TRADE talks

A podcast about the economics of trade & policy
with Chad P. Bown

Episode 195. How did Canadian workers adjust so well to US trade?

[Episode webpage]

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Transcript

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Chad Bown: On January 1, 1989, Canada and the United States finally opened up to free trade with each other.

US President Ronald Reagan: *"I consider this agreement one of the major achievements of my two terms in this office. I think our nations have set an example for the rest of the world. In the face of rising protectionism, we've forged an agreement that eliminates tariffs and opens markets and will create jobs on both sides of the border…"*

As part of that deal, some in Canada faced the threat of a huge surge in imports from their giant southern neighbor. Canadian companies and their workers would suddenly have to compete with American goods newly available in the Canadian market.

Looking back, Canadian workers in industries facing that new competition from America were more likely to lose their jobs. But perhaps surprisingly, those same Canadian workers also adjusted relatively quickly. They found new jobs. And over the next two decades, it turns out, their wages and earnings did not suffer. The Canadians seem to have done OK.

This episode explores that puzzle. Why was this Canadian worker experience with international trade so different from workers in other countries that have had bigger struggles with globalization.

To tackle all of this, I will be joined by a very special guest.

Peter Morrow: Peter Morrow, University of Toronto.

Chad Bown: Peter Morrow is an economics professor at the University of Toronto. He is an expert on trade and workers, and today Peter is going to share results from some of his new research into Canada's response to free trade with the United States.

Hi, Peter.

Peter Morrow: Hey, Chad

Chad Bown: You are listening to an episode of *Trade Talks*, a podcast about the economics of trade and policy. I'm your host, Chad Bown, the Reginald Jones Senior Fellow, at the Peterson Institute for International Economics in Washington.

THE EPISODE

Chad Bown: Peter, to start things off, let's talk about the trade relationship between Canada and the United States in the mid-1980s before their free trade agreement. They did have a limited free trade agreement for cars and car parts – the 1965 Auto Pact – but how would you characterize their relationship for everything else?

Peter Morrow: Prior to the Canada-US Free Trade Agreement, Canadian and US exports to one another were similar in some respects, and this is what you would expect from them both being high-productivity countries with relatively educated workforces.

But there were also important differences in terms of the structure of trade. For example, the United States exported more machinery to Canada, whereas Canada would send more oil and wood-related products back to the US. And this what you would expect from endowments. And then, obviously, there was strong two way trade in auto parts dating back to the Auto Pact of 1965.

But there were tariffs. Canada did have tariffs on US exports into the Canadian market. On average, Canada's protection was about 10 percent. And the United States provided itself with less protection, maybe 3 or 4 percent.

There were lots of important differences, though, across goods. If you're a Canadian and you wanted to buy a wool jacket or some gloves for those long winter months, you paid a 20 percent tariff on those if they were imported from the US. Whereas, if you're a Canadian farmer and you wanted to import dairy machinery, that was protected far less, at roughly 2 percent. There was a lot of variation across different industries in terms of how precisely protected they were prior to the trade agreement.

Chad Bown: Was a free trade agreement with the United States in the 1980s a no brainer politically in Canada?

Peter Morrow: It wasn't obvious at all that this trade agreement was going to be ratified by Canada. Canada had always held the United States at arm's length, and this was a very controversial trade agreement to implement. The Canadian Prime Minister, Brian Mulroney, had started negotiating this agreement and it had actually been agreed to by the negotiators in 1987 and signed by President Reagan and Prime Minister Brian Mulroney on January 2nd, 1988.

But then what happened was it became the topic of the Canadian 1988 federal election, with the Conservative Party being in support of the trade agreement and the Liberal Party in opposition. And it wasn't clear at all who was going to win this federal election.

Canadian Broadcasting Corporation: *"It's an issue most Canadians say they do not understand and perhaps because of that it has become the issue of the election campaign.*

Prime Minister Brian Mulroney, 'That is the facts in the free trade agreement. It creates new wealth, it creates new prosperity, and it gives British Columbia an opportunity that others in Canada have enjoyed for decades.'

John Turner (Liberal Party), 'I'm not going to let Mr Mulroney destroy a great 120 year-old dream called Canada. I'm not going to do it.'

Ed Broadbent (New Democratic Party), 'The decisions made that effect the people of Canada and their future ought to be made in Ottawa and not in Washington.'

Mulroney, 'Canadians do not believe in fear and falsehoods and they will reject it on the 21st of November…'"

Peter Morrow: And it was really only in November 1988 when the Conservative Party actually came from behind to win that ratification of the trade agreement was assured.

Chad Bown: Why was the agreement so controversial in Canada? What was Canada worried about?

Peter Morrow: The way the Canada-US Free Trade Agreement was viewed going in was, it was definitely going to be transformative. Outside of the auto sector, a lot of Canadian firms were constrained in the size of the market that they were able to sell to. And there was some sense that allowing Canadian firms to access the US market might allow them to achieve a higher scale of production and perhaps lower average costs through increasing returns to scale.

If these gains from increasing returns to scale weren't realized then Canadian firms might just be opened up to import competition, in which case there might be substantial job loss.

For those who were opposed to the trade agreement, what's interesting is that it seems to have been more about sovereignty and the actual implementation of the trade agreement, which stirred up the most negative feelings. For example, there was a famous retired judge from Alberta, Marjorie Bowker, who was actually pro- free trade, but she disagreed with how it was being implemented and how things like dispute resolution were going to be imposed on Canada. What kind of power would the United States have on Canada and would this make Canada overly reliant on the United States in some sense?

Chad Bown: There have been some famous articles written about Judge Bowker.[1] Given the Trump administration's approach to renegotiation of the NAFTA in 2017, she might have been a little bit right about concerns that Canada might someday become overly reliant on the United States.

OK, let's go back again to the 1980s. Tell us a little more about the differences in pre-trade agreement tariff rates across industries in the two countries and the size of the tariff cuts that were going to result from the free trade agreement.

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[1] See, for example, John McLaren. 1997. Size, Sunk Costs, and Judge Bowker's Objection to Free Trade. *American Economic Review* 87, no. 3: 400-420.

Peter Morrow: Going into the trade agreement, both countries had high levels of protection on certain goods, such as textiles, coats, and clothing. But there are also industries where the Canadian tariff cut was larger than the US tariff cut. And there's other industries where the US tariff cut was larger than the Canadian tariff cut.

For example, communications equipment – i.e., telephone equipment or audio equipment – then the Canadian tariff cut was larger than the US tariff cut. But in medical equipment, the reverse is true with the US tariff cut being larger than the Canadian tariff cut.

And when you look at the resulting trade flows that came out of the tariff cuts associated with the free trade agreement, trade flows responded in a way that you would expect.

High tariff cut industries had larger increases in trade flows between the two countries.

Chad Bown: Your focus is going to be on Canadian workers. What worker data are you able to examine?

Peter Morrow: We're looking at this really amazing data set that's been assembled by Statistics Canada. This is a confidential data set that we had to apply to use and is based on individuals' tax records, and that allows us to follow workers for 21 years across any job that they had during this time span.

For example, even if a worker loses their job due to import competition, we can see what happened to them after they lost their job. Were they able to recover? Did things get worse? Were they forced to move across provinces?

One of the nice things about this data set is that we're able to see a worker's annual earnings from each employer that they worked for during a given year. Expanding over 21 years, this allows us to see how their incomes evolved over this time span.

Chad Bown: This is amazingly detailed information and there are lots of outcomes you can look at for Canadian workers exposed to new competition from the United States. Where did you start?

Peter Morrow: The way we structured our study was to look at workers who were employed in 1988 in industries that then subsequently lost protection due to Canadian tariff cuts.

We then focus on just a couple of very simple outcomes. For example, we started by looking at the question of did workers in more affected industries lose their jobs more frequently? We also looked at how many years they worked overall. Did they have long spells of unemployment, or did they work as many years as other workers?

Finally, we looked at their earnings over the time span covered by the data. And we did that because we wanted to know, even if they kept their jobs, were they forced to work for lower wages?

Chad Bown: What did you find, and were you surprised?

Peter Morrow: We started our analysis by looking at what happens to workers if they're in industries that saw Canadian tariff cuts, and we find that there were fewer jobs and lower incomes. Workers had higher probabilities of layoffs, workers worked for fewer years at those jobs, and their incomes from those jobs went down.

These results weren't surprising to us at all. This is what has been found by other researchers in the past. What we were able to do using this data from Statistics Canada was to ask what happens to these workers after they lose their jobs. Were they able to recover or did things get worse over time?

Chad Bown: When you examined what happened to Canadian workers over the longer run, what did you find? Were they able to recover and find new jobs at reasonable wages?

Peter Morrow: Looking at the longer run, we actually found that workers were able to respond fairly positively to import competition in Canada. Workers tended to move out of their initial industries into other jobs relatively smoothly, to the degree that, in the long run, their incomes didn't look any different from workers who had initially worked in industries that didn't see any import competition.

This was really surprising to us because, in a number of different contexts, researchers have found prolonged negative labor market experiences for workers who lose their job due to import competition. For example, David Autor, David Dorn, and Gordon Hanson find that for the "China shock" in the United States, workers had pretty bad labor market outcomes for a long time.[2]

In the Brazilian context, my coauthor Brian Kovak and Rafael Dix-Carneiro found that Brazilian workers had really bad labor market outcomes for a long period of time after trade liberalization in the 1990s.[3]

Given how different this result was from what so many other researchers have found, we were really curious about *why* this happened. Why did things work out this way in Canada?

Chad Bown: Workers in Canada affected by new competition from the United States that lost their jobs were able to adjust. To figure out why, where did you look?

Peter Morrow: To think about why we found the results that we found, we first looked at some theories that ended up not being very good explanations for our results.

One possibility was that this change in tariffs didn't really cause changes in trade flows – i.e., that the shock wasn't that big. And that's just absolutely not true. There was a huge expansion in trade into Canada from the United States in response to these tariff cuts, and this was much larger than the expansion of Chinese imports into the US during the China shock (for example), and also larger than the increase in imports from China into Canada during the same time.

The second potential explanation that we looked at was that maybe Canadian tariff cuts and US tariff cuts offset each other in the same industry. I.e., if you're a Canadian worker producing textiles and you lower your tariffs by 10 percent, and the US also lowers its tariffs by 10 percent, maybe you don't have to do anything because maybe these tariffs offset in some sense. But that's just also not true in the data. We do see workers (1) losing their jobs in their initial industries, and (2) moving across industries, which wouldn't happen if tariff cuts were simply offsetting each other.

A final explanation is that maybe the macroeconomy was booming in Canada during this period, and there were simply lots of jobs to go around. This also just isn't true. There was

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[2] See David Autor, David Dorn, and Gordon Hanson, 2021. On the Persistence of the China Shock. *Brookings Papers on Economic Activity* Fall: 381-476.
[3] See Chad P. Bown. 2023. Brazil's trade opening and its toll on workers and crime. *Trade Talks* episode 191, October 15.

actually a really bad recession in North America, and especially bad in Canada, during the early 1990s when these tariff cuts were implemented.

Chad Bown: If none of those theories explain it, then what did explain why these Canadian workers were able to recover and find new jobs?

Peter Morrow: We did find evidence that four factors do have some ability to explain our results.

First, when the tariff cuts were enacted, Canadian workers really moved quickly into less affected industries. This stands in stark contrast to the United States experience with the China shock, where workers moved from one affected industry to another affected industry to another affected industry. Canadian workers really had a better sense of how to escape these shocks.

Second, we found that US tariff cuts in related industries may have helped speed this transition. We showed this in two steps. First, we looked at the period before the trade agreement and we asked how easy was it for workers to move across specific pairs of industries.

Using the communications equipment and medical equipment example from before, suppose that we found large flows of workers between those two sectors before the trade agreement. This would suggest that Canadian workers could transition between those two industries relatively easily if they needed to.

Also remember that there were differential tariff cuts across these two industries. This allowed Canadian workers to move across industries within manufacturing and not move into other industries where they might have had to really retool their skills and incur large adjustment costs.

Chad Bown: So there, when the US is cutting its tariff in the medical equipment sector by a lot, that helps Canadian exporters of medical equipment and their workers. Because Canadian workers in the communications equipment sector have similar skills, they can transition out of the shrinking communications equipment sector and into the expanding sector for medical equipment.

OK, but I cut you off. You said there were four factors. What else did you look at?

Peter Morrow: We looked for whether the trade agreement caused Canadian firms to incur mass layoffs. Mass layoffs are generally defined as when a firm sheds employment by, say, 20 percent or more over some short time span. There's been a lot of work done showing that mass layoffs are really bad for workers. And this might be because local areas are decimated and these mass layoffs somehow make things much worse than an idiosyncratic layoff.

We didn't find any evidence of mass layoffs by Canadian firms in response to Canadian tariff cuts.

Fourth, we found that Canadian firms largely responded to the Canadian tariff cuts by hiring fewer workers who were entering into the labor market. This is important because they could have responded by shedding workers who were already there, but they didn't do this.

This means that older workers who might have built up a lot of experience and a lot of tenure at firms didn't need to find new jobs, and that new workers to the labor force, perhaps younger workers, simply had to look in different places than they might have looked at previously.

Chad Bown: Overall, you find that Canadian workers did much better when opening up to trade with the US in the 1990s than US workers did when opening up to trade with China in the 2000s or than Brazilian workers did when opening up to trade with the world in 1990s.

But why? Is the answer just that the Canadian labor market is different and we should all try to be more like Canada?

Peter Morrow: So it'd be really convenient if the Canadian labor market is just different somehow, and this explains our findings. For example, suppose there was some Canadian policy that everyone could just replicate that would make all countries invulnerable to import competition.

But that's not the case. We find that Canada responded roughly as you'd expect due to the China shock in the mid-1990s and early 2000s. There were mass layoffs, there were reduced years worked, and reduced earnings. It's not that the Canadian labor market responds perfectly to all shocks.

The implication is that there was something about this particular episode for Canadians that was different. Canadian workers successfully adjusted to the shock, but were less successful in other contexts.

Chad Bown: The fact that Canadian workers also suffered – just like the American workers – when facing new import competition from China suggests Canada is not immune from these problems. So there is this puzzle, but it's not a Canada puzzle – it's a Canada-US free trade agreement puzzle. And this one is a relatively good puzzle to have to work on.

OK, having spent a lot of time on this, what is your advice for where future researchers should look? In the US we have TAA, the trade adjustment assistance program dedicated to workers hurt by import competition. Describe for us Canada's domestic policies designed to help worker adjustment and whether those might be part of the explanation.

Peter Morrow: Canada doesn't have a trade adjustment assistance program the way the United States does. The reason for this is that it's generally folded into unemployment insurance. The idea, and if you read the history of this, is that Canadian policymakers said, why would we want to treat unemployment caused by import competition any differently than we treat other forms of unemployment?

It would be interesting to see, is there an intersection of healthcare provision and how people respond to unemployment shocks. How does that affect how we think about import competition induced unemployment and potential recoveries there from?

Maybe a hypothesis is that the trade shock was better understood (by Canadian workers) and if we can get better information on that – that would be amazing.

I think what's really standing out to us right now is that there's room for really important research to understand why Canada's response from the shock was not so bad.

I really wish there was a smoking gun, but it's still an open question.

Chad Bown: Stepping back, are there warnings to how we should interpret your results?

Peter Morrow: We're not saying no one was hurt. There were clearly corners of the labor market that did see depressed earnings for periods of time. However, what we don't see is broad swaths of the population having catastrophic labor market outcomes.

While being optimistic about the lack of truly horrible labor market outcomes, we still have to keep in mind that there were portions of the labor market that were affected.

Another caveat is that we're only able to look at relative performance across workers and industries. So it may have been the case that all workers were better off just by differing amounts, or all workers were worse off just by differing amounts. We can't really say anything about that, but we think that's a great topic for future research.

Chad Bown: As my last question, what would you suggest to policymakers are key takeaways from your research?

Peter Morrow: Just for a moment, I'd like to step away from our results as they are. One of the key lessons for policymakers is that it's really important to have a well-funded and robust statistical agency that has the institutions to engage with academic researchers. We couldn't have done this project without the data from Statistics Canada, and there's better and better data coming out all the time. Making sure that statistical agencies and academics can use this data is really something that should not be dismissed as unimportant.

I think another lesson is that it's useful to use this data to come back and look at longstanding questions. Again, data is getting better all the time, and there's some questions that are outstanding that become answerable as time passes.

Chad Bown: Peter, thank you very much.

Peter Morrow: It's been an absolute pleasure.

GOODBYE FOR NOW

Chad Bown: And that is all for *Trade Talks*.

A huge thanks to Peter Morrow at the University of Toronto. Do check out Peter's paper with Brian Kovak at Carnegie Mellon University titled "The Long-Run Labor Market Effects of the Canada-U.S. Free Trade Agreement." I will post a link the paper on the episode page of the *Trade Talks* website.

Thanks to Melina Kolb, our supervising producer. Thanks to Sarah Tew, on digital. As always, thanks to Collin Warren, our audio guy.

Do follow us on Twitter or X, we're on @Trade__Talks. That's not one but two underscores, @Trade__Talks.

<insert super funny double underscore joke here>. ■

Read more…

- Kovak, Brian K. and Peter M. Morrow. 2023. [The Long-Run Labor Market Effects of the Canada-U.S. Free Trade Agreement](). NBER Working Paper #27393, October (revised).