



TRADE

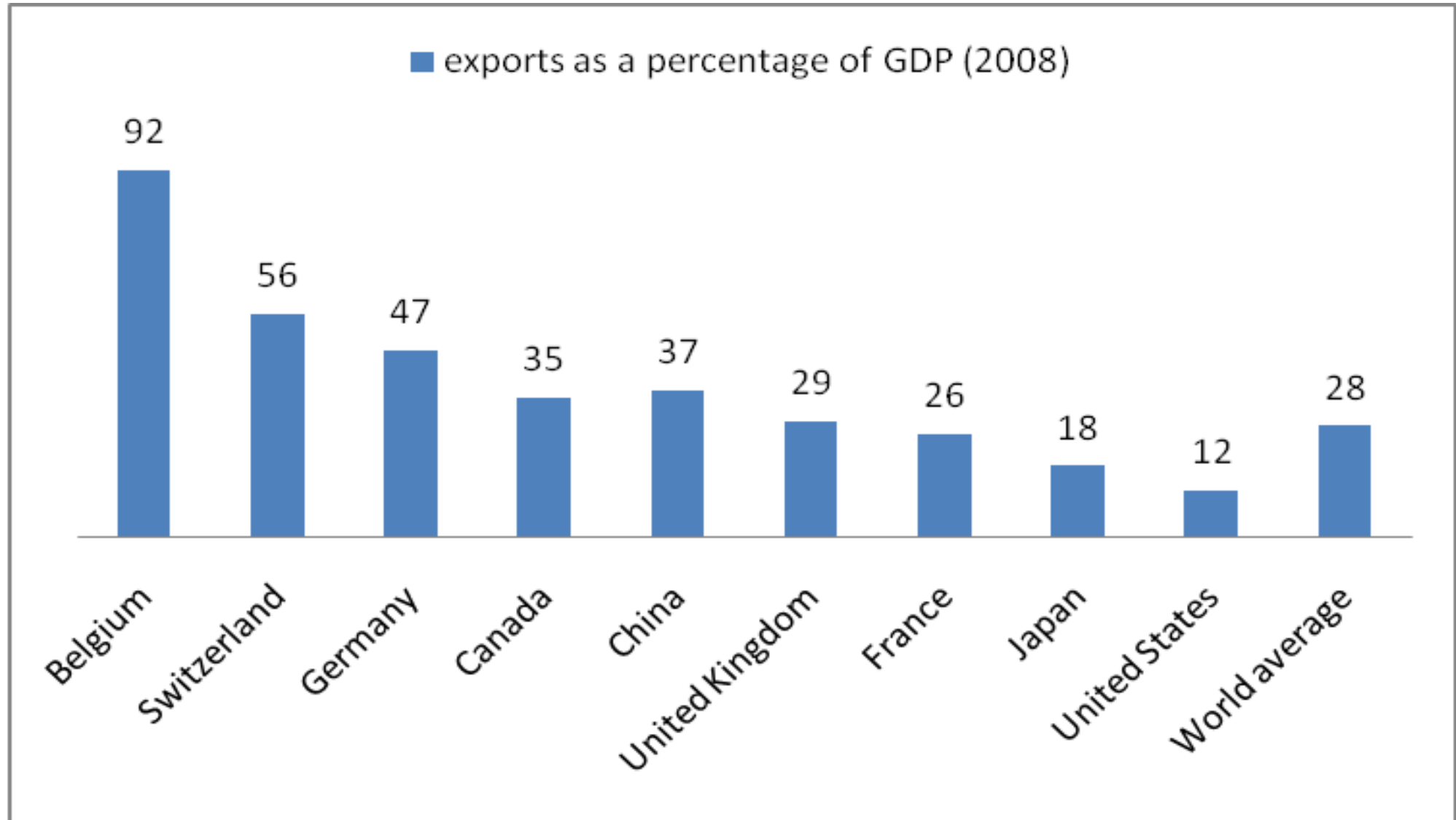


WHY TRADE?

- International trade brings many economic gains to both the consumer and the country as a whole.
- One of the main benefits to the consumer is the variety in products and services to consume.
- In addition it encourages creativity and competition both nationally and internationally.
- Trade brings about more availability and choice of products, freer trade, increased competitiveness, higher productivity, higher consumer satisfaction and a better standard of living for all involved.

THE IMPORTANCE OF TRADE

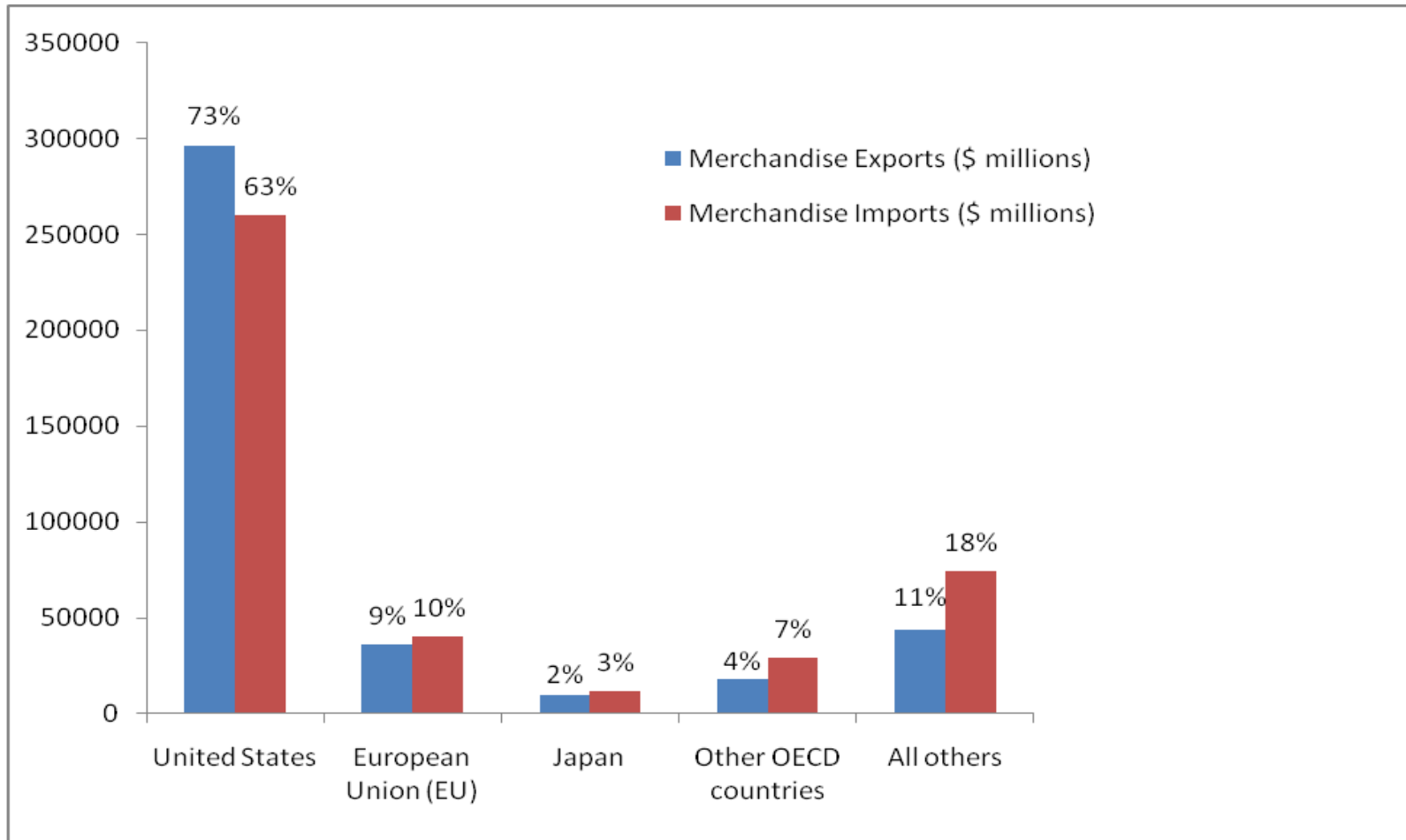
- Canada has shown a heavy reliance on trade, with exports representing 35% of its GDP.
- When compared with other countries, Canada's exports are a higher proportion of GDP than is average for the world's countries, including Japan and the US.
- Some small industrialized countries, such as Belgium, have a higher reliance on foreign trade than does Canada.



CANADA'S TRADE PATTERNS

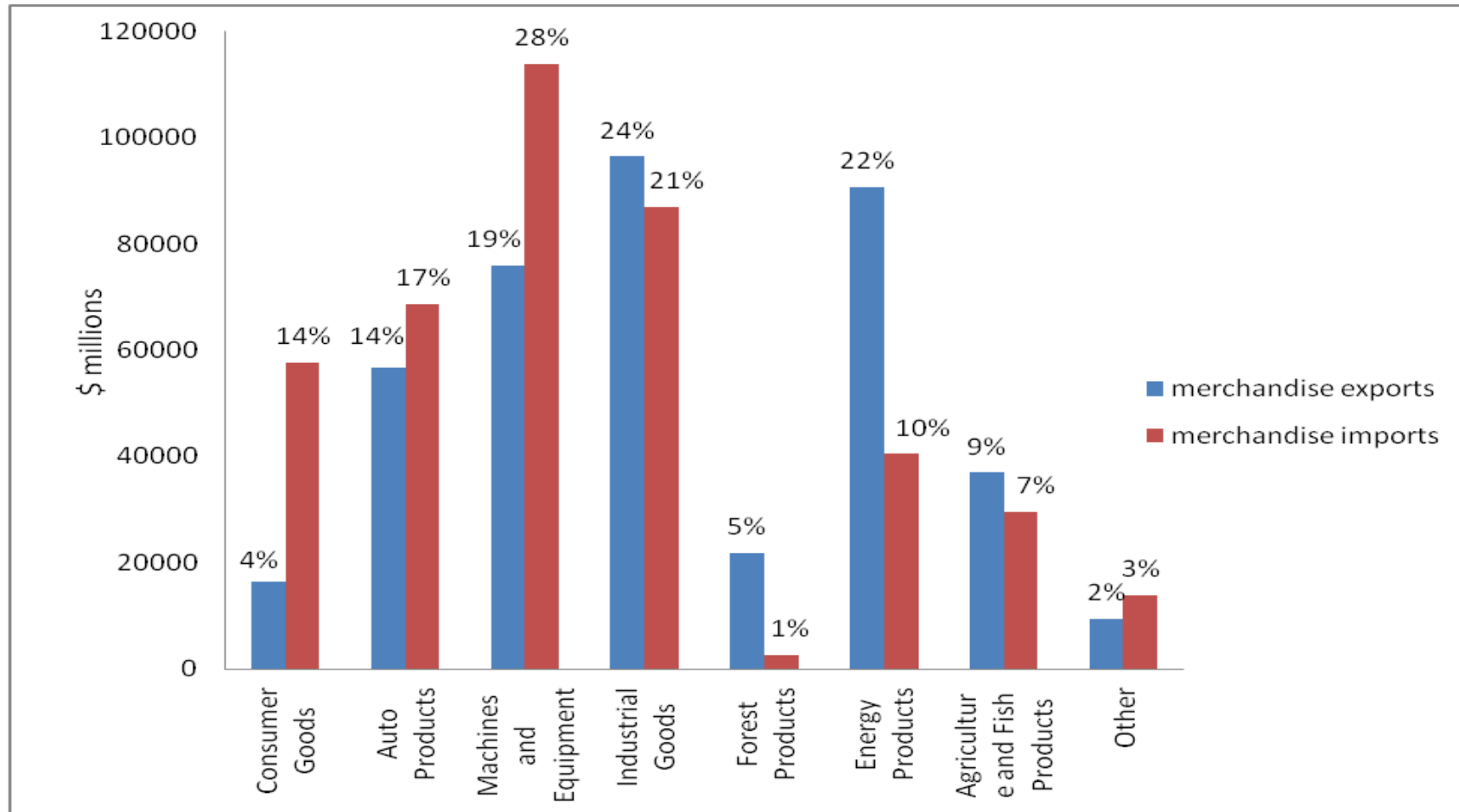
- Canada's primary trading partner is the US, which buys almost three-quarters of Canadian merchandise exports and provides just under two-thirds of Canadian merchandise imports.

CANADA'S MERCHANDISE TRADE BY REGION (2010)



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- Canada's merchandise exports are about equally divided between natural resources (both raw and processed) and manufactured goods.
 - Canada's merchandise imports of manufactured goods are more than double its merchandise imports of natural resources (both raw and processed).

CANADA'S MERCHANDISE TRADE BY TYPE OF PRODUCT (2010)



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- The impact of Canada's service sector on trade is not fully reflected in the stated figures for service exports and imports.

WHAT IS TRADED?

- Three main factors determine what products a country exports and imports:
 - Resources
 - Market size
 - Climate

THE CASE FOR TRADE

- International trade brings three main economic gains:
 - Product variety
 - Competition
 - Specialization

ABSOLUTE AND COMPARATIVE ADVANTAGE

- David Ricardo, a master economist, put forward the theory of Comparative and Absolute Advantage.
- This theory has served as justification for Free trade and liberalization of markets for years.
- Specialization can be based on either absolute advantage or comparative advantage.
 - Absolute advantage is exhibited by a producer who can supply a certain quantity of an item more efficiently than can other producers.
 - Comparative advantage is exhibited by a producer who can supply a certain item with a lower opportunity cost than can other producers.

THE TERMS OF TRADE

- The terms of trade represent the international price of one product in terms of another.
- The limits of the terms of trade for a pair of products traded between two countries are determined by the cost ratios of the products in each country.

FAIR EXCHANGE OF GOODS

- This fair exchange depends on the terms of trade based on products they exchange.
- Two countries will only trade items if trade is advantageous to each of them.
- The Labour Theory of Value states that the value of a good could be measured in terms of the man hours invested in the creation of a given product.
 - Thus differences in comparative costs are reflected differences in the productivity of labour.

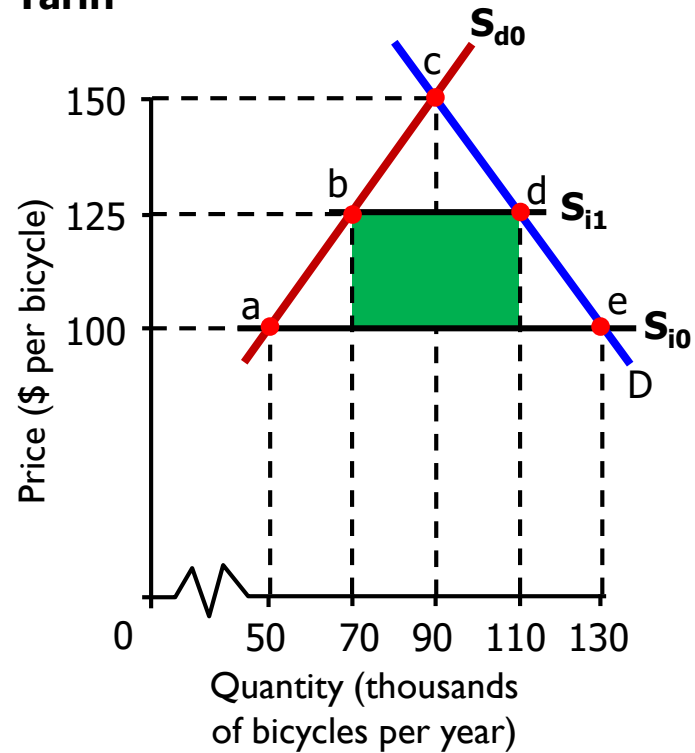
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- For example, this suggests that high productivity labour countries would have a comparative advantage of trading sophisticated technology to countries with low productivity labour who would be advantaged by producing low technology goods.
 - In the real world, this is definitely true.
 - Developing countries usually produce basic goods such as cocoa beans or fruit while advanced economies produce more complex goods like computers or automobiles.

THE IMPACT OF TRADE PROTECTION

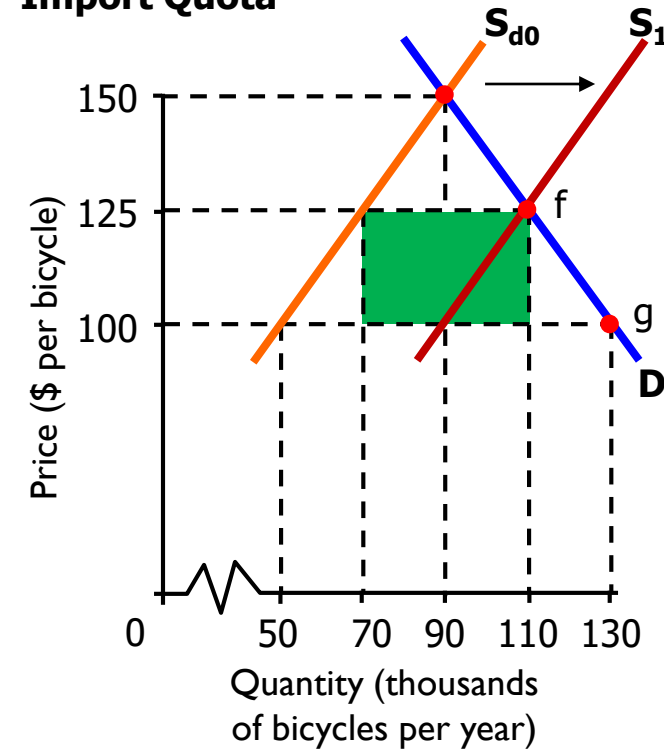
- In a perfectly competitive market:
 - A tariff (which is an excise tax on imported goods) decreases consumption and foreign imports, while it increases domestic production and government revenues
 - An import quota (which is a non-tariff barrier) has the same effect as a tariff, except that the increase in government revenues is replaced by an increase in the price of foreign imports

THE IMPACT OF IMPORT BARRIERS

Tariff



Import Quota



ISSUES WITH “FREER TRADE”

1. Dumping of Surpluses

- In order to protect prices in their markets certain countries dump surplus goods in other countries.
- Dumping will cause the price of goods in the other country's economy to fall.
- Thus, dumping makes it very hard for producers in the affected nation to compete.
- Example: Dumping Canadian surplus of milk production into another country may cause the industry for the production of milk in the affected country to suffer or even collapse.



2. Retaliation by market

- Several years ago to protect their industry American interests banned the importation of lumber from Canada into the US.
- This allowed the US market to thrive by reducing unemployment, artificially inflating prices, and seriously disadvantaging Canadian interests.
- Overreliance on free trade can create these types of situations where one country tries to get back at another country.



3. To protect Jobs

- When one country imports cars from a foreign nation, it essentially creates jobs in the other country while taking jobs away from the importing side.
- Lower demand and production for domestic goods can cause a slow down in the economy.



4. Diversity

- An economy with few products will be advantaged by having trade restrictions and tariffs because it will allow domestic companies to survive and thrive.
- Without barriers these domestic companies would have little chance of success



5. Protecting of developing industry

- Industries that are just beginning must be protected from large foreign multinational companies who already have all it takes to take over the smaller companies.
- By protecting these developing industries, they are allowed to compete.



6. Safety and Environmental standards

- Standards that increase costs by imposing strict environmental standards usually reduce the profitability of a firm.
- When allowing for trade varying levels of standards should be considered.
- For example, in Canada and in much of the world, there is a push to use much more environmentally friendly policy such as applying the Kyoto/Paris agreement to reduce greenhouse emissions as we produce our much-needed resources.
- If this is the case, other countries we trade with should also participate in this agreement because otherwise their production costs will be lower thus making them more competitive.



7. Protection from foreign influences

- Domestic intrusion of foreign ownership of key services and goods can undermine the economy of a nation.
- In Canada, therefore, restrictions on the ownership of certain companies and industries are usually considered important to protect Canadian interests.

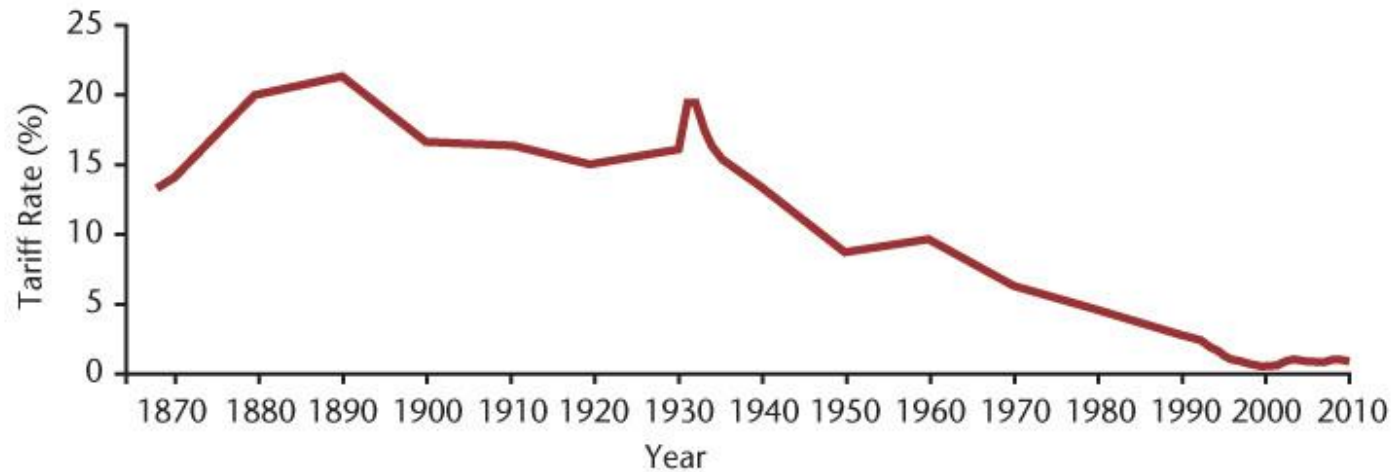
PAST CANADIAN TRADE POLICIES

- Canadian trade policy has undergone several significant shifts:
 - The National Policy (1879) initiated wide-ranging Canadian tariffs on manufactured goods to stimulate a domestic manufacturing sector.
 - The Great Depression sparked an international round of protectionism in which Canada participated.

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- The General Agreement on Tariffs and Trade (GATT) and its replacement, the World Trade Organization (WTO), represent multilateral initiatives to reduce trade protection among member countries, including Canada.

AVERAGE TARIFF RATES IN CANADA

FIGURE 15.8 Average Tariff Rates in Canada



Since 1868, tariffs as a percentage of total merchandise imports have fallen from above 20 percent. The National Policy, which began in 1879, pushed up the average tariff rate. While the rate gradually fell from the early 1890s, it rose again during the Great Depression. Since the early 1930s, the rate has declined considerably due to the effects of various GATT and WTO agreements, as well as regional agreements, that Canada has signed.

Sources: Statistics Canada "Average Tariff Rates in Canada." Adapted from "Historical Statistics of Canada," Catalogue 11-516, 1983, Series G473-487 and from the Statistics Canada CANSIM II database <http://cansim2.statcan.gc.ca>, Tables 384-0007 and 228-0003 (March 17, 2011).

RECENT TRADE BLOCS

- A trading bloc (which is a relatively small number of countries involved in a trade agreement) can take three forms:
 - A Free Trade area is an area in which trade is tariff-free, although member countries are able to impose separate trade barriers on outside countries (e.g. NAFTA).

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- A Customs Union is a group of countries with common trade barriers with outside countries as well as a free trade area (e.g. Mercosur).
 - A Common Market is a customs union that allows for the free movement of labour and capital among member countries (e.g. the EU).

THE AUTO PACT (1965)

- Is an example of a free trade area in one class of products.
- Eliminated tariffs on both sides of the Canada-US border as long as the “Big Three” auto companies met North American content and Canadian value-added rules.
- Was successfully challenged in the WTO by Japan and the European Union.

THE FREE TRADE AGREEMENT

- The Free Trade Agreement (FTA) signed by Canada and the US in 1988:
 - Eliminated tariffs on virtually all products.
 - Included services.
 - Reduces governments' ability to screen foreign direct investment.

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- Introduced a new North American content rule for autos.
 - Created a continental energy market.
 - Accompanied by a significant increase in trade between the two countries.

THE NORTH AMERICAN FREE TRADE AGREEMENT

- The North American Free Trade Agreement (NAFTA) signed by Canada as well as the US and Mexico in 1993:
 - Extended most of the provisions of the FTA to include Mexico.
 - Includes side agreements concerning labour and environmental standards.
 - Had little effect on Canada given Canada's relatively minor trade with Mexico.