with all Central and South American countries. Canada was then faced with the decision of whether to join in the negotiations or to permit Mexico and the United States to negotiate their own separate bilateral agreement. Either way, Mexico and the United States had made their decision. They would pursue an agreement with or without Canada. Canada could not influence that decision.

It was clear that absent the trilateral NAFTA, a series of bilateral agreements would develop with the United States at the center. What would be the consequences of such an arrangement to Canada? The Free Trade Agreement (FTA) had provided Canadian producers with preferential access to the U.S. market. This preferential access accomplished two Canadian goals. First, it meant that Canadians had an advantage over all other importers into the U.S. market, making Canadian products more competitive. Second, it made Canada a relatively more attractive location in which to invest, produce, and create jobs. Under a Mexico-U.S. bilateral agreement, Mexican producers would obtain similar preferential access to the U.S. market. The advantage to Mexico of a bilateral agreement was the same as it had been to Canada.

Faced with the unavoidable result of an agreement between the United States and Mexico, Canada would have been confronted with three problems if it had not joined the new agreement. First, any bilateral agreement would erode Canada's preferential access to the U.S. market, thus reducing Canada's export opportunities and, consequently, employment. One of the great benefits of the Canada-U.S. agreement would be diminished and Canada would receive no offsetting benefit in return.

Second, any U.S. policy that improves American competitiveness relative to Canada is potentially detrimental to Canadian producers because of the importance to Canada of the U.S. market. A Mexico-U.S. bilateral agreement could improve the competitiveness of U.S. producers with no offsetting competitive improvement for Canadian producers. This would make it more difficult for Cana-

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<sup>25</sup> The Canada-United States Free Trade Agreement (FTA), entered into between the Government of Canada and the Government of the United States and signed on January 2, 1988. The FTA entered into force on January 1, 1989. Concurrent with signing NAFTA, Canada and the United States signed an additional side agreement whereby they agreed that the operation of the FTA would be suspended as long as both countries were parties to NAFTA.

dian producers to compete in the U.S. market, further reducing Canadian exports and employment.

Third, and probably most important, employment cannot be created without investment. Located next to the United States, Canada is exceedingly conscious of its ability to attract and retain employment-creating investment. A Mexico-U.S. bilateral agreement would make Canada a much less attractive investment location. Two bilateral agreements with the United States at the center of both would create a "hub-and-spoke" system, making the United States the preferred location for investment and production. By manufacturing in the United States, a producer could gain preferential access to all three markets. If production occurred in Mexico or Canada, the producer could gain preferential access to only two markets. The more bilateral agreements the United States negotiated, the more attractive it would become to investors and the less attractive Canada would become.<sup>26</sup> Less investment in Canada would mean fewer jobs.

However, by joining the negotiations and creating a trilateral agreement, Canada was able to avoid most of these problems. First, although Canada's preferential access to the U.S. market has been eroded, Canada has obtained preferential access to a growing Mexican market of eighty-five million people that had previously been almost completely closed to Canadian exports. Second, Canada obtained the same potential for productivity improvements that U.S. producers obtained. Thus, Canadian jobs will not be lost because of productivity improvements in the United States. Third, by avoiding a hub-and-spoke arrangement, Canada was able to maintain its relative attractiveness as an investment location. This will assist in maintaining investment levels in Canada, thus producing more employment than would otherwise have been the case.

Abrogating NAFTA now would have the same effect on Canada as not participating in the original negotiations—a significant loss of investment and employment over time. Faced with the choice between the mild benefits of membership with a small amount of labor dislocation, or significant costs in terms of lost employment

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<sup>26</sup> Taking this argument to its logical conclusion, the worst possible scenario for Canada would be abrogation of NAFTA, followed by the abrogation of the FTA. By doing so, Canada would lose its preferential access to the U.S. market. In order to meet the competition in the U.S. market, Canadian producers would be required to establish production facilities there, diverting investment and employment from Canada.

and investment with virtually no benefit, the Canadian government appears to have little choice but to remain in NAFTA.

#### CONCLUSION

The debate over NAFTA in Canada has not ended with its implementation. Many will continue to argue that Canada should abrogate the Agreement. While abrogation could potentially benefit a very small group of Canadians, in view of the potential costs to the economy as a whole, such action does not appear to be in Canada's best interests. Without a doubt, NAFTA will cause some Canadians to lose their jobs. This is one of the unavoidable consequences of international trade, indeed of a free-market economy generally. Resources are constantly being reallocated to their most efficient use. This is not to say that we should simply ignore those who will bear the costs of economic change. Those who will bear the brunt of NAFTA's costs will likely be those who are least able to adapt to change—unskilled workers who have insufficient education to find employment in the expanding sectors of Canada's export-driven economy. These workers' problems are not directly related to NAFTA, but rather to the globalization of the world economy (to which NAFTA is one response) and a social safety net in Canada that focuses on intra-sectorial re-employment (new job, same sector) rather than inter-sectorial re-employment (new job, new sector). The solution does not lie in raising trade barriers in an attempt to avoid globalization, but rather in properly focused educational and retraining programs that will prepare workers for jobs in the expanding sectors of Canada's economy.

