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Changing environment of the Canadian retail trade sector

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The Changing Environment of the Canadian Retail Trade Sector

by

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The Changing Environment of the Canadian Retail Trade Sector.

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An investigation into the effects that the Canada-United States Free Trade Agreement, the Goods and Services Tax, and recent conditions affecting the Canadian economy have had and will have on Canadian retailing was conducted. This study, from a Canadian point of view, reviewed the time frame between June 1991 and January 1992, utilizing primary and secondary data.

The Canada-United States Free Trade Agreement (FTA) represents a positive influence on Canadian businesses. The emergence of Canadian businesses operating in the global market necessitates the lowering of trade barriers and continued aggression in seeking new markets for which Canada's goods and services may be sold. This agreement represents one of many steps leading to Canada's participation in the global market. However, Canadian small retail businesses are fearful because many currently do not participate, nor do they have plans to participate in international trade with the United States. As such, Canadian small retail businesses have very little to gain and much to lose.

The Goods and Services Tax (GST) has altered Canadian retailing immensely. It presents a unique challenge for Canadian retailers in that businesses must now begin to deal head-on with the United States and must do so subject to increased levels of taxation from the Government of Canada. The Goods and Services Tax benefits Canada, in that it represents an aggressive step towards federal government deficit reduction. Nonetheless it causes a series of short-term concerns for Canadian retailers.

Another factor in retail trade trends in Canada is the rise in the Canadian dollar, which poses a threat to the Canadian economy. Additional forces impeding the Canadian economy include rising interest rates, the limping U.S. recovery, Canada's own debt overhang and the eroding competitiveness of Canada's manufacturers. This in combination with the changes in the Canadian retailing environment will represent a period of short-term difficulty for the Canadian retail trade sector. Nonetheless, success in the long-term is forthcoming.

In this constantly changing environment, it is extremely difficult to distinguish between the effects of the Canada-U.S. Free Trade Agreement, the Goods and Service Tax, and the current recession in Canada on the Canadian retail trade sector. Therefore, all the above variables assist in explaining the presented conclusions.

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CHAPTER 1:

INTRODUCTION

The purpose of this paper is to examine the variables which influence the Canadian retail trade sector. The primary variables are: The Canada-United States Free Trade Agreement (FTA) and the Goods and Services Tax (GST). In order to understand the degree of influence of each variable, it is important to understand the role of the Canadian economy with respect to the Canadian retail trade sector. This paper, utilizing primary and secondary data, focuses on information collected over a period ranging from June 1991 until January 1992.

The body of this paper is divided into three distinct chapters to illustrate the changes in the Canadian retail trade sector. Chapter Two addresses the issues which affect the Canadian economy and the overall role of the economy on the Canadian retail trade sector. Chapter Three confronts the effects of the Canada-United States Free Trade Agreement and the implications for the Canadian retail trade sector. Finally, Chapter Four discusses the effects of the Goods and Services Tax and the repercussions of this tax on the Canadian retail trade sector. As a prelude to these chapters, it is important to have a basic understanding of the Canada-United States Free Trade Agreement, the Goods and Services Tax, and recent trends in the Canadian economy.

In 1989, Canada and the United States entered into one of the most complex and comprehensive trade agreements in history. In essence, the Free Trade Agreement seeks to eventually abolish most tariff and non-tariff trade barriers affecting Canadian and U.S. goods and services trade. Because it is a complex agreement, the two nations, initially represented by Canadian Prime Minister Brian Mulroney and Former U.S. President Ronald Reagan, agreed that it will be executed in stages. (Benderoff, 1991) Beginning in 1989 and continuing over a ten-year period, Canada and the U.S. began a process of tariff and non-tariff barrier reduction. Prior to this agreement, approximately 70-80 percent of Canada-United States goods and services were already traded between the two countries, tariff free. (External Affairs Canada, 1987) In order for a good to qualify under this agreement, goods must be largely made in either Canada or the United States and must be shipped directly from one country to another.

Many large Canadian corporations are finding it very difficult to compete with equivalent U.S. corporations, as the laws and regulations governing business operations vary sharply between the countries. (Newman, 1991) Much of the Free Trade Agreement is directed at "leveling the playing field." Entering 1992, the fourth year of the agreement, Canadian corporations are gearing up for intense competition with their U.S. counterparts. However, some Canadian retail firms are as competitive as they believe possible, yet it appears to not be good enough. (Dunnery, 1991)

In 1991, the Canadian government introduced a Goods and Service Tax of seven percent to be applied at the retail level. This tax was designed to replace an existing thirteen percent manufacturers' tax. However, the manufacturers tax which was replaced by the Goods and Services Tax was not taxing all goods and services. The tax rate was reduced from 13 percent to 7 percent by broadening the tax base. The manufacturers' tax was simply passed onto retailers. Thus, retail service providers that are now taxed cannot pass the tax onto consumers quite as easily. As a result, retailers in these industries have been forced to raise total prices as a direct result of this tax (Best, 1991). The Goods and Services Tax is yet another reason Canadian retailers are feeling increased pressure from the United States.

The Canadian economy is currently beginning to pull-out of perhaps one of the worst recessions since the quarterly national accounts began in 1947. This latest recession was aggravated by federal government policies, implemented by the Bank of Canada for the purpose of reducing inflation. As a result of this action short-term borrowing rates hit an all-time high which averaged well above 14 percent in 1991. As such, these rates were too high for businesses and households to handle. Consequently, as long as these rates remain high consumer spending and business investment will remain low. (Akinson, 1992)

Currently, the forces which continue to hold the Canadian economy back are: relatively high interest rates, a strong Canadian dollar, the limping U.S. recovery, Canada's own debt overhang and the eroding competitiveness of Canada's manufacturers. (Akinson, 1992)

On a more positive note, these factors are forcing Canadian retail businesses to become much more competitive and to operate much more efficient businesses. Although the immediate positive effects are not nearly as visible for the retail trade sector as they are for other industries, they are forthcoming. The Canadian retail trade sector will experience a complete revampment and as such will strengthen the industry as a whole.

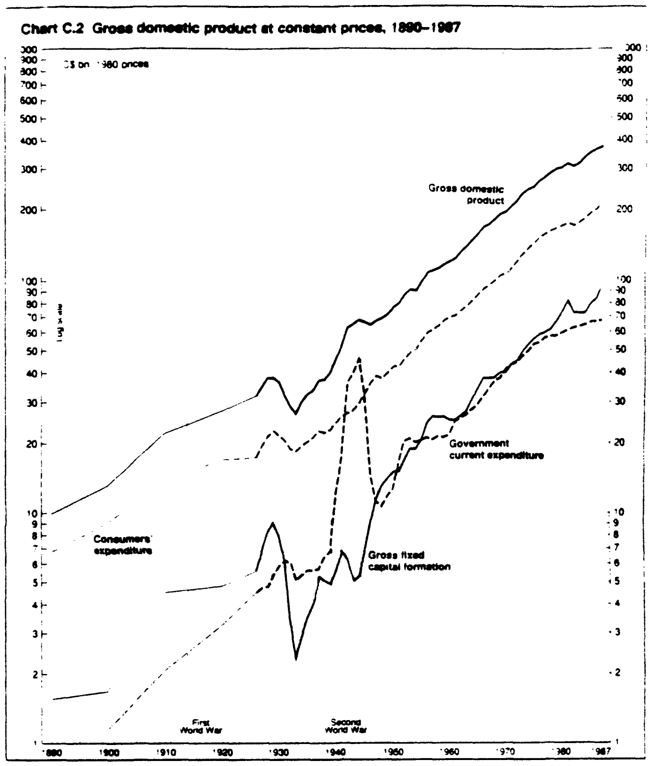
CHAPTER 2:

THE CANADIAN ECONOMY

The Canadian economy plays an important role in determining the success of Canadian retailers. It is important to understand the key issues which affect the economy and consequently, affect Canadian retailers.

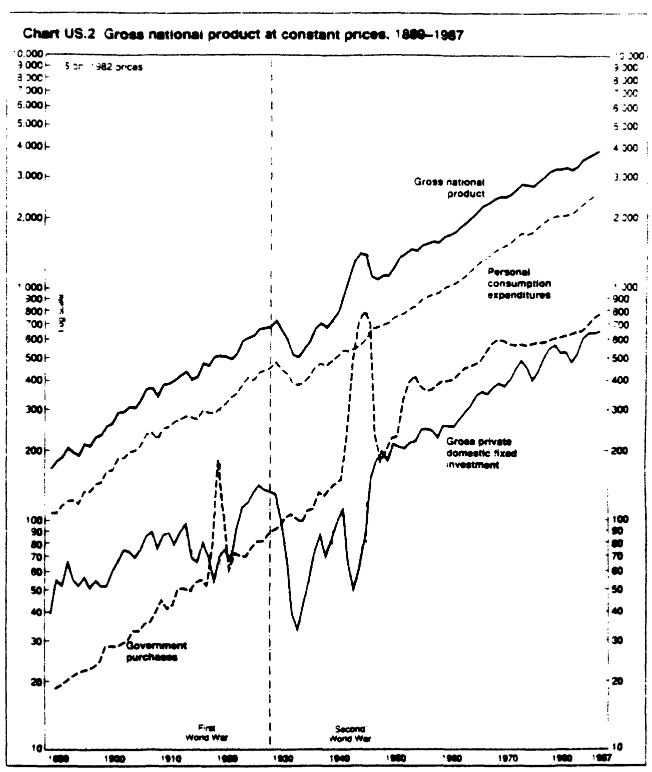
Since the Second World War, the Canadian Gross Domestic Product (GDP) has increased steadily with minor fluctuations. (International Monetary Fund, 1990) As would be expected over this same fifty year period, consumers' expenditures have followed suit. The following graph further illustrates these past trends in the Canadian economy. For comparison purposes, a graph illustrating the U.S. economy for this same period of time has been included. (International Monetary Fund, 1990)

Canadian
Economy
(CDN$)



(source: International Monetary Fund, 1990)

U.S.
Economy
(US$)



(source: International Monetary Fund, 1990)

These graphs indicate that over the past forty years the Canadian economy has followed much the same path as that of the United States. It should be noted that the Gross National Product of both countries (GNP) has steadily risen with minor fluctuations over the same time period. (International Monetary Fund, 1990)

In addition, these graphs also serve to illustrate the close relationship between the two economies. It is clear that both economies experience the same increases and decreases in consumer spending at basically the same period of time. This is particularly important to the retail trade sector in that recent U.S. buyer behavioral patterns can predict trends for what Canadian retail businesses can expect.

With respect to the Canadian economy, late in the summer of 1991 much fuss was made of the immense rise in Canada's real GDP in the second quarter. (Akinson, 1992) (See appendix 4.) The rise seemed to announce the recession's end, and it encouraged many to conclude that Canada's recovery, far from being weak, would be strong. As such, monetary policy went on hold for fear the rebound would undo the progress on the battle against inflation.

That optimistic mood was replaced by a realistic sober assessment. When set against the equally large decline posted in the first quarter, one is confronted with the fact that between the fourth quarter of 1990 and the start of the third quarter 1991, the Canadian economy scarcely budged. Real consumer spending rose 8.0 percent in the second quarter; it fell 8.5 percent in the first. Durable consumer goods jumped 29.1 percent in quarter two 1991; then fell 26.1 percent in quarter one, 1991. Residential construction, which rose 33 percent in quarter two, 1990, fell 26 percent in quarter one, 1991. And, as for overall final demand, it rose 7.5 percent in real terms in quarter two, but that was after a 6.8 percent decline in quarter one. Simply put, the rise in real GDP in quarter two merely duplicated the equally large falls registered in quarter one. The second quarter of 1991 leap in real GDP was indeed very good for Canada, but the economy slowed dramatically in the third quarter. (Akinson, 1992)

It does not end there. Looking at the monthly pattern of GDP growth over the course of the second quarter of 1991 indicates some concern. The quarter roared ahead with April's GDP up almost 14 percent at an annual rate; May's rise was more tepid at about 5 percent; June's rise was only 1 percent. Consequently, the recovery momentum would not appear to be gathering much needed strength. (Akinson, 1992)

Looking at the economy from the employment side it would appear to be following suit. There was a bit of a rise in the spring months of 1991, but more recent data have indicated diminished strength. The 0.2 percent rise in October was good news, but it was very concentrated in the service sector and public administration. This was a direct result of the need for additional personnel for the provincial elections in British Columbia and Saskatchewan, and municipal elections in Ontario. As such, the 0.4 percent employment decline in November meant that there were 145,000 fewer jobs than in the same months just one year earlier. In December, employment dropped another staggering 25,000. (Akinson, 1992)

Finally, further examination of the strength in consumer spending this year has been almost entirely related to autos. If auto retailing was taken out, then the rest of the retail trade sector looks overwhelmed by the recession. And, even the auto sector, which showed diminishing strength in August and greater strength in September, since then has expressed no trend of advancement. The only true indication of recent strength has been housing starts which has to some extent, been associated to government support efforts. However, in recent months, strength in this sector has began to fall off. (Akinson, 1992)

So, with respect to Canada's solid recovery, as described in the media, it is not solid after all. Interest rates at least at the short end of the market, have fallen a great deal since the summer of 1990. The prime rate, for example has dropped from 14.75 percent in July of 1990 to 7.5 percent in January 1992. That drop will certainly do some good for the economy. However, in real terms, January 1992's prime rate is still quite high. The underlying rate of inflation in today's economy is near 2 percent; as indicated by the Consumer Price Index. Thus, the real prime rate is about 6 percent. (Akinson, 1992)

Obviously, "prime plus" customers are paying even steeper real rates. Straightforwardly put, the cost of borrowing is still high despite the steep interest rate declines over the past 18 months. And, when compared with interest rates south of the border, Canada's are very high.

This brings us to the prospective values of the U.S. and Canadian dollars between now and the end of the year. First, the U.S. dollar, which on the surface at least, looks easier to predict than the Canadian dollar. According to most forecasts, U.S. short-term interest rates will most likely head upwards. However, given the weakness of the recovery from the recession, it should not be expected that any cyclical rebound in U.S. rates of interest will be experienced this year. (Akinson, 1992)

Many people have been surprised by the strength of the

Canadian dollar. In retrospect, its strength can be explained. The perception in financial markets, and sometimes perception is reality, was that the Bank of Canada would resist, by intervention or by interest rates, any significant downward pressure on the Canadian dollar. Under the circumstances, the Bank of Canada was perceived as having eliminated the Canada/U.S. dollar exchange rate risk. The interest rate spread, being so much in Canada's favor, attracted capital from abroad, actually putting further upward pressure on the Canadian dollar. That perception is changing. With inflation, including wage inflation, now coming under control, it would appear that the Bank of Canada is more willing to permit a decline in the dollar.(Akinson,1992)

In the last half of the decade the Canadian dollar has appreciated by about 20 percent; and in recent months, it strengthened further to above 89 cents U.S. before falling back more recently to the 86-87 cent range. The appreciation of the Canadian dollar is acting to brake the recovery. The following table further illustrates the historical value of the Canadian dollar in U.S. dollar terms.

VALUE OF CANADIAN DOLLAR IN U.S. TERMS, 1981-1991

Year	Quarter 1	Quarter 2	Quarter 3	Quarter 4
1981	.838	.834	.825	.839
1982	.827	.804	.800	.812
1983	.815	.812	.811	.807
1984	.797	.774	.761	.758
1985	.739	.730	.735	.725
1986	.712	.722	.722	.722
1987	.747	.750	.756	.763
1988	.789	.813	.820	.829
1989	.839	.838	.846	.856
1990	.846	.854	.867	.861
1991	.865	.870	.865	.891

(source: International Monetary Fund, 1992)

Third, the staggering U.S. recovery is continuing to have negative effects on Canada. However, there does appear to be some proof that a recovery is under way in the U.S. One commonly used predictor in this regard is the purchasing managers index, which moved above the critical 50 percent point early in the summer of 1991. However, in December 1991 it declined from 53 to 46 percent, causing a worrisome development. Thus, there is no doubting as of January 1992, that this is a below-par recovery. Indeed, most of the statistical growth series monitored in the U.S. are indicating about one half or less the strength characteristics of other post WWII recoveries. Furthermore, with a third quarter gain of 1.8 percent, with final sales down 0.7 percent annualized, employment falling sharply in November, and up only slightly in December, there can be no doubt about the continuing absence of strength in the U.S. recovery. (Akinson, 1992)

Nevertheless, despite the weak and somewhat turbulent U.S. recovery expectations are that it will be maintained through 1992 at least. Consequently, most other output measures, however stammering, are on the rise. Moreover, with inventories in good shape, and with the federal government prepared to move interest rates lower in response to perceived weakness in economic growth, there is little reason to expect this recovery is to be non-existent. (Newman, 1991)

By the same token, there is no reason to expect erratic progress either. Real wage and salary growth in the U.S. was negative in 1991, and continues negative. Consumer confidence has fallen to lows not seen since 1982; the personal savings rate, at 4.7 percent, is very poor; and household debt to disposable personal income, at 120 percent, is at a post-WWII record high level. (Akinson, 1992)

Not only the U.S. consumer, but the U.S. federal government and the U.S. corporate sector are heavily buried in debt, the overhang of which is inhibiting much needed growth. Exports from the United States will increase substantially as a direct result of the depreciation of the United States dollar against the Japanese yen and especially against the German mark in 1992.

Combine the above facts with a slowdown in Western Europe and

Japan, and retrenchment and/or tax increases at the state and local government level, the U.S. economy appears vulnerable. In addition, the "credit crunch" problems that have revealed themselves in a different lending style by commercial banks and other financial institutions makes it difficult to imagine anything other than weak U.S. recovery, at least through 1992.

A weak U.S. recovery has distinct ramifications for Canada's recovery outlook. At less than one percent in 1991, and at only 2.5 percent this year, the predicted U.S. real GDP gain for Canada, measured fourth-quarter-to-fourth-quarter, will not provide a big lift for Canada's south-bound exports. (Akinson, 1992)

Fourth, Canada's debt overhang is continuing to impede the economy's recovery. Canada's corporate sector does not carry into this recovery a debt burden as massive as U.S. corporations, but, as was true of the U.S. consumers, debt relative to personal disposable income is at record levels in Canada. Subsequently, Canada's government debt burden is much more severe than that of the Government of the United States. (Akinson, 1992)

Fifth, the eroding competitiveness of Canada's manufacturing is a long run structural problem that, additionally, will serve to hinder a recovery. The problem is easy enough to identify; from 1985 to 1990 unit labor costs in Canadian manufacturing in U.S. dollar terms rose by over 46 percent compared to a decline of 0.3 percent in U.S. manufacturing over the same time period. (See appendix 3.) Importantly, only about two-fifths of the deterioration in Canada's relative manufacturing competitiveness has been caused by the appreciation of the Canadian dollar. The remaining can be explained by the much sharper advance in Canada's manufacturing wages than in the U.S.; and the much stronger advance in productivity on the part of the U.S. manufactures. Coming out of this latest recession, Canada's manufacturers will face intensified and growth-limiting pressures. (Akinson, 1992)

All this put together spells out a message of increased financial pressures for Canadian retailers. Increased financial pressures in the form of higher rates of borrowing and increased levels of inflation. Canadian retailers are being forced to compete with markets at home and abroad subject to the obvious limitations within the Canadian economy. First and foremost, if Canadian retailers are to be competitive, it will be necessary for the Canadian economy to lead the way.

CHAPTER 3:

THE EFFECTS THAT THE CANADA-UNITED STATES FREE TRADE AGREEMENT HAS HAD AND WILL HAVE ON CANADIAN RETAILING.

To truly understand the current situation in the Canadian retail trade sector, it is first important to understand the forces which are leading the way. In addition to the state of the overall economy and the Goods and Services Tax (GST), the Free Trade Agreement (FTA) plays a large role in influencing the Canadian retail trade sector.

The major components of the Free Trade Agreement are as follows:

<u>The Canada - U.S. Free Trade Agreement</u>

In general, the FTA seeks to liberalize and expand upon the most extensive trading relationship in the world by requiring the gradual reduction and elimination of most tariff and non-tariff barriers to trade between Canada and the U.S. More specially, the agreement calls for the following:

<u>Tariffs</u>: Eventually eliminates all tariffs on Canada-U.S. trade.

<u>Rules of Origin</u>: Establishes rules to limit the agreement's coverage to Canadian and U.S. goods, not those of third countries.

<u>Standards</u>: Restricts either nation from using product standards or similar regulations in constructing barriers to trade.

<u>Services</u>: Assures that open markets in each country are maintained for services trade and improves the ability of businesses to perform after-sale servicing of their products across national borders.

<u>Border-Crossing</u>: Streamlines procedures for business persons and professionals in crossing national borders while conducting their business affairs.

<u>Investment</u>: Restricts each nation from enacting new measures restricting investors in either country from investing in the other. Specifically liberalizes investment in financial institutions.

Agriculture: Eliminates all agricultural tariffs between the countries within ten years and eliminates or reduces other non-tariff barriers affecting the trade of agricultural commodities.

Energy: Removes most barriers to freer trade of energy resources and supplies between the nations and promotes the free transmission of electricity across borders.

Wood Products: Temporarily retains the current agreement requiring a 15 percent Canadian export tax on softwood lumber until further negotiations on provincial stumpage pricing practices.

Government Procurement: Expands opportunities for U.S. and Canadian firms to freely compete for government procurement in each country.

Trade Disputes: Creates a Canada-U.S. trade Commission with power to settle most trade disputes that may arise.

(Swanson, 1990)
(See appendix 2.)

Dealing specially with the Free Trade Agreement and the Canadian retail trade sector, the first two provisions will be addressed in further detail. First, the eventual elimination of most tariffs represents a positive effect of the agreement for Canadian retailers. (External Affairs Canada, 1987) Under this provision, it will enable Canadian retailers to import U.S. made goods which before the Free Trade Agreement were not available in the Canadian market or the price of importation was too great. This will allow Canadian retailers to more aggressively compete with their U.S. counterparts. On the flip side, this provision will also allow Canadian consumers the same opportunity to travel south of the border to shop tariff free. Thus, encouraging cross border shopping and ultimately lost sales for the Canadian retail trade sector.

Second, the rules of origin provision will allow Canadian retailers to import those goods which are largely made in the United States, and vice versa. This, as did the above provision, will allow Canadian retailers the opportunity to aggressively compete with their U.S. counterparts, as market offerings become more similar. (External Affairs Canada, 1987)

It is important to note that for every positive aspect of the agreement there are many potentially negative aspects. The agreement is opening up new markets for Canadian consumers, thus this may result in lost dollars for Canadian retailers. However, the agreement is also opening up new markets for American consumers, and thus represents an opportunity for increased sales by Canadian retailers. At this time it is difficult to establish to what extent the agreement will effect Canadian retailers as data is available to support either a positive or negative claim. However, what is unrefuted is that a change will occur.

Before the days of free trade, the same inherent problems existed in Canada. However, all those in direct competition with one another were subject to the same limitations, price and tax structures. With Free Trade opening new, larger markets which are not subject to these same limitations, it is causing Canadian retail businesses to close as a direct response of not being able to compete with their U.S. counterparts. What these forces add up to is a very weak recovery from the 1990-91 recession. (Akinson, 1992) And as such, this indicates that the recovery of the Canadian retail industry will continue to follow that of the U.S.

To further illustrate the effects that the agreement is having on Canadian retail businesses, Mayor Hazel McCallion of Mississauga, Ontario comments. "We can't compete!" Mississauga, a suburb of Toronto, Canada's largest city boasting a population of 4,000,000, has approximately 450,000 residents. Mayor McCallion disputes that there is no way that Canadian retail businesses can compete with their U.S. counterparts. She continues that taxes are much higher in the Province of Ontario but social services abound. Businesses pay for medical care and through government funding, university tuition is low, unemployment benefits are generous. Consequently, this all adds up to higher prices which Canadians are forced to pay if they are to maintain the same high standard of living as currently enjoyed. American businesses are not faced with such upgraded social services and subsequently, are able to enjoy lower prices. (Newman, 1991)

In addition to the crippling circumstances surrounding the

Canadian retail industry, Canadian chain retailers are feeling the negative repercussions caused in part by this agreement. Of the approximately 16 major U.S. retailers which have come north to Canada, essentially all have been successful, versus a one-third success rate for Canadian retailers going south. As has been well broadcasted, fully two-thirds of the Canadian retailers that ventured across the line have failed (Crookell, 1990).

Companies which have demonstrated their ability to make a profit and achieve continued trends of growth, are abruptly seeing the changes of the times. As a direct result of American firms taking business from Canada to the United States, the Free Trade Agreement is forcing Canadian retail corporations to settle for less or no growth at all. As a consequence of this loss of growth in Canadian corporations, these companies are beginning to lose their economies of scale, followed by reduced profits and loss of the tremendously high quality of work life Canada is so proud to boast.

Another important area to note, is that a number of small Canadian retail companies are being forced out of business through indirect means. Many of these small retail stores are finding it increasingly difficult to find suppliers and distributors which are able to provide them with the inventory they require. Many small and mid-sized distributors and suppliers have been forced out of business by their American counterparts. Often, these American operations are not large enough to cover the geographic area that the Canadian suppliers and distributors were able to. The increased coverage, in addition to their own, merely becomes too large, too quick. As such, the Canadian retailer is forced to secure new suppliers or distributors, at increased costs. (Crookell, 1990) This concern represents a very large problem for Canadian small businesses. Not only must Canadian small businesses be solely concerned with the welfare of their own company, they must now seek to protect all those other companies which directly and indirectly affect them.

On the other side of this coin, many small and mid-sized distributors and suppliers are finding it increasingly difficult to secure adequate numbers of final end users, specifically, retailers. For the same reasons as mentioned earlier, small Canadian retail companies are being forced out of business as a direct result of not being able to compete with their American counterparts. This is causing Canadian distributors to experience a shortage of customers since they are not large enough to expand their operation into the United States. (Crookell, 1990) Directly or indirectly, this agreement brings along a number of harsh repercussions for Canadian retail small businesses.

As the Canada-United States Free Trade Agreement is phased in, hardly a day goes by without some story in the Canadian media concerning its impacts. The coverage primarily focuses upon U.S. retail competition and its disastrous effects on small Canadian retail businesses. At the offset, Free Trade crippled many retail businesses, yet more recently, many are finding that the agreement has opened new doors for them. As such, they are beginning to see the more positive effects of this agreement.

Canadian bargain-hunting entrepreneurs are becoming more and more visible by setting up shop across the border. (Crookell, 1990). Although the majority of these businesses are retail/manufacturing outfits, it none-the-less, represents an euphoric spirit unlike what has been seen in past years.

Canadian businesses are springing up along the borders of the two countries, primarily in Washington state, Minnesota, the New England states and upstate New York. State officials and local specialists are beginning to see the rise in the investment and interest of Canadian businesses in their states (Benderoff, 1990).

One city at the center of considerable activity is Buffalo, New York, where the number of joint Canada-U.S. ventures is sky-rocketing. "Canada Row" located in Buffalo, boasts many retail/manufacturing outlets, trucking and trading companies which benefit both Canada and Buffalo through profits and a decrease in unemployment, respectively. Unemployment in Buffalo has dropped from 13 percent in 1990 to 6.9 percent in a period of one year. In combination with this, it is important to note that in 1991 unemployment in New York state averaged in the 9-10 percent range. (Newman, 1991)

Many retail businesses are finding that they are able to enjoy the best of both countries. They believe they possess the high standard of living which Canada offers, yet enjoy the increased levels of profit attainable through business in the United States. An example further illustrating this changing dimension of Canadian retail business is Henry Jelinek's family business, which has been in operation in Oakville, Ontario for more than 40 years. Mr. Jelinek is the president of a small retail/manufacturing company which is rapidly expanding, thanks to the United States. Mr. Jelinek, in a recent interview said, "I feel a sense of patriotism, and I will stay in Canada." Mr. Jelinek may stay in Canada but the growth of his company is all happening south of the border. (Newman, 1991)

As a result of the Canada-United States Free Trade Agreement, Mr. Jelinek and his company are now able to produce his product for about three-fifths of the cost of what he makes the same product for in Canada, yet sells it at the same price in his retail outlet. In Lockport, New York, land is about one-tenth as expensive, taxes are lower and wages run about $5.50 per hour as compared to $10.00 in Oakville. (Newman, 1991)

The above example is definitely the exception to the rule, but none-the-less, there is the possibility for Canadian retail business to prosper from this agreement. If Canadian retail business are to survive in this increasingly more competitive marketplace, Canadians must toughen up and take more risks. The days of the global market dictate global thinking.

Perhaps the most positive effects of the Free Trade Agreement have not yet been felt by small retail businesses. Industry experts predict that the short-term effects for Canadian retail businesses are depressed, however, they are optimistic that these conditions will improve as the agreement matures. Canadian retail businesses are expected to enjoy reduced costs, as inventory and supplies are becoming more readily available from the U.S.   As such, forcing their Canadian counterparts to lower prices or lose business (McQueen, 1991).

In addition, Canadian businesses can expect lower taxes with increased levels of government support in the years to come.

Canada is slowly realizing that retail businesses are the path to the future and combined, represent the largest employer of Canadian people. The Government of Canada has made a commitment to increase government support through reduced taxing, business start-up incentives and wage/salary contributions. All these attempts by the federal government to help retail businesses survive through these turbulent times are a direct result of the Free Trade Agreement and will affect retail businesses greatly. (Srodes, 1991)

As the Free Trade Agreement continues to receive much attention through the Canadian press, Canadian consumers are becoming fearful of losing their national identity. (Newman, 1991) The repercussions of this are positive for Canadian retail businesses. Canadians, throughout the past year, have become more aware of "Thinking Canadian" when they are shopping. Along those lines, they are purchasing more and more from Canadian retail businesses. They feel that by spending money in Canada, they are doing their part to support their country economically. A lot of Canadians feel they have no control over international economics and commerce, and this is their attempt to do their part. As a larger number of Canadian consumers realize that they can accomplish such significant effects on the Canadian economy, and ultimately themselves, they will begin to patronize more and more Canadian retail businesses. Although this is not the spirit of the Free Trade Agreement, this news is most welcome to Canadian retail businesses who are merely attempting to keep their heads above water.

As was mentioned earlier in this chapter, perhaps the single most positive effect that this agreement has had on Canada is the ability to prepare Canadian retail businesses for the future. If Canadian retail businesses are not to become a thing of the past, as large multi-national corporations begin to take over, they must initiate change immediately. These large corporations with economies of scale that are absolutely unattainable by small outfits will cripple Canadian small retail businesses unless they become more aggressive. Retail businesses in Canada will be forced to fight for their place in the market. The global market is here and it will stay. Accordingly, Canadian retail businesses must learn to adapt, play by new rules and learn how to survive in this new environment.

The potential growth that this agreement will allow for Canada is great. For a number of years, Canadian retail corporations have been in a dormant phase illustrated by little expansion. The Canada-U.S. Free Trade Agreement will allow retail Canadian corporations the opportunity to begin expanding their operation by serving new markets. This agreement will give Canadian retail corporations the possibility to expand and recognize some real growth.

Canadian large retail corporations are amazed and astounded by the depth of the market which the Canada-U.S. Free Trade Agreements has opened for them. Canadian corporations have been typically catering to a population of 26 million and now there is a market at their fingertips of approximately 270 million.

Before any of the real benefits are realized, Canadian retail corporations must begin to alter their business methods. Now that there is a new market, Canadian retail corporations must begin to learn how to operate in such an environment. An environment which Canadian businesses have very little expertise or past experience.

Many experts feel that constant development and revision of strategic direction is one of the U.S. retailer's biggest and best weapons. (Akinson, 1992) The U.S. has the ability to remain on the cutting edge which has become more and more essential to the survival and growth of a company in this global marketplace. As such, Canadian consumers are wanting the newest, best and most technologically advanced products, all of which they find in the United States.

Canadian retail corporations are striving to become more competitive, yet at the same time, are struggling to change the image of Canadian-made products. For so long, Canadian consumers have been looking towards the U.S. to lead the way in this industry. It is hard to break old habits, especially when Canadian consumers have been happy with what they have had.

This agreement will force Canadian retail businesses to take a plunge into this new and ever-changing environment. The global marketplace will include Canada eventually, and this agreement is allowing Canadian corporations to enter at their own pace with a limited market. The agreement has not yet produced any noticeable positive effects for Canadian corporations, yet the possibility of future benefits is great. Canadian retail corporation will be able to enjoy economies of scale through increased sales and reduced inventory and overhead costs.

Through these increased economies of scale, Canadian retail corporations will be able to enlarge profits. Consequently, in the long-term, Canada will be able to compete much more aggressively with all its foreign counterparts in the world market.

Increased profits, in addition to allowing Canadian retail corporation to prepare for the future, will increase the quality of work life within Canadian corporation in the short-term. With higher levels of profit, Canadian corporation will have the opportunity to re-invest more resources into improving the standards of the work place. As such, this Free Trade Agreement will not only benefit the company, but also its employees. This agreement opens a number of areas for which Canadian retail corporations can benefit from immediately and in the future.

In addition, it is important to note that in a truly free trade environment, overtime, it will be less and less easy to distinguish between the "Canadian" retail trade sector and the "U.S." retail trade sector. For example, both markets will include large multi-national companies including Shopko, Walmart, K-mart, Eaton and Zellers. The sole difference in each market will be in specialty retailing. Therefore, the Canada-U.S. Free Trade Agreement is allowing Canadian retail corporations to prepare for the future, and in essence, allowing them to survive in the long-term.

CHAPTER 4:

THE EFFECTS THAT THE GOODS AND SERVICES TAX HAS HAD AND WILL HAVE ON CANADIAN RETAILERS

To truly understand the current Canadian retail trade sector, it is important to understand the forces which are leading the way. In addition to the state of the overall economy and the Free Trade Agreement (FTA), the Goods and Services Tax (GST) plays a large role in influencing the Canadian retail trade sector. However, it is important to note that to what extent each of these play in influencing the Canadian retail trade sector is unknown.

In January 1991, the Government of Canada instituted a 7 percent Goods and Service Tax, designed primarily to replace the existing 13 percent manufactures tax. On the surface, it appears to be a tax savings, however, a more in-depth evaluation will reveal that this tax represents some serious consequences for Canadian retailers.

The following table will help to further illustrate those effects.

Manufactures tax (pre-GST)	GST
13 percent tax	7 percent tax
Applied solely to manufactured goods.	Applied to most goods and services.
Applied at the manufactures level and therefore was not visible to consumers.	Applied at the retail level and as such is highly visible.
Little negative opposition at government as a result of little knowledge. Thus little negative opposition to manufactures.	Much negative opposition as a result of much knowledge. Thus a lot of negative

Continued...

Manufactures tax (pre-GST)	GST
	opposition to retailers.
Tax collection and bookkeeping at manufacturer level.	Tax collection and bookkeeping at retail level.

(source: Derbyshire, 1992)

As is clearly illustrated by the above table, the Goods and Services tax represents a large number of negative repercussions for the Canadian retail trade sector. Appropriately, on the flip side the Goods and Services Tax has very few, if any direct positive benefits for the industry.

Prior to the implementation of the Goods and Services Tax, the 13 percent manufactures tax was applied to manufactured goods at the manufacturing stage. As such, consumers had relatively little knowledge as to the degree of tax they were paying. For the first time, the tax is very visible at the retail level and as such, is creating resentment among Canadian and American consumers to Canadian retailers. As a direct result of this tax being highly visible and as a direct response of consumer non-acceptance, Canadian retailers are losing business to their counterparts south of the border.

On the surface, it would appear that the Goods and Service Tax represents a tax savings, however, it should be noted that the tax is now being applied to all goods and services sold in Canada, with a few exceptions based on quantity and nature of intended use. The Government of Canada has decided not to tax those goods and services which are considered "staples" for everyday living and those items which are sold in bulk amounts to the final end user. Nonetheless, this tax appears staggering to the consumer when applied at the retail level.

In addition, the Goods and Services Tax represents yet another area of government bureaucracy that the Canadian retail trade sector must be forced to address. The burden to collect and keep accurate records of this tax falls on the hands of Canadian retailers, as such, it creates more paperwork to the already staggering amounts of government "red-tape" at the retail level.

In addition, cross border shopping definitely represents the largest of the many uncontrollable challenges facing Canadian retail businesses. (Chisholm, 1988) As the vast majority of Canadians reside within 150 kilometers of the Canada-United States Border, cross border shopping is made all the easier. (See appendix 1.) The average Canadian because of lower prices and better selection is encouraged to cross the border and shop.

As the recession in Canada is merely starting to lift, Canada is expected to remain feeling its effects well into the third and fourth quarters of 1992. In addition, as a result of the recession, unemployment has been driven up to 10.3 percent. This is consequently, forcing Canadians to stretch their dollar to its limit. To further compound these conditions, the Bank of Canada's firm anti-inflation policies have pushed the Canadian dollar up 20 percent against the U.S. greenback since 1986 (International Financial Statistics, 1990).

A further problem is that the prices Canadian retailers must pay for goods are generally higher than those comparable goods their American counterparts pay. This is primarily caused by the lack of competition at home, but, none-the-less, illustrates yet another way Canadian retail businesses are finding it increasingly difficult to compete with cross border shopping. Cross border shopping has been initiated and compounded by customer opposition to the Goods and Services Tax.

The cost of doing business in Canada is a full 20-30 percent higher than that in the United States. Many Canadian retailers pay more for U.S. made goods as a direct result of Canadian law which states that a product sold in Canada must be labeled in both English and French. Payrolls for Canadian companies, due to taxes and higher minimum wages, are higher and make it nearly impossible for Canadian retail businesses to compete on basis of price. Thus, the application of the Goods and Service Tax to already higher priced goods and service, as compared to that sold in the U.S., is forcing many retail businesses operating in Canada to close their doors. (Akinson, 1992)

With having such a visible tax, many Canadian consumers will continue to travel south of the border for "bargains" and protest there opposition to the Goods and Services Tax (Akinson, 1992). On the other hand, Canadian retailers are now seeing fewer American travelers to Canada. The stark reality is that the retail tax structure scares them away.

The Goods and Services Tax does present a difficult challenge for Canadian retailers to address. They must now begin to reduce costs in an attempt to offset the increased retail tax structure in order to attract customers. The Goods and Services Tax is yet another obstacle for Canadian retailers to overcome in the days which lie ahead.

CHAPTER 5:

AUTHOR'S OUTLOOK

First and foremost, it is extremely difficult to distinguish in terms of the Canadian retail trade sector among the effects of the Canada-U.S. Free Trade Agreement, the Goods and Service Tax, and the current recession in Canada. Consequently, all conclusions assume that to some degree, all the above variables are responsible.

The Canada-U.S. Free Trade Agreement has changed retailing in Canada greatly. Just one relatively short year ago in 1990, Canadian retailers dismissed the idea that Free Trade and its effects would affect the way business was done in Canada. Now, a day does not go by without Canadian newspaper headlines illustrating the revampment of Canadian business with Free Trade leading the way.

The preliminary results indicate that in the short-term, Canadian businesses will experience a reduction in sales and consequently, will be forced to become more competitive on an international scale. The long-term outlook is one of success, in that it broadens the market for Canadian goods and services. Most Canadian retail corporations favor FTA, however, it is not without its criticisms by a number of Canadian retail small businesses. These small retail businesses fear that as many currently do not participate, nor have plans to participate in international trade with the United States; they have very little to gain and a lot to lose.

With that as a background, Free Trade and its harsh repercussions will cripple a good part of current Canadian retail businesses. Although the effects in the long-term are expected to be positive, it is not easy to dismiss the negative effects that the agreement is currently having on Canadian retail businesses. Regardless of the size of the operation, the agreement is going to change the way business is done in Canada.

Canadian retail businesses will initially struggle for an extended period of time until the effects of the agreement are accepted. Canadian retail businesses were not adequately prepared for this agreement and what it represented. Many Canadian retail businesses, instead of planning for the future, merely ignored the warning flags of changing times for them and for business in Canada. Canadian retail businesses must begin to plan and follow those plans. American retail businesses are noted for their ability to plan and execute their plans. Their Canadian counterparts have much to learn from this.

In addition to planning, Canadian companies, both large and small, must be prepared to lose or adjust a number of their "welfare" benefits including areas in education and health care. Canadian companies and individuals have become too dependent on the benefits which The Government of Canada supplies its citizens, funded through businesses. Canadian retail businesses must become much more lean and more profitable. This means that Canada must change willingly now, or it will be forced to accept the disastrous results which may lay ahead.

The Canada-United States Free Trade agreement represents a positive influence on Canadian retail businesses. As businesses must now operate in a global market, it is necessary for Canada to begin lowering trade barriers and begin aggressively seeking new markets for which Canadian goods and services can be sold. Free trade with the nations of the world will happen, and this agreement represents the first of many steps leading to Canada's participation in this new market.

What is definite is that Free Trade is here to stay. This will allow Canada to prepare for the future which includes the global economy. Free Trade, with all its perceived negative repercussions, is still a positive step in the right direction for Canada and Canadian retail businesses. Nothing, including Canadian businesses, like change; but change is inevitable. Canada is a traditional society in which change is not encouraged or even welcomed. Canadian retail businesses are being forced to change and as such, are resenting the change, which is the Free Trade Agreement. However, it is clear the Free Trade Agreement does play a large role in the overall picture, but to what extent is unknown.

In combination with the Canada-United States Free Trade Agreement, it is becoming increasingly important for the Canadian retail trade sector to monitor the development of the North American Free Trade Agreement (NAFTA), which will include Mexico. The NAFTA will necessitate restructuring of the Canadian retail trade sector. Restructuring questions include: where to locate manufacturing headquarters within the NAFTA market; costs of operations; government environment; transportation costs; quality of life; quality of education; and market densities and patterns. The North American Free Trade Agreement represents yet another area of positive change in the years to come for the Canadian retail trade sector as it opens new markets for which Canadian goods and services may be sold.

With respect to the Goods and Services Tax, many economists attribute the bulk of the retail problem in Canada to this new tax. It is unrefuted that the Goods and Services Tax does play a large role in the overall picture, but to what extent is unknown. Obviously, as was discussed in this paper, cross border shopping does present one of largest concern for

Canadian retailers, and as such the Goods and Services Tax is involved in this argument. The Goods and Services Tax does provide incentive for Canadian shoppers to head south of the border to obtain "bargains."

In an attempt to differentiate between the effects of the Free Trade Agreement and the Goods and Services Tax, it is important to note a key buyer behavioral norm. Through Free Trade, Canadians are able to purchase more technologically advanced products in the United States which they were not able to do before the agreement was in effect. This issue has very few implications for the Goods and Services Tax. In addition, it is important to note that all items brought into Canada from the United States which exceed allowed dollar amounts or exemption status are subject to tariffs and the Goods and Services Tax. Therefore, with all this put together, it would signify that Canadian customers are not turning to the United States to avoid paying the Goods and Services Tax, as the tax is paid regardless. The Goods and Services Tax plays a key role in the future of Canadian retailing, however not to the extent that the Free Trade Agreement does.

As for the Canadian economy, Canada can expect a short-term period of financial difficulty, which will indeed have a large effect on the Canadian retailing industry. The more financial constraints Canadian shoppers are forced to address the less money Canadian retailers can expect in the form of sales.

Canadian businesses must change immediately. They must accept responsibility for themselves and stop blaming the United States for their lack of competitiveness. The United States is not the problem, it is merely the challenge. If the necessary changes are made to enable Canada to compete more competitively are enacted, there is no doubt that Canada and Canadian businesses are able to successfully compete in the world market. Canada has all that it will take to be successful in the global marketplace, it merely needs to bring it all together.

Canadian retailing in the 1990s will be different from that of the past, there are new challenges, new questions, new answers, and new ways of effectively addressing various situations. Nonetheless, Canadian retailers will enjoy a new and exciting marketplace both at home and abroad, a marketplace with unlimited opportunities waiting to be uncovered.

Appendix 1:

Map of Canada and United States Border

Appendix 2:

The Canada-United States Free Trade Agreement

PREAMBLE

The Government of Canada and the Government of the United States of America, resolved:

TO STRENGTHEN the unique and enduring friendship between their two nations;

TO PROMOTE productivity, full employment, and a steady improvement of living standards in their respective countries;

TO CREATE an expanded and secure market for the goods and services produced in their territories;

TO ADOPT clear and mutually advantageous rules governing their trade;

TO ENSURE a predictable commercial environment for business planning and investment;

TO STRENGTHEN the competitiveness of the United States and Canadian firms in global markets;

TO REDUCE government-created trade distortions while preserving the Parties' flexibility to safeguard the public welfare;

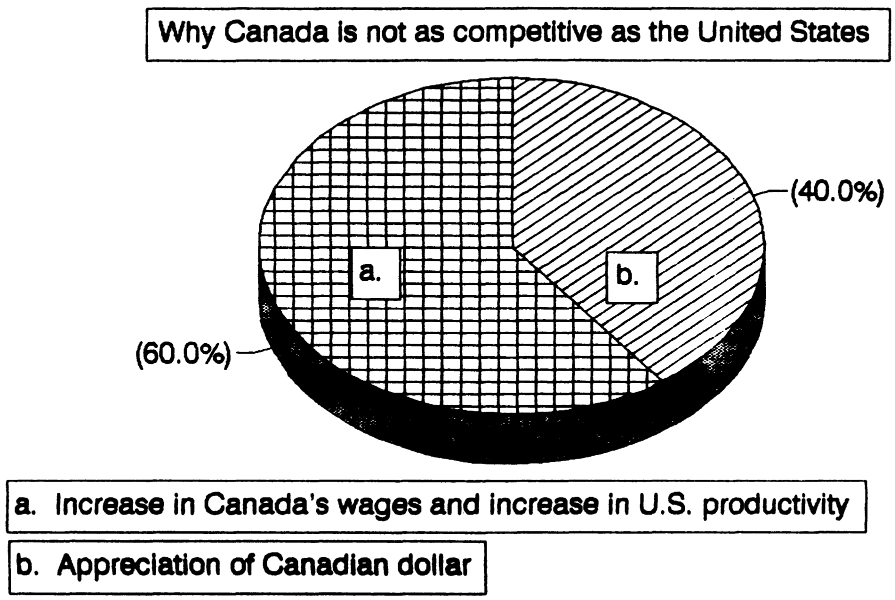
TO BUILD on their mutual rights and obligations under the General Agreement on Tariffs and Trade and other multilateral and bilateral instruments of cooperations;

and

TO CONTRIBUTE to the harmonious development and expansion of world trade and to provide a catalyst to broader international cooperation.

Appendix 3:

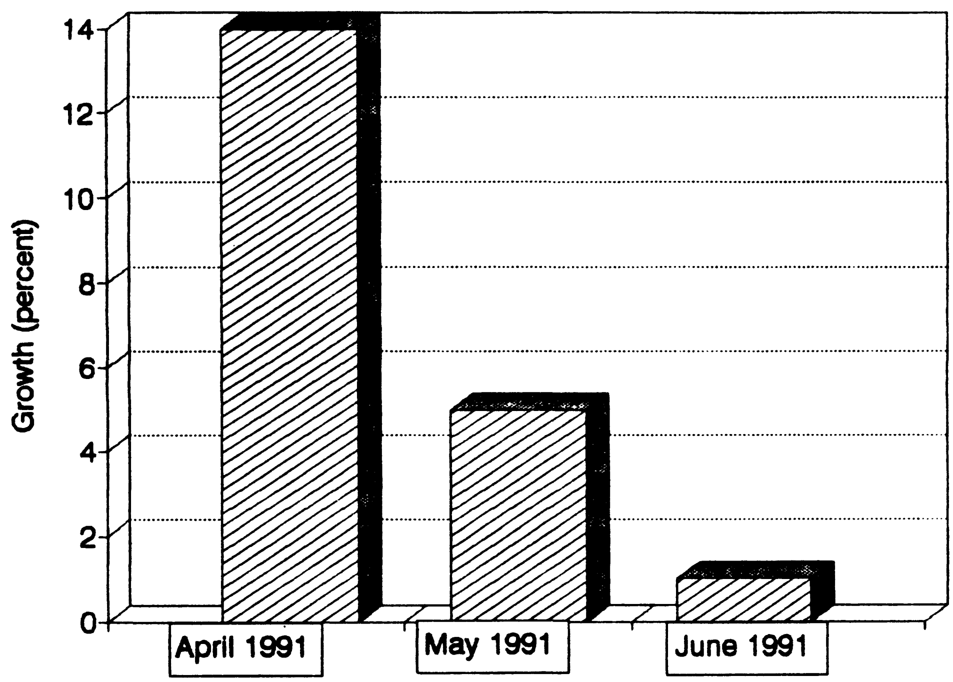
Eroding Competitiveness of Canada's
Manufacturing Industry



(Akinson, 1992)

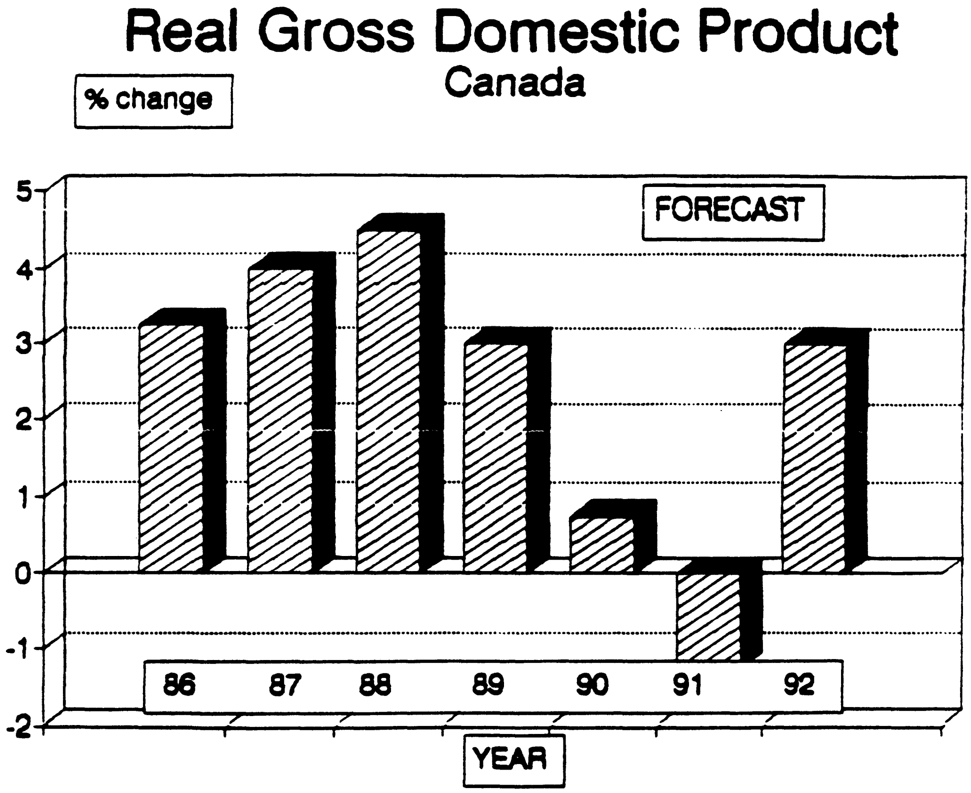
Appendix 4:

GDP Growth Over First Quarter 1991



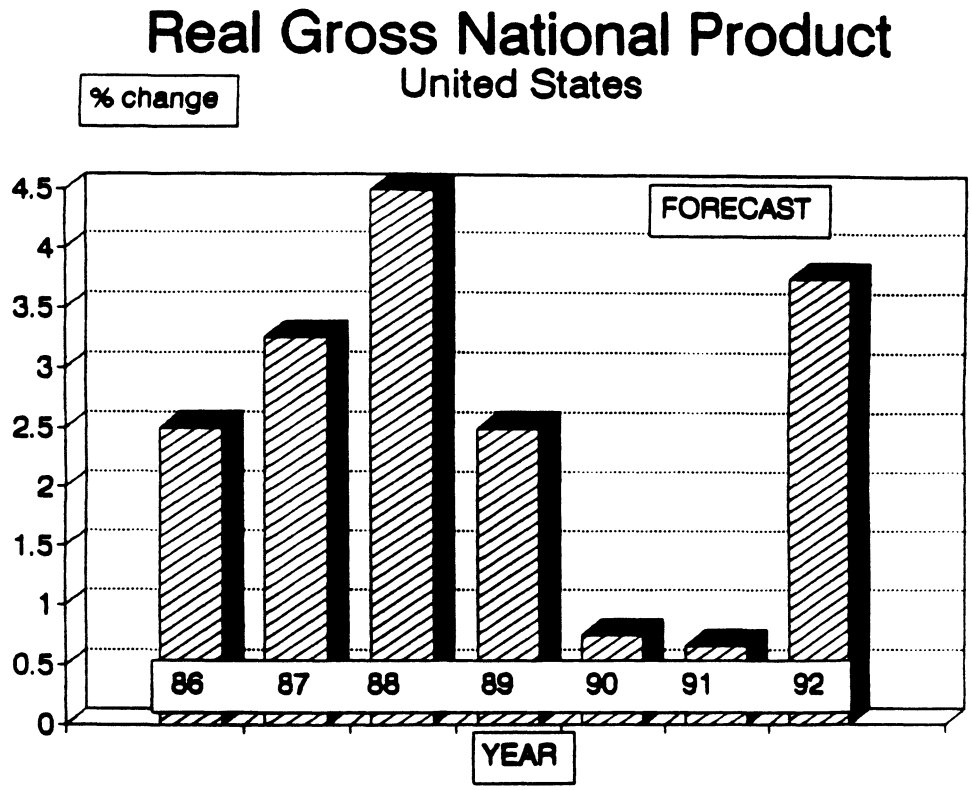
(Akinson, 1992)

Appendix 5:



(International Monetary Fund, 1990)

Appendix 6:



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