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Breaking Free: A Post-mercantilist Trade and Productivity Agenda for Canada

Canada's declining trade performance has been matched by an equally anemic productivity performance. To revitalize both, Canadians will have to be prepared to address remaining barriers to greater global engagement.

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The Study In Brief

To revitalize its flagging trade and productivity performance, Canada needs to adapt its international trade and investment policies to a world of value chains, evolving trade and investment patterns, and deepening global integration.

To be more competitive in this context, Canada needs to wean itself more completely from a mercantilist approach best suited to an era in which it was assumed that products and firms had clear national identities, which is rarely the case today.

Canada should not wait for a hypothetical "payoff" from negotiations with other countries, but instead proceed in its own interest to remove home-grown impediments to trade. The author identifies disruptive anti-dumping and countervailing duty regimes, ineffective subsidies and procurement preferences, tariff restrictions in supply-managed sectors, overabundant regulations and many remaining restrictions on foreign ownership, as areas where less trade-restrictive measures should prevail. Such reforms would generate cost savings for the government, and leave the economy more competitive and with a stronger tax base.

These reforms would leave Canada free to focus on easing passage for secure trade and people at the vital Canada-US border, and on aligning its regulations with the United States and other major trading partners in areas where duplication does not make sense. Beyond the United States, Canada should better use its diplomatic resources by proceeding with trade negotiations only on the basis of "clear business support, extensive consultations, and a clearly articulated rationale."

By these criteria, there is more potential for a useful breakthrough for Canada across the Pacific – where there is growing demand for what Canada can provide and where government-to-government relations "remain an important part of enhancing economic ties" – than across the Atlantic or in the rest of the Americas.

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Notwithstanding Canada's many advantages, we remain very concerned about the continuing instability of the global economy of which we are a part. The problems afflicting Europe – and for that matter the United States – are not only challenging today but, in my judgment, threaten to be even greater problems in the future.

Having said that, each nation has a choice to make. Western nations, in particular, face a choice of whether to create the conditions for growth and prosperity, or to risk long-term economic decline.

In every decision – or failure to decide – we are choosing our future right now. And, as we all know, both from the global crises of the past few years, and from past experience in our own countries, easy choices now mean fewer choices later. Canada's choice will be, with clarity and urgency, to seize and to master our future, to be a model of confidence, growth, and prosperity in the twenty-first century.

— Prime Minister Stephen Harper, Davos, Switzerland, January 2012

The prime minister's call to world leaders at the 2012 World Economic Forum in Davos, Switzerland,[1] provides much food for thought. His words echoed similar calls in the 1940s to deal with a world economy devastated first by global depression and then by a second world war.

Today's circumstances might not be as dire as they were then, but there is much to be learned from the response of world leaders at that time: the construction of a global economic regime that stood the test of time in underpinning much of the growth and prosperity that followed. Then as now, the interconnected nature of national economies was an important part of the challenge facing world leaders, and global trade rules were an integral part of the response.

The system of trade rules and procedures worked out and applied in the period from the founding of the General Agreement on Tariffs and Trade (GATT) in 1948 through the establishment of the World Trade Organization (WTO) in 1995 embodied both sound economic goals and sensible political procedures to achieve them. That system of rules suited well the political economy of the postwar years. By the end of the first decade of the 21st century, however, the regime appeared to

This paper builds on a body of work pursued together with the late Bill Dymond, and published in various earlier pieces either individually or under both names, including by the C.D. Howe Institute. Helpful comments on earlier drafts of this paper were provided by Gilles Leblanc, Daniel Schwanen, and Philip Stone, by the Institute's anonymous reviewers, and in discussion by the Institute's Trade Policy Council.

1 "'Major transformations' coming to Canada's pension system, Harper tells Davos," *National Post*, January 26, 2012; available at http://news.nationalpost.com/2012/01/26/major-changes-coming-to-canadas-pension-system-harper-says-in-davos-speech.

be proving inadequate to the challenges facing the global economy. To that end, Prime Minister Harper's call to action suggests a need for some new thinking about trade policy to take account of changing patterns of production and cross-border exchange, which largely reflect the positive impact of the GATT-based trade regime.

As a share of global production, trade in goods alone quadrupled in volume over the second half of the 20th century. The last 20 years of the century, in particular, saw a quantum leap in global integration. Trade historian Douglas Irwin calculates, for example, that US merchandise *exports* as a share of merchandise *production* grew from 15 percent in 1970 to nearly 40 percent in 1999, even though the share of merchandise trade to gross domestic product (GDP) grew much more modestly, largely because of the growth of services production as a share of GDP (Irwin 2005, 8).

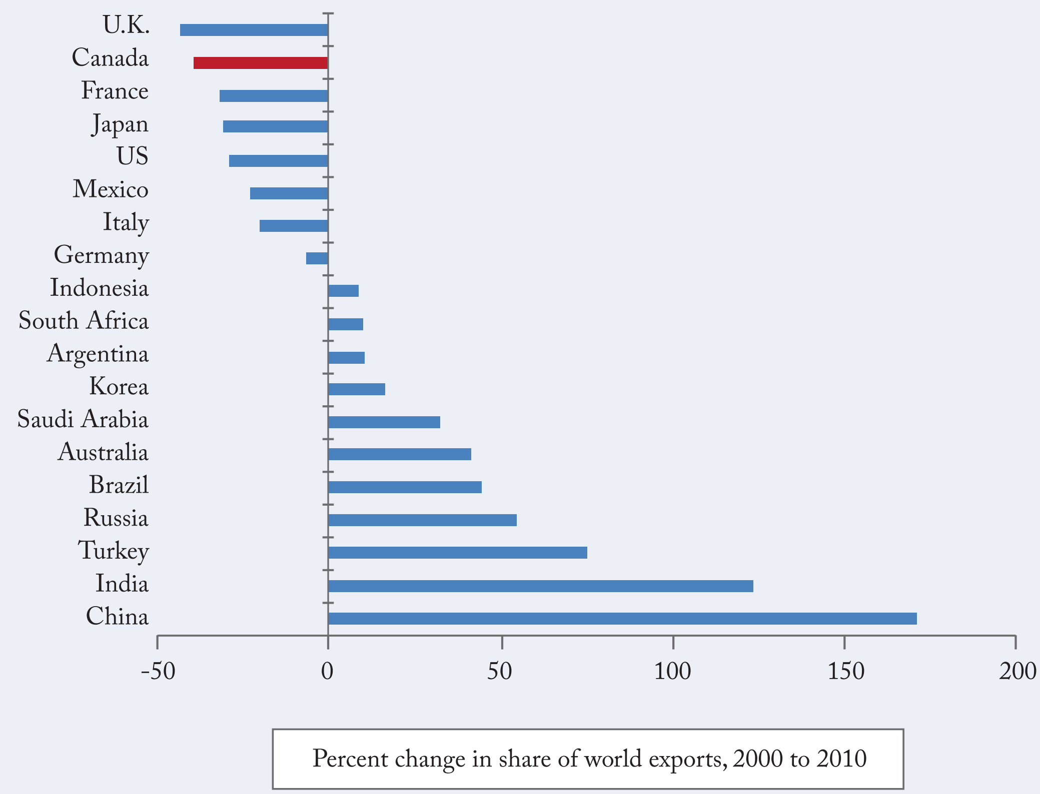
In Canada, the exports of goods in 1999 represented 125 percent of the value of goods production, consistent with the higher level of imports in Canadian exports and the much more export-intensive nature of production in Canada. The comparable figure for 1970 was 65 percent, suggesting a similar rise in the export intensity of the economy. The growth of Canada's export intensity reached its zenith, however, in 2000. Since then, both trade as a share of Canadian economic activity and Canada's share of world exports (see Figure 1) have steadily declined, as trade with the United States and most other traditional markets has stagnated. Mark Carney, the governor of the Bank of Canada, recently observed that, "[s]ince 2000, Canada's export growth was almost 5 percentage points slower than global export growth on average per year. Our share of the world export market fell from about 4.5 percent to about 2.5 percent and our manufactured-goods export market share has been cut in half. Consistent with this drop, employment in Canada's manufacturing sector has fallen by more than 20 percent, representing nearly half a million jobs" (Carney 2012). Carney concluded that three factors have contributed to Canada's export malaise: waning competitiveness due to changes in the exchange rate, wages, and relative productivity; the failure of Canadian firms to adapt with sufficient dispatch to changing global demand; and a lack of focus by Canadian firms on the best markets.

Canada's experience is not unique. Mature trade relationships have weakened globally while new economic relationships remain fragile. Efforts to address the growing pains of emerging global trade patterns at the WTO have proven disappointing and mired in the thought patterns and negotiating habits of an earlier era. Bilateral and regional efforts have been more interesting, but even they have been hampered by mandates that look too much to the past rather than to the future, including in Canada.

Many of the assumptions upon which the trade regime was built have become difficult to sustain. Rather than the original system of rules designed to govern trade in goods among 23 autonomous national economies, the much more ambitious WTO was designed to address frictions emerging from the exchange of goods, services, capital, and intellectual property rights among 155 increasingly interdependent economies, with a further 33 countries in the process of negotiating their accession. More and more firms are now located in more than one jurisdiction – often in many more. In addition to the multilateral GATT/WTO regime, governments have negotiated hundreds of complementary bilateral and regional arrangements.

Ultimately, the global trade regime will need to be rethought at the multilateral level and brought into line with the reality of a much more integrated and interdependent world. Canada can exercise leadership in working toward that objective, but

Figure 1: Canada's Export Performance Second Worst in G-20



Source: Carney (2012, page 4).

there is also much that Canada can do on its own to bring its policies and practices into line with new realities.[2]

Canada's declining trade performance has been matched by an equally anemic productivity performance. In many ways, trade and productivity are inextricably linked; together, they are the key determinants of prosperity. The transformation of Canadian trade, productivity, and investment patterns in the 1980s and 1990s flowed not only from more liberal terms of access to the US market, but also from domestic policy measures as well as new technologies and industrial strategies. The boost to Canadian productivity that flowed from the reforms of the 1980s, however, had worked its way through the economy by the end of the 1990s. Since then, both trade and productivity have stagnated.

To revitalize Canadian trade and improve Canada's productivity performance, Canadians will have to be prepared to address remaining barriers to greater global engagement. A concerted effort

2 For an overview of the evolution of the postwar trade system and the challenges to it posed by increasing global economic interdependence, see Hart and Dymond (2000, 2008). Good summaries of the achievements of the postwar trade regime can be found in Sally (2008) and Schenk (2011).

to address the effect of dated, dysfunctional, and intrusive border administration, the remnants of the inward-looking regulatory state, the haphazard process leading to cross-border regulatory convergence, and the frail institutional capacity to govern integration will be critical to improving trade with the United States. More strategic cooperative policymaking to address investment, intellectual property rights, labour, services, and other economic transactions will be an important determinant of Canadians' ability to reap greater benefits from deeper global integration, particularly with the rapidly developing economies of northeast and southeast Asia.

Although the trade policy of the past might have reached the point of diminishing returns, the challenges that remain are amenable to resolution through a combination of domestic reforms and intergovernmental negotiations. In this *Commentary*, I argue that progress on these issues requires a better understanding of the nature of modern production and exchange, the changing patterns of Canadian trade and investment, and the barriers, both domestic and international, to gaining greater advantage from deepening global integration. Following a discussion of these factors, I conclude with an overview of the trade and productivity-related policy issues that need to be addressed and the benefits that should flow from their successful resolution.

The New Global Industrial Context: Fragmentation and Integration

Starting in the late 1970s, traditional international exchange gradually gave way to a much more integrated kind, with more and more cross-border transactions taking place within firms, among related parties, or within integrated networks. Global competition, scientific and technological breakthroughs, and increasing consumer sophistication shortened the product cycle and placed a premium on quality, manufacturing fluidity, and innovation. As a result, many more goods now traded internationally are parts and components, as firms have sliced up the value chain and located discrete activities in the most congenial locations. Production has been reorganized to serve much wider markets, the range of goods and services that are exchanged internationally has widened considerably, and capital and technology move more freely to create value in optimum locations. The vertically integrated firms of the first four postwar decades have given way to much more flexible, horizontally organized enterprises and networks.[3]

Three basic catalysts were critical to the acceleration of this new phase of globalization: the steady, GATT-based liberalization of trade and investment among industrialized countries after the Second World War, the more recent but rapid industrialization and liberalization of the post-Soviet and more advanced developing countries, and the impact of technological breakthroughs that have brought down the costs of transportation, communication, and information processing. The impact of these three factors proved mutually reinforcing and cumulative.

The effective market today is global, as is the organization of production. The United States in the 19th century – and the European Union and, to a lesser extent, Canada in the closing years of the 20th century – saw a need to forge rules and governance structures consonant with the

3 See Cattaneo, Gereffi, and Staritz (2010) and Sydor (2011) for further discussion of emerging global production patterns and their impact on trade and investment. Arndt and Kierzkowski note that "fragmentation is not a new phenomenon; nor is outsourcing.…In the modern era, however, both have acquired *international* dimension and complexity and probably represent one of the most important distinguishing features of contemporary globalization" (2001, 2).

emergence of larger markets and more widely integrated production strategies. These efforts focused on divergent regulatory regimes that artificially segmented markets and frustrated the achievement of the benefits of wider markets and more efficient production structures. Today, although both markets and production have gone global, governance remains largely national or regional in scope
and reach.

East Asia has emerged as the prime site for locating labour-intensive assembly and related activities. The process of increasing value through disaggregation and rebundling is in many ways the key to understanding the rapid growth of that region. No other countries embraced the benefits of these new production patterns more enthusiastically than those in East Asia. They provided the means by which economic reforms initiated in the late 1970s could be harnessed to bring development to large parts of Asia and its huge labour pool. More recently, India has become the favoured place for services inputs, to take advantage of its wealth of information technology professionals and English-speaking, well-educated workers. Its contribution began with low-value-added activities, such as back-office transactions and call centres, but it has expanded steadily to include software programming, engineering, design, accounting, legal and medical advice, and a broad array of other professional services.

Systematic data on the extent of this fragmentation and integration are difficult to find, in part because official statistics cannot capture the full value of cross-border service links or the input of services provided through proprietary and other networks, whether done in-house, outsourced locally, or outsourced internationally. Statistical agencies have yet to devise a reliable and systematic way of counting the value of, for example, US design, engineering, and marketing in a computer assembled in China from components manufactured in various locations in East Asia. In a world in which tariffs are increasingly unimportant, customs officials are less interested in the origin or foreign value added of a particular transaction, and are content to record a product's final transaction price and country of export. The data they supply to statistical agencies often severely overstate the value contributed by the last country of export and undervalue the diverse inputs from other countries (Maurer 2011). A decade ago, Alexander Yeats, by analyzing data for selected industries and extrapolating the results more widely, estimated that a third or more of world trade was made up of parts and components (2001, 108–43); the proportion has grown since then.

From a policy perspective, governments are particularly interested in the intersection of firm-specific and location-specific value. Firms are now less constrained in their choice of location by geography and policy, and seek to enhance value by spatially dispersing a wide range of discrete activities. Governments, in the interest of attracting value-added activities to their location-specific jurisdictions, now compete in promoting policy settings that are congenial to increasingly mobile slices of production by removing barriers and providing positive incentives. In this quest, they are learning that, although the trade agreements of the past might have been critical to providing the framework of rules that initially promoted fragmentation and integration, they are no longer sufficient.

Canada-US Cross-border Integration

The integration that increasingly characterizes the global economy has a longer history at the bilateral Canada-US level. In an earlier era, proximity disposed Canadians to develop trade and investment dependence on the US market and US capital, on which both the exploitation of Canada's storehouse of raw materials and the establishment of miniature-replica branch plants depended. Indeed, Canada continues to exhibit a high level of both production and consumption dependence on the US economy.

Cross-border integration's earliest modern manifestation involved the automotive industry. A unique set of circumstances at the time, including common ownership and integrated labour unions, disposed auto firms to develop cross-border production patterns, to which the Canadian and US governments responded with an auto pact that removed policy disincentives to integration. Much of what is now commonplace was pioneered in the Canadian-US auto sector: in-house fragmentation and outsourcing on a continental, rather than a national, basis, followed by out-of-house cross-border fragmentation. The successful introduction of lean, just-in-time production techniques, developed in Japan and introduced in North America in the 1980s, further accelerated this fragmentation process.

Since the implementation of the Canada-US and North American Free Trade Agreements, fragmentation and integration have become routine throughout North American industry, including in the agriculture, manufacturing, and services sectors. High levels of both two-way intra-industry trade and foreign direct investment (FDI) – Canada is the second-leading destination of US direct investment while the United States is the prime destination of Canadian direct investment – indicate that cross-border integration, rationalization of production, and deepening interdependence of manufacturing industries are continuing. Proximity of the two countries' industrial heartlands and their well-developed infrastructures, transparent legal systems, and similar regulatory regimes have all contributed to the highly integrated nature of the two economies. In turn, this integration has contributed to high trade levels.

Today, both cross-border and global supply chains depend critically on relationships that extend well beyond arm's-length transactions between customers and suppliers. Cross-border rationalization has allowed Canadian industry to become more specialized and has contributed importantly to productivity and the growth of value-added sectors. Discussion of Canadian international economic patterns often focuses on trade in goods, and emphasizes exports. A more realistic picture emerges, however, if one looks at imports and exports of both goods and services, inflows and outflows of investment capital, sales by foreign affiliates, and exports of goods as a share of domestic shipments. As Howard Lewis and David Richardson point out, "it is becoming increasingly meaningless, if not outright impossible, to think of trade as something separate from cross-border investment, or of exporting as something separate from importing products and innovative ideas. All are tied together in the extended family of global commitment" (2001, 11). As such, Canada's involvement in the global economy is much more diversified, and the full importance of international exchange becomes clearer. It also makes clear why, as the US economy moves further up the value chain, the Canadian economy does too, increasing trade opportunities for foreign exporters to North American markets and investment opportunities in overseas economies.

The Evolving International Trade Policy Context

The conclusion of the Uruguay Round of GATT negotiations in 1994 and the entry into force of the multilateral WTO in 1995 marked the culmination of an extraordinarily productive decade of parallel regional trade liberalization and rules making. Consider the following developments.

- In 1994, Canada, the United States, and Mexico implemented the North American Free Trade Agreement (NAFTA), itself built on the 1989 Canada-US Free Trade Agreement.
- In Europe, the 1993 Maastricht Treaty transformed the European Common Market into the European Union (EU) on the basis of a much deeper and more intrusive set of economic and political commitments. With the reunification of East and West Germany in 1993 and the addition of Sweden, Austria, and Finland in 1995, Western Europe could boast of a single market comparable in size to that of the United States.

- The implosion of the Soviet bloc in 1989 paved the way for the Eastern European satellites and the periphery of the USSR to pursue autonomous and more liberal trade policies. The first group – some of which were already members of the WTO – pursued membership in the EU, while the latter sought membership in the WTO.[4]
- In Asia, the members of the Association of Southeast Asian Nations (ASEAN) embarked on efforts to expand membership and deepen commitments, China continued its remarkable progress toward becoming a more open and market-oriented economy, and India showed early signs of a willingness to abandon its statist and closed economic policies.
- In Latin America, the long infatuation with import-substitution industrialization appeared to be coming to an end with a new generation of leaders prepared to make serious efforts at internal reform and external liberalization.

The period since 1995, however, has been much less productive – more a matter of consolidation than of innovation. Membership in the WTO has expanded (from 125 to 155 at the end of 2011), and the initiation of hundreds of cases of dispute settlement has provided important confirmation of WTO members' commitment to the rule of law. On the other hand, the Doha Round of multilateral trade negotiations, launched in 2001, reached a stalemate by 2005 and has been on life support ever since.[5] Bilateral free trade agreements and negotiations have proliferated, but the majority of the 319 agreements in force among WTO members at the end of 2011 extend well-established commitments to smaller countries reluctant to make them without the support of a major economy.

The stalemate at the Doha Round suggests that, among other problems, the bargaining techniques that worked so well for more than 50 years are proving less well suited to the new architecture and the much more comprehensive and intrusive ambit of international trade rules. Nevertheless, the GATT trade relations system, now encompassed in the WTO, remains an enduring idea, and continues to be at the centre of the modern trade relations system. A report prepared by the secretariats of the WTO and the Organisation for Economic Co-operation and Development (OECD) for the 2010 G20 Summit, for example, concluded that, for the first time in modern history, the 2008/09 recession had not resulted in a surge in protectionism (WTO and OECD 2010). Whatever the problems of deeper integration, the political appetite for short-term protectionist responses proved more a matter of rhetoric than of action, a tribute to the effect of the existing body of rules on governments' capacity for protectionist mischief (see Hart and Dymond 2010).

Most government-to-government negotiations involve finding a politically acceptable balance among competing domestic interests. The mercantilist bargaining technique – trading concessions on market access – that dominated postwar negotiations satisfied this need by maximizing export opportunities for some domestic economic sectors while minimizing import exposure for others. This is less feasible in a world of

4 Poland, the Czech Republic, Slovakia, Hungary, Romania, Latvia, Estonia, Lithuania, and Slovenia have acceded to the EU. Poland, Czechoslovakia, Hungary, Rumania, and Yugoslavia had all been members of the GATT. Since 1995, Latvia, Estonia, Lithuania, Ukraine, Bulgaria, Moldova, Albania, Macedonia, Croatia, Georgia, Armenia, the Kyrgyz Republic, Montenegro, and Russia have acceded to the WTO; Azerbaijan, Uzbekistan, Belarus, Bosnia-Herzegovina, Kazakhstan, Tajikistan, and Serbia are in the process of acceding

5 This *Commentary* is not the place to discuss the many reasons for the failure of the Doha Round, but they range from (i) developed countries being sufficiently satisfied with the current trade regime to find the need for major new concessions politically underwhelming to (ii) developing countries being dissatisfied with major demands that would affect developed country interests but having very little willingness to make political reforms that would make their demands more compelling. See Bluestein (2009) and Jones (2010) for overviews of the Round's many problems.

proliferating bilateral and regional negotiations. As defined originally in GATT Article XXIV for trade in goods and later in Article V of the General Agreement on Trade in Services, such negotiations must involve deeper commitments by extending, for example, tariff-free trade to substantially all sectors of the economy. To that end, regional arrangements such as the EU and NAFTA are built on an architecture of positive, rather than negative, prescriptions, and in which mercantilist bargaining played a much less prominent role. Both are much more ambitious in their coverage than the WTO, and both reflect the much more integrative nature of exchange within the territories covered by the rules. In the case of the EU, treaties have helped to forge more integrative business strategies. In the case of North America, the agreements reflect the extent to which businesses were already pursuing more integrative strategies. In both instances, the architecture and bargaining strategy of the old trade policy were insufficient.

Emerging Patterns of Canadian Trade and Investment

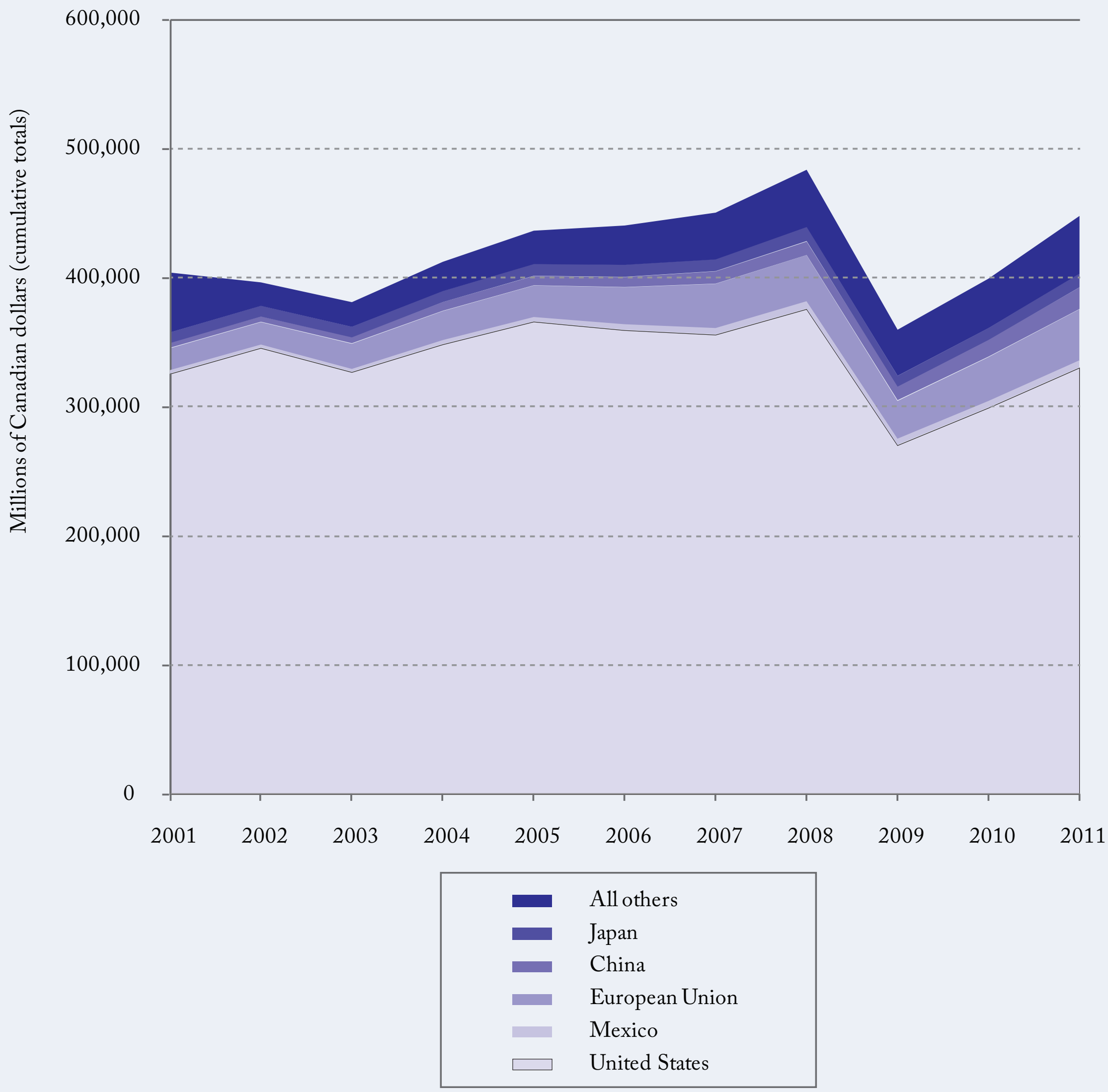
Canada's historic decision in 1985 to negotiate a free trade agreement with the United States was well grounded in the patterns of Canadian trade and economic development in the postwar years, and sought to remove public policy impediments to Canadian firms' ability to participate more effectively in a much larger and more integrated North American market. In response to the agreement, cross-border trade and investment grew rapidly, underpinning strong growth in the Canadian economy. NAFTA, which incorporated Mexico into the mix, consolidated the gains of the earlier bilateral agreement.

Canada's 1985 decision was consistent with broader societal recognition that economies do best when public policies and private initiatives are aligned. Public policies that provide an open, enabling, competitive market environment, that work with, rather than against, market-based preferences, and that limit direct government intervention to market failures have a much higher success rate in democratic societies than do *dirigiste* policies. As a result of that decision, the Canadian economy is much more open and productive today than it was 30 years ago, although as outlined further below, there remain pockets of protection reflecting the policy preferences of an earlier era.

Canada's choice also reflected recognition of the dynamism of the US economy, the waning prospect of the EU's ever emerging as anything more than a specialized, limited regional market for Canadian suppliers, and frustration with the slow pace of multilateral trade negotiations at the GATT in Geneva. At the time, there was also some hope that stronger Canada-US ties would create an enhanced platform from which Canadian firms could pursue emerging markets in Latin America and Asia. The Latin American market did not develop as many had hoped, despite some early hopeful signs and efforts to build stronger institutional ties. The Asia-Pacific market, on the other hand, took off with a dynamism that few had anticipated.

The dynamism of the US economy, so evident in the 1990s, slowly waned, however, as the United States faced a growing list of domestic and international problems and its political leaders seemed unprepared to take the tough decisions needed to put the economy back on track. For Canada, the initial surge in bilateral trade and investment reached its peak in 2000. Since then, bilateral trade and investment have stagnated – Figure 2a and Figure 2b show the declining US share of Canada's trade profile – as a result of factors that include the US housing and financial crises, the thickening of the border following the terrorist attack of 9/11, the lingering recession of 2008/09, and the globalization of production. Although bilateral trade improved strongly in 2011 and continues to do so in 2012, it is unlikely to regain the dominant role it enjoyed in the 1990s. Nevertheless, despite the decline in the US share in Canadian exports, the US market still outweighs Canada's next-largest market, the EU, by a factor of

Figure 2a: Canada's Merchandise Exports by Destination

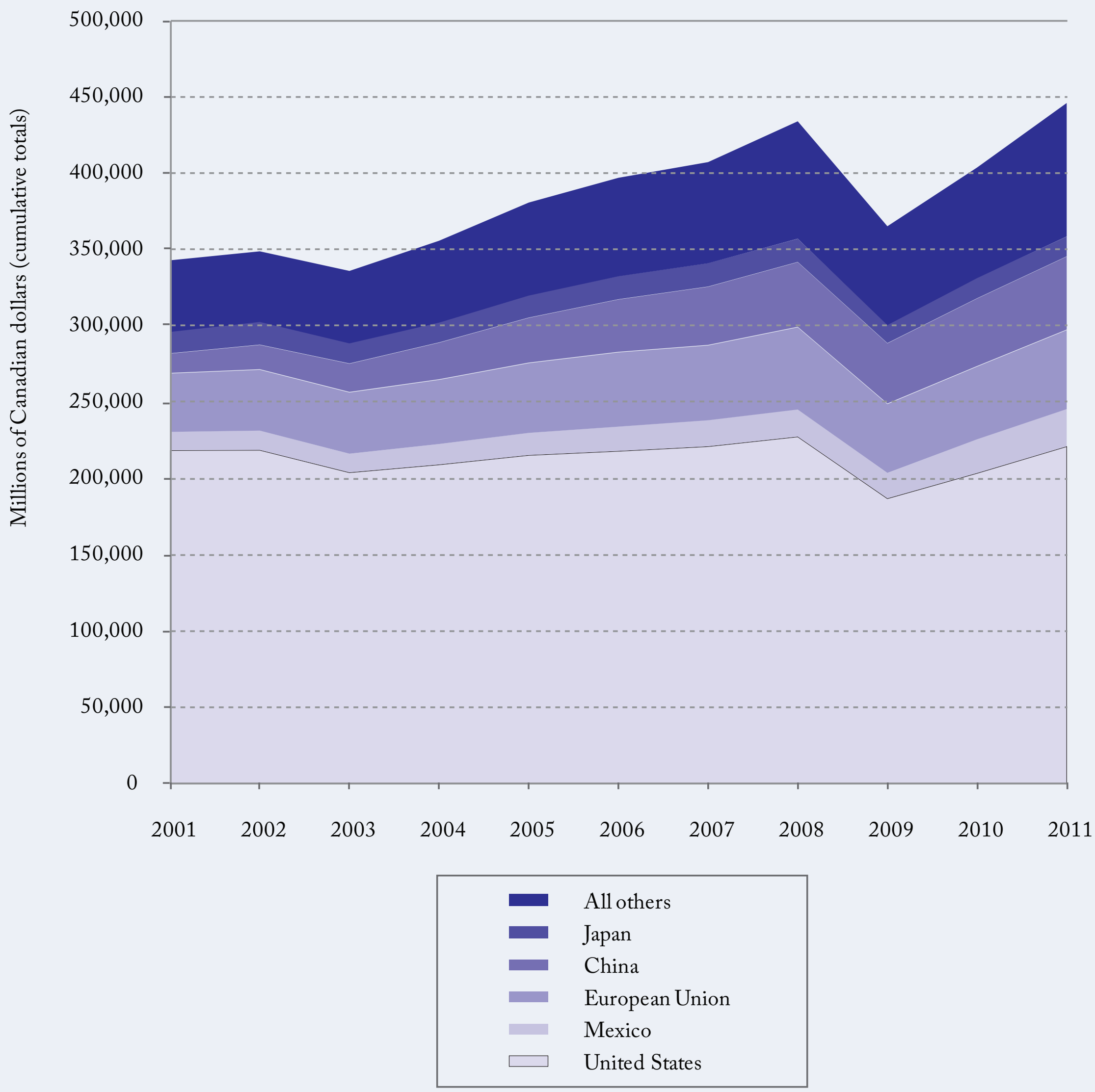


Source: Compiled from Statistics Canada, Canadian International Merchandise Trade Database, retrieved July 24 at: http://www5.statcan.gc.ca/cimt-cicm/home-accueil?lang=eng

almost nine and that of China by a factor of twenty. As Bank of Canada governor Mark Carney (2012) points out, sustained Canadian recovery depends upon US recovery, which all signs suggest will take longer than after previous recessions, as will growth in other mature markets. The rapidly expanding markets of China, India, and other Asian countries are well worth the pursuit, but the US market will remain the bread and butter of the Canadian economy for the foreseeable future.

Canada's spotty trade performance over the past few years, however, reflects not just a decline in bilateral trade with the United States. The 2008 global financial crisis and the resulting recession took a serious toll on international trade in general, and although Canada's GDP growth recovered in 2010, trade – largely reflecting anemic demand in Canada's primary markets – continues to

Figure 2b: Canada's Merchandise Imports by Source



Source: Compiled from Statistics Canada, Canadian International Merchandise Trade Database, retrieved July 24 at: http://www5.statcan.gc.ca/cimt-cicm/home-accueil?lang=eng

underperform. The direction of Canadian trade has also changed. Conventional trade statistics provide an indication of this change, but they cannot capture the full impact of changing international trade patterns. China, for example, appears the most prominent new player in Canadian and US markets, but East Asia as a whole has become an increasingly prominent player. The evolution of the global economy – particularly the rise of value-chain production networks – has driven East Asia (including China) and North America into an interdependence that is stronger than with any other parts of the globe: transatlantic trade links are now of a distinctly lower order than transpacific ones. Thus, although Canadian firms' continued attention to their US customers reflects their experience that the United States is their most profitable market, they nevertheless have been quietly expanding their presence elsewhere, particularly in Asia. Indeed, as a study for the Department of Foreign Affairs and International Trade shows, Canadian firms are overperforming in China and other Asian markets and underperforming in more mature markets, including in the United States (Vesselovsky 2009). The principal reason is that demand in Asian markets for competitively priced Canadian goods – particularly resources – is rising rapidly. Accordingly, while Canada needs to continue to press the United States to resolve remaining bilateral issues, under current circumstances Canadian business leaders and policymakers also should consider alternative and complementary opportunities beyond North America.

The figures for Canadian direct investment abroad and foreign investment in Canada, however, have been more encouraging than trade figures over the past decade (see Table 1). While bilateral investment flows between Canada and the United States have continued to grow steadily, the growth of such flows between Canada and East Asia has been remarkable, though absolute numbers remain modest. Two-way investment flows with the EU have also increased significantly, but with an important difference: much of the investment flow across the Pacific is trade creating, involving either value-chain production in Asia or investment in resources exploitation in Canada; transatlantic investment, on the other hand, tends to be a substitute for trade in that Canadian and EU firms locate in each other's markets only in order to serve those markets.

The growing role of Canadian firms as players in the global economy is indicated by the rise in sales by the affiliates of Canadian-based multinational firms (see Table 2). Although there has been some systematic analysis of the extent to which Canadian firms are engaged in the more complex world of value chains and production networks, analysts have yet to gain a firm grasp of the full implication of this new phenomenon in the organization of international trade and production (see, for example, Goldfarb and Beckman 2007; Ridgeway 2007; Hart and Dymond 2008; Sydor 2011). Ministerial speeches and other federal government initiatives suggest an increased awareness of the influence of this phenomenon on Canadian trade interests, but there is scant evidence that Ottawa is factoring this awareness into the design and delivery of Canadian economic policy and practice.

The Emerging Policy and Research Agenda

Canada's evolution as a trading nation has contributed significantly to making Canadians better off both as consumers and as producers in at least three important ways. First, Canadians employed in export-oriented sectors have been consistently better educated and better paid than the national average. Second, greater access to internationally competitive goods and services has allowed Canadians to stretch their earnings further. And, third, specialization has increased as markets have expanded in response to the increased openness fostered by trade agreements. Maintaining and expanding Canadian engagement in the global economy, however, will require more than a continuation of the policy orientation of the years since the Second World War. The trade stagnation of the past decade suggests that Canadians need to reconsider their priorities in determining how best to use government resources and policies to facilitate and strengthen the country's trade and economic performance.

As already noted, the period since 1995 has been largely one of consolidation, rather than of innovation. Multilateral negotiations are moribund, and offer little prospect of meaningful breakthroughs in the foreseeable future. The enthusiasm for bilateral negotiations with relatively minor – and seemingly randomly selected – partners has been good for those partners and for some Canadian firms and sectors, but has had little impact on Canadian trade and economic performance as a whole. The expansion of

Table 1: Canada's Foreign Direct Investment (FDI) Position (millions of current Canadian dollars)

FDI in Canada	2001	2005	2009	2010	2011
All countries	340,429	397,828	572,842	585,107	607,497
United States	219,927	251,477	299,340	318,412	326,055
Europe	100,747	116,138	185,029	174,210	184,211
Asia/Oceania	15,390	21,416	67,578	66,714	69,310
South/Central America	997	3,168	13,303	17,421	18,785
Canadian FDI Abroad					
All countries	399,253	452,195	629,717	639,911	684,496
United States	188,481	202,398	255,397	253,417	276,145
Europe	99,240	123,239	178,110	176,826	181,885
Asia/Oceania	28,617	30,664	46,086	58,889	66,065
South/Central America	22,536	20,717	34,323	36,253	37,849

Source: Statistics Canada, CANSIM Table 376-0051 - International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by country; 2011 figures preliminary.

Table 2: Canadian Foreign Affiliate Sales (millions of current Canadian dollars)

	2001	2005	2007	2009	2010
All countries	364,554	401,507	476,926	472,626	462,201
United States	223,798	223,770	240,519	240,277	228,690
European Union	75,258	87,594	92,324	84,584	73,247
Rest of the World	65,498	90,143	144,083	147,765	160,264

Source: Statistics Canada, CANSIM Table 376-0061 - Foreign affiliate trade statistics, Canadian operations abroad, by countries.

Canada's network of foreign protection investment agreements, double-tax agreements, air services agreements, and similar instruments has improved the policy framework within which competitive Canadian firms can pursue outward-oriented opportunities, while improvements in trade-facilitating infrastructure, such as the Pacific Gateway, have made important contributions to Canada's global engagement. Yet Canada-US relations have been marked by numerous initiatives but limited achievements. Domestically, Canada has taken a few steps to reform trade-inhibiting laws and policies, but Canadians would benefit from a bolder approach.

Home-grown Impediments

In order to tackle the challenges posed by changing global trade and production patterns, Canadian firms will have to ensure that their domestic operations are as competitive as possible. Canada's productivity performance over the past decade was among the worst in the OECD. A recent analysis of this dismal record (Deloitte 2011) identifies six key issues: business-leader risk aversion; inefficient and insufficient private sector support for innovation; lack of risk capital for start-up companies; chronic underinvestment in machinery and equipment; sheltering of the Canadian economy; and increasing competition for human capital. The study concludes that the "courage to lead must come from within the highest levels of business, government, and academia" (44-5).

To remain competitive at home and abroad, Canadian firms must innovate and make better use of human resources and scarce capital. In the words of Bank of Canada governor Mark Carney (2012), "the more Canadian businesses refocus, retool and retrain, the more they can take advantage of opportunities in Canada and around the world." Deloitte reports that "Canada offers one of the highest levels of support for R& D [research and development] in the OECD,…[but] Canada yields the lowest business expenditure in R&D per dollar of government support" (Deloitte 2011). The record is particularly poor among small and medium-sized enterprises (SMEs). Canadian firms would also benefit by paying greater attention to the commercialization of Canadian R&D by transforming innovative ideas from universities into commercially successful enterprises in Canada.

Although the heavy lifting to improve Canada's productivity performance will be the work of the private sector, and although there are many ways in which Canadian public policy creates a business environment that promotes private investment in productive, efficient, and competitive economic activity, there remains considerable scope for improvements in public policy. Such improvements should be pursued not only on their own merit but also because of the important contribution they can make to improving Canada's productivity performance, to strengthening the competitive position of Canadian firms in the global economy, and to ensuring greater prosperity for individual Canadians. At a time when governments are looking for ways to reduce their expenditures, many such domestic reform initiatives should also improve governments' fiscal positions, both by reducing direct expenditures and by strengthening the tax base.

Progress in reducing conventional tariff and non-tariff barriers to trade and investment flows has now reached the point that, with a few exceptions, the Canadian economy is open to broad international competition, as are most markets of interest to Canadian suppliers and investors. Canadian trade and investment patterns thus increasingly reflect the market choices of Canadian consumers, investors, and traders and are less and less the result of Canadian and foreign trade and investment policies. There remain, however, pockets of high tariffs, such as those sheltering supply-managed dairy and poultry products and a few consumer products such as clothing and footwear. Eliminating these tariffs would reduce existing drag on the economy by allowing markets to determine areas of comparative advantage in these sectors.

To its credit, the federal government has recognized that access to competitively priced inputs is essential for business success. Both the 2009 and 2010 budgets provided for the reduction and elimination of tariffs on essential imported inputs and capital goods. In addition, many "nuisance" tariffs – for example, on products no longer produced in Canada or rates that had fallen below 2 percent – have been eliminated. Indeed, fluctuations in exchange rates alone are now more important to profitability than remaining low tariffs. Nevertheless, a surprising number of tariff lines continue to defy explanation. For example, maintaining tariff protection as possible "payment" to be used in future trade negotiations makes little sense; conventional access to most foreign markets is already good, so continuing to hobble some sectors of the Canadian economy on the slim mercantilist premise that some of this protection can be traded for improved access to other markets at some point in the future does more harm than good.

Removing protection from the supply-managed dairy and poultry sectors would require a thorough review of the costs and benefits of supply management and a willingness to consider appropriate transitional arrangements. More generally, the time has come for the federal government to consider seriously more thorough tariff reform. In addition to the benefits that would accrue from lowering the costs of agricultural and industrial inputs and consumer costs, tariff elimination should lead to significant savings in customs administration. Ottawa would no longer need to administer a complex tariff regime, including valuation provisions, differential rates arising from the growing number of free trade agreements with minor partners, and onerous rules of origin. Border officials would be freed to deal with more pressing security-related concerns rather than collecting a residual tax. The contribution of this tax to government revenue has shrunk to negligible levels, an amount that would be recouped readily from savings and from enhanced tax revenue in a stronger economy.

Antidumping (AD) and countervailing duty (CVD) measures are equally anachronistic and in need of serious cost-benefit analysis. Canada invented antidumping duties in 1904 as a way of defending its import-substitution industries from the alleged harm arising from dumped imports by larger, more efficient US competitors. It introduced CVDs in 1977 in response to new-found US zeal for rooting out the subsidy practices of other countries through its own CVD investigations.[6] Economists have long pointed to the economically nonsensical arguments used to justify these measures and to the costly procedures required to implement them. Unfortunately, both these trade remedy measures were enshrined in the original GATT rules. Even more regrettably, detailed constructions of rules governing these trade remedies were embedded within the WTO, and have now been adopted by an increasing number of developing countries in the perverse belief that they are integral to full WTO participation. In the Canada-US free trade negotiations, Canada made the case, with limited success, that neither measure was compatible with an integrated market. The years since have demonstrated the strength of that case and extended it to a wider range of trading relationships. The incidence of new AD and CVD cases between Canada and the United States declined rapidly after the initial free trade agreement entered into force (Hart and Dymond 2007). Now, as markets integrate, most businesses refrain from attacking their competitors in another jurisdiction because, while they might be competitors in one product line, they might be suppliers, customers, or strategic partners in others. More generally, production networks and value chains can be disrupted easily by ill-conceived antidumping or countervailing duty investigations affecting any of the production nodes. Again, Canada can provide global leadership by dismantling these instruments of an earlier era of

6 US CVD procedures date back to 1890, but they had been used sparingly. Their utility was rediscovered by the Washington trade bar in the 1970s in the *Michelin Tires from Canada* case. That case was followed by a flood of new cases, some involving Canadian products, such as ground fish, glass beads, and optic liquid sensors, a development that spurred Canadian business interest in an agreement with the United States that would curb this new appetite for protection. Ottawa had authority to impose CVDs, but lacked detailed procedures to put this authority into effect until remedial regulations were introduced in 1977.

industrial policy and relying on competition law and simpler safeguard procedures to address any egregious cases of injurious price discrimination or seriously harmful import surges.

Canada also maintains a variety of other trade-impacting policies that remain as reminders of an earlier era of regulatory zeal and nationalist foolishness, including ownership restrictions in the telecommunications, energy, and transportation sectors, subsidies to favoured sectors, government procurement preferences, restrictive banking regulations and tax policies that coddle some economic activities and shackle others, and competition policies that limit mergers and acquisitions and growth. Such policies, which are from an era that assumed that products and firms had clear national identities and would benefit from policies to promote national champions, are also at odds with facilitating Canadian participation in global value chains and North American integration. For example, although the Harper government has eliminated some ownership restrictions and raised review thresholds, Canada continues to impose severe restrictions on foreign ownership and control in selected sectors of the economy. There is no apparent reason the standard rules of investment protection agreements should not be applied to FDI in protected industries. Most FDI today originates with multinational corporations and is often part of larger regional or global business strategies. Canadians gain no benefits from cutting themselves off from these developments in selected sectors.

The presumed benefit of linking ownership to the achievement of a range of regulatory objectives appears to be a holdover from the era when there were many more regulated industries – particularly so-called natural monopolies such as telephone, electricity, urban transit, and similar activities – and the belief that such restrictions were needed to ensure effective public regulation. Over the years, both economic theory and practice have demonstrated the benefits of competition, privatization, and foreign investment even in these industries, as well as the capacity of governments to regulate in the public interest without regard to ownership or control. Canadians would be better off if these lessons were applied across all sectors of the economy.

Similarly, subsidies ostensibly help some industries but penalize others. No matter how welcome to individual firms, regions, or industries any particular government grant or "investment" might appear, each involves a transfer of resources from one group of taxpayers to another. Any jobs "created" or "saved" by such programs rely on reduced opportunities for other, often more productive and competitive firms or sectors. It might be theoretically possible for governments to make choices that, over time, prove wise and beneficial, but experience is less than overwhelming in validating the superiority of political over business judgment for market-based activities: factors that are persuasive to governments are rarely so to private capital. In the long run, Canadians would be better off and would gain greater benefits from their engagement in the global economy if there were fewer politically motivated investments of public funds in market-based activities.

Government procurement preferences – purchases made by governments for their own use – are another remnant of activist industrial policy. An early exemption in the GATT's national treatment provisions gave governments the scope to favour local suppliers. In response, governments began to use procurement as a tool for industrial development. It was not until the 1970s that industrialized countries accepted that procurement preferences could have perverse effects and concluded a modest GATT agreement to discipline their use. That agreement has since expanded in scope but remains largely one among the industrialized countries. In Canada, some federal government purchases are subject to the agreement's discipline, but not those of provincial governments. As Canadians learned from the use of preferences in recent US federal stimulus programs, preferences make little sense in a world of geographically dispersed production. Accordingly, both the federal and provincial governments should phase these out gradually and place their civilian procurement programs on the same market criteria as private firms: price and quality.[7]

Public finance experts have long maintained that tax efficiency is critical to the competitiveness and productivity of the corporate sector, and in recent years the federal and provincial governments have made significant progress in reducing corporate tax rates. As a result, Canada has moved from the least to the most tax-competitive member of the G7. More could be done, however, to ensure that Canada's tax regime places Canadian-based firms in the best competitive position to tackle global markets, particularly in light of the fact that other jurisdictions are moving in the same direction. Tax neutrality is among the most important considerations in maintaining an efficient and effective corporate tax regime. Using the tax regime to favour some sectors over others leads to distortions in the allocation of scarce resources and to sub-optimal economic performance. Canada's tax regime continues to favour manufacturing and extractive industries over the services sector, thus penalizing investment in some of Canada's most outward-oriented firms. The tax regime also favours small firms over large, a policy that discourages SMEs from growing into globally competitive players.

Over the past 30 years, the regulatory role of government in society has grown exponentially, even as economically oriented regulations have been reduced or eliminated. Every year, the federal and provincial governments initiate or amend some 5,000 regulatory requirements affecting Canadian citizens (Hart 2006, 2009). Most of these new regulations are related to matters of health, safety, and the environment, and ostensibly are grounded in evidence-based science. In fact, many are based on irrational fears that serve little purpose other than to satiate the bureaucratic hunger for information or to accommodate what British blogger John Brignell (2008) calls the "march of the zealots." The result has been a massive intrusion of the state into matters involving private choices and responsibilities, with a large and energetic bureaucracy administering an expansive body of laws and regulations predicated on the belief that governments can shield their citizenry from the vicissitudes and risks of life. This development involves not only the direct costs of administering regulations, but also the much larger indirect costs of compliance, a burden that falls disproportionately on the corporate sector, particularly SMEs. Canada might be one of the easiest jurisdictions in which to start a business, but it has become among the most expensive in which to maintain it. Although there might be little social appetite for a major reduction of risk-based regulations, there are good reasons to review the continued application of some of them. At a minimum, Canadian governments need to consider systematic reviews of existing regulations to consider their continued utility; introducing mandatory review and sunset provisions into new or amended regulatory requirements; and aligning regulatory requirements to the greatest extent possible with international norms and those of Canada's major trading partners, particularly the United States, as discussed further below.

All of these reforms of Canadian policies and practices, in addition to providing a more open and less discriminatory business environment, reducing

7 A case in point is Ottawa's October 19, 2011, announcement of a major warship acquisition project worth $35 billion. Three Canadian firms applied and two received major contracts; no foreign firm was invited to apply. Watson (2011) estimates that Canadians will pay a 20 percent premium for this exercise in industrial policy.

consumer costs, and enhancing productivity, would have the added benefit of reducing government expenditures. Literally thousands of officials in Ottawa and around the country are engaged in administering tariffs, trade remedies, supply management, subsidy programs, investment restrictions, procurement preferences, regulatory requirements, and other holdovers from the past. For a government looking for ways to reduce charges on the public purse, that most of these programs retard rather than promote Canadian productivity, efficiency, and economic growth should be sobering news. Their elimination should not only strengthen the Canadian economy, but also lead to savings and a stronger tax base.

The Canada-US Agenda

Beyond Canadian domestic policy, the area of potentially greatest immediate benefit lies in addressing impediments to trade with the United States. Cross-border trade remains the indispensable foundation of any Canadian policy to strengthen benefits from international engagement. The policy attitude since the implementation of NAFTA, however, has been that such improvements as might be desirable in facilitating Canada-US trade and investment can be tackled on the basis of incremental improvements in discrete policies and programs, many of them by Canadians on their own. But this approach is slow and fails to take advantage of the synergies that might exist in dealing with related issues, particularly those of interest to the United States, and thus provide scope for tradeoffs. If the purpose of many of these programs is to strengthen US confidence in Canada as an economic and security partner, full bilateral engagement is critical. Additionally, given the forces of proximity and consumer and producer preferences, deepening integration is inevitable; without bilateral engagement, however, it will happen on a basis that favours US default positions rather than jointly agreed programs.

Reaping the full benefits of deepening cross-border economic integration will require that Canada and the United States jointly address three fundamental, and interrelated, issues: reducing the impact of the border; accelerating and directing the pace of regulatory convergence or alignment; and building the necessary institutional capacity to implement and administer the results of meeting the first two challenges.

Border administration. Since 1996, six different bilateral or trilateral initiatives have sought to improve border administration. Some progress has been made, but it has been much slower than desirable (see Hart 2010; Schwanen 2011a). The latest bilateral effort – *Beyond the Border: A Shared Vision for Perimeter Security and Economic Competitiveness* – announced by Prime Minister Harper and President Barack Obama in February 2011, produced a bilateral action plan aimed at making the border more open, predictable, and secure. Unlike earlier initiatives, the action plan outlines specific "deliverables" and the time frame within which they are to be completed. To date, progress has been encouraging.[8] The federal government has consulted widely with and received strong endorsement from the business sector and other interested parties for a bold, comprehensive approach to these discussions. If Ottawa proceeds on the basis of what it has learned from the consultations and what is set out in the action plan, and if the US government shares some of this vision

8 The detailed action plan, announced in December 2011, can be found at http://www.borderactionplan-plandactionfrontalier.gc.ca/psec-scep/index.aspx?lang=eng&view=d. The website includes the details of consultations with Canadians and provides information on the work of the Regulatory Cooperation Council.

and is prepared to follow through, the prospects for a breakthrough on this difficult file could be more promising than was the case with earlier initiatives.[9]

Regulatory cooperation. At the same time as the prime minister and president announced their border initiative in February 2011, they also announced a regulatory cooperation initiative. Similar to the border initiative, officials have prepared an action plan containing "deliverables" and timelines aimed at identifying areas ripe for early agreement to forge greater regulatory alignment.[10] The main cautionary note suggested by the past decade of similar initiatives is the need for strong political leadership. In its absence, bureaucratic ducks on both sides of the border will nibble this initiative to death. Inertia is a powerful force in bureaucracies, particularly for those engaged in administering established regimes, requiring determined leadership at the top to overcome.

Institutional capacity. Integral to any progress in addressing the governance of deepening integration is the need to build sufficient institutional capacity and procedural frameworks to reduce conflict and provide a more flexible basis for dynamic rule-making and adaptation for the North American market as a whole. It might well be necessary to overcome traditional Canadian and US aversion to bilateral institution building and to look creatively to the future. Although the EU model of a complex supranational infrastructure might not suit North American circumstances, Canadians and Americans can learn from the EU experience. Much can be achieved on the basis of existing networks of cooperation, with the addition as necessary of specific joint or bilateral commissions in instances where existing networks are inadequate. More would be achieved, however, if Canada and the United States were to commit to establishing a limited number of bilateral institutions with a mandate to provide their two national governments the necessary advice and information to effect a more integrated approach to regulation and border administration.

Policy Priorities beyond North America

Ironically, Canada's self-image as a trading nation and its record of active and constructive engagement in international trade negotiations might stand in the way of rethinking the objectives of contemporary export trade policy. Officials remain busy pursuing a wide range of activities, from trade negotiations to export financing. To be sure, there remain problems amenable to resolution through such activity. World agricultural markets, for example, remain deeply distorted by misguided subsidy, border, and other measures; the markets of many developing countries are less open than those of developed countries; and the spread of trade remedy measures to an ever-increasing number of countries is a blight on the international trade regime. However, while these policies might affect the interests of individual Canadian firms, their impact on the Canadian economy as a whole is often marginal. Much of this activity, therefore, now serves what might be characterized as retail trade policy, responding to the interests and complaints of individual Canadian firms rather than to the broader interests of the Canadian economy.

9 In a press interview, Alan Bresin, commissioner for the US Customs and Border Protection Agency, offers some comfort to those who are optimistic that the US government is taking the initiative seriously enough to warrant cause for cautious optimism; see "US-Canada: a relationship 'unique in world history'," *Financial Post*, October 20, 2011.

10 See "Terms of Reference for the United States-Canada Regulatory Cooperation Council, June 3, 2011"; "What Canadians Told Us: A Report on Consultations on Regulatory Cooperation between Canada and the United States"; and "Regulatory Action Plan" at the Perimeter Security and Economic Competitiveness website, http://www.borderactionplan-plandactionfrontalier.gc.ca/psec-scep/index.aspx?lang=eng&view=d.

Most modern industries, from automobiles to electronics and banking, have developed sophisticated global and regional supply and distribution networks, and would be hard pressed to identify the national origin of their inputs or even of some of their final products. Individual firms are not averse to using the extensive trade and investment promotion services offered at Canadian missions around the world, but few would be prepared to pay for them, suggesting that their importance has become marginal to their interests. In these circumstances, it might be time for the federal government to reconsider the benefits Canadians derive from such services. Many domestic services to Canadians, from access to national parks and museums to passports and mail delivery, are now provided on a cost-recovery basis, so why should not trade-promotion services be offered on the same basis or be reduced or even eliminated where they are of little benefit? Cost recovery would ensure that these resources are deployed where they are most needed and appreciated, rather than at posts with attractive amenities but little prospect for new trade and investment.

The Doha Round of multilateral trade negotiations effectively has been put on ice. The diminishing role of the WTO as a negotiating forum, however, does not mean that Canada should be indifferent to other developments at the WTO. As noted earlier, the rules and procedures embedded in the WTO and its constituent agreements provide an essential basis for the conduct of world trade. Canada should exercise leadership in ensuring that the WTO is fully engaged in the important task of managing the existing regime and in preparing the ground for possible future negotiations on a more realistic basis than was evident during the Doha Round.

In recent years, Canada's instrument of choice for pursuing trade diversification and strengthening trade and investment with new, typically small partners has been the bilateral free trade agreement (see Table 3). This is an admirable policy impulse, and signals the extent to which free trade, rather than protection, has become the default position in Canadian trade policy. Bilateral negotiations have the advantage of being more nimble than multilateral ones and provide greater scope for experimentation. Nevertheless, experience shows that it is difficult to conclude such agreements with minor partners; more to the point, there is no evidence that such agreements serve strategic objectives or have any discernible impact on subsequent bilateral trade and investment patterns. Negotiations with Israel, Chile, Costa Rica, Colombia, Peru, Jordan, and Panama all concluded successfully within a reasonable time period, but negotiations with the rump of the European Free Trade Area (Norway, Switzerland, Iceland, and Liechtenstein) took 13 years to conclude in the face of politically significant opposition from the shipbuilding industry. Negotiations with South Korea – a market that is at least large enough to warrant some serious attention – have faced well-organized opposition from the auto sector and remain in limbo. Negotiations with other minor partners, such as Singapore, the Dominican Republic, Central American countries, and Ukraine, seem to be facing a similar fate. In the absence of strong support from the business community as a whole, such negotiations are easily derailed by entrenched import-competing interests concerned about the loss of a cherished remnant of the interventionist past. As a result, federal ministers determine that the amount of political capital needed to conclude such agreements is out of all proportion to their economic and commercial, let alone political, benefits. The result is a willingness to initiate, but not to conclude, such negotiations. This misuse of resources signals a lack of seriousness that is unlikely to advance long-term Canadian trade and investment interests. Should Canada proceed with some or all of the domestic reforms outlined above, such agreements would become easier to conclude and implement, as should be the case with those that serve largely as statements of political interest, rather than as instruments of commercial policy.[11]

In any event, rather than the seemingly random initiation of bilateral trade negotiations, Ottawa should proceed with negotiations only on the basis of clear business support, extensive consultations, and a clearly articulated rationale – in short, it should pursue agreements that are geared to the most pressing issues in the bilateral relationship. It makes little sense, for example, to negotiate a full-fledged free trade agreement when the principal issue between Canada and the other country is, say, investment protection and where the most appropriate instrument would be a revamped foreign investment promotion and protection agreement. Ottawa should also take a broader view of such negotiations – for example, it should consider such issues as education exchanges as part of relationship building.

In 2009, Canada entered into negotiations with the EU to conclude a comprehensive economic and trade agreement (CETA), with the hope of concluding negotiations by 2012. This initiative marks but the latest attempt by Canada to forge stronger ties with Europe, dating back to the 1970s. Over the years, however, Canada's quest has been hampered by two inconvenient realities: indifference by business communities on both sides of the Atlantic and indifference by the European political class. The latter impediment apparently was overcome in 2009, but there is no evidence that the two business communities have become enthusiastic supporters of the initiative, in part because, over the years, they have forged mutually beneficial investment ties and are hard put to identify issues that require negotiations on the scale of a CETA. Undoubtedly, there are irritants in the relationship that might be resolved through negotiations, but most that have been identified are EU complaints about Canadian practices, ranging from supply management to geographical indications for European wine, cheese, and similar products to provincial procurement practices. Some of these issues should be cleaned up on their merits; others would place Canadian producers at a disadvantage. None, however, adds up to a comprehensive agreement that would make much difference to bilateral trade and investment.[12]

Transpacific Prospects

There is more scope for potentially useful breakthroughs across the Pacific than across the Atlantic. The EU represents a mature market with limited potential for growth; indeed, even more than in the United States, political leaders in Europe are finding it extremely difficult to cope with the fallout from the 2008 financial crisis, and the fiscal position of most EU members is even more parlous than that of the United States. Asia, on the other hand, represents the future. The growth

11 Some of Canada's bilateral negotiating activity flows from the demise of the Free Trade for the Americas initiative. Canada devoted considerable resources to making this initiative a success, but learned that Canadian enthusiasm was not enough to offset the many problems that led to its demise, including US and Brazilian reluctance to proceed. Nevertheless, it served the useful purpose of leading many governments in Latin America to examine their trade policies in depth and to strengthen their intellectual and negotiating capacities on the trade front. For Canada, the initiative provided a solid base on which to build stronger bilateral ties, some of which have resulted in the desire to underpin these with a bilateral trade agreement.

12 Before initiating negotiations, both Canada and the EU commissioned studies to estimate the potential impact of an agreement; only with heroic assumptions could the analysts generate numbers that were not embarrassing. See European Commission and Canada (2008); and Guerin and Napoli (2008). For opposing views of the CETA initiative, see Hart and Dymond (2002); and Schwanen (2011b).

Table 3: Post-NAFTA Canadian Bilateral and Regional Trade Initiatives

Status/Country/Group	Total Merch. Trade 2011 (Millions Cdn dollars)	Status/Country/Group	Total Merch. Trade 2011 (Millions Cdn dollars)
Initiated/Signed		**Initiated, but not concluded**	
Israel (1995/97)	1,382	Singapore (2001)	2,360
Chile (1996/97	2,730	South Korea (2004)	11,703
Costa Rica (2000/02)	637	Dominican Republic (2007)	297
Colombia (2007/08)	1,561	Caricom (2007)	2,400
Peru (2007/08)	4,925	European Union (2009)	92,123
Jordan (2007/09)	85	India (2009)	5,162
Panama (2008/10)	235	Ukraine (2010)	287
EFTA (1996/2009)	11,535	Morocco (2011)	419
Honduras (2001/Legal review)	236	Japan (2012)	23,727
Initiated, but now suspended		**Study Launched**	
Guatemala (2001)	513	Turkey (2011)	2,394
El Salvador (2001)	166	Thailand (2012)	3,514
Nicaragua (2001)	371	China (2012)	64,966
Interest indicated	**Trans-Pacific Partnership (2011)**		
Suspended	**Free Trade Area of the Americas (2005)**		

Source: Author's compilation based on Burney et al. (2012), Table 1 and Statistics Canada, Canadian International Merchandise Trade Database, retrieved at: http://www5.statcan.gc.ca/cimt-cicm/home-accueil?lang=eng

of China alone over the past 30 years has been astounding. India is now catching up. ASEAN members and South Korea have become established markets. All are important components of the world of value chains and production networks.

Yet, while acknowledging the importance of Asia to its future, Canada remained conspicuously absent from the Trans-Pacific Partnership (TPP) initiative, choosing instead to continue to rely on the increasingly sclerotic Asia-Pacific Economic Cooperation (APEC). The APEC forum, established in 1993, sought to stimulate transpacific ties through a range of government initiatives. Rather than negotiating a regional accord, governments opted for "concerted unilateralism" as the key to more liberal trade and investment conditions, reflecting Asia's preference for ambiguity and consensus rather than structure and rules. This government-led initiative soon ran out of steam. In its place, private businesses forged their own ties and opened markets by means of production networks and value chains. To capture a share of this activity, governments throughout East Asia, often unilaterally, took the steps necessary to welcome foreign investors and become players in this world of integrated or networked production. Even India, long one of the world's most reluctant liberalizers, introduced reforms that encouraged firms to locate slices of activity there, particularly the services dimension of global production networks.

Governments on the eastern and southern fringes of the Pacific have now begun to catch up to the reality of this Asian dynamism by looking at ways to consolidate business ties with stronger governance provisions. New Zealand and Australia led the way with bilateral overtures and arrangements, followed by the TPP initiative launched by Chile, New Zealand, and Singapore in 2002. At the 2011 APEC Summit, Prime Minister Harper, perhaps mindful of the pessimistic discussions a week earlier at a G20 meeting in Cannes, France, dominated by Europe's problems, signalled Canada's interest in becoming a party to the TPP talks, as did Japan and Mexico, bringing the potential number of participating governments to 12. To date, China has not indicated any interest in joining, but it is watching developments closely (Dawson 2012).[13]

Canada's expression of interest in the TPP marked a further step in a significant, if recent, reorientation of Canadian public policy. In its first five years in office, the Harper government showed a preference for strengthening ties with Europe and Latin America, but five years of frustration have shown the limits of this preference. In its place, Ottawa has turned toward Asia, particularly China, no longer emphasizing the human rights concerns that seemed high on the agenda prior to the 2011 election, but focusing instead on strengthening trade and investment ties. High-level visits to the region have proliferated, as have expressions of interest in negotiating the intergovernmental instruments that would strengthen bilateral and regional ties.

At one level, Canada is well positioned to increase trade across the Pacific. Both South and East Asia are hungry for energy, protein, and other resources, and Canada is potentially a much more reliable and stable supplier than those in Africa, Latin America, and the Middle East. More needs to be done, however, to improve transportation infrastructure on the West Coast and to remove regulatory bottlenecks. For Canadian businesses affected by the global recession and looking worriedly toward their customers and suppliers in the United States and, to a lesser extent, Europe, Asia provides the most dynamic opportunity in more than a decade. Some firms, of course, have already decided to put resources into developing or expanding their presence in Asia. Others might be thinking about it, and need to hear from their colleagues about both good and bad experiences. Those that have shied away from China and other Asian markets might have done so for reasons that made sense a few years ago but look less compelling today. Those waiting for the federal government to prepare the way and reduce the risk premium are likely to fall further and further behind as more nimble and adventurous firms make the connections and establish the relationships so vital to developing Asian markets.

Complementary agreements have also proven their value in gaining and defending access and in strengthening institutional ties. These begin with such instruments as foreign investment protection, aviation, and double tax agreements. Canada has negotiated a new foreign investment agreement with China, but also needs to ensure that other ancillary agreements are consonant with the new reality – a new air agreement was negotiated in 2005, but the double tax agreement dates to 1986.

At this stage in Asia's economic development, government-to-government contacts remain an important part of enhancing economic ties. Such contacts range from ministerial visits and government-led business delegations to on-the-ground government representation. Recent visits to China by the prime minister and the trade and foreign affairs ministers mark a new beginning, but they will need to be repeated on a regular basis

13 Canada was formally invited to join the talks in June 2012.

to achieve higher levels of awareness of Canada in both official and business circles. Accordingly, effective Canadian representation in the region will be essential; leaving posts vacant for extended periods of time, as now happens, sends a poor message.

Consultations with Canadian Business

In the 1980s, the Mulroney government established a horizontal and sectoral business advisory system to obtain confidential advice on the free trade negotiations with the United States, the GATT multilateral trade negotiations, and the NAFTA negotiations. The system responded effectively to a long-standing business desire to be engaged more closely and systematically in developing and implementing Canada's trade agenda, providing the federal government with valuable insights on business trade priorities, and ensuring business support for Ottawa's agenda. Since then, however, the system has been replaced by public on-line consultations on specific issues – for example, negotiations with the EU and spasmodic "multi-stakeholder" meetings involving business, labour, and nongovernmental organizations. The result is that those businesses that are engaged in international trade and investment believe they have been deprived of an effective and coordinated voice in the setting of Canadian trade policy priorities.

In developing and implementing a future-oriented trade agenda, Ottawa should convene a small group of 15 to 20 senior business leaders engaged in international trade and investment to provide advice on the structure, organization, and agenda of a consultative trade policy mechanism. The minister of trade should further ask the House of Commons Standing Committee on Foreign Affairs and International Trade to resume the highly effective, democratic role it played as a consultative forum and lightening rod for broader public comments on Canada's trade agenda.

Conclusion

The world has become increasingly intertwined in response to demands by producers and consumers alike for the best products, services, capital, and ideas, in the process creating jobs and wealth across many sectors and accelerating the forces of mutually beneficial global integration. The trade policy of the postwar years, grounded in well-established international trade theories and pursued on the basis of the politically pragmatic strategy of mercantilist bargaining, proved critical to underwriting the first stages of modern global integration. The framework of rules and institutions developed during that period worked well to facilitate and govern a process of market-led integration.

The rules and institutions of the postwar regime are no longer well suited, however, to the global trade and production patterns that have emerged over the past few decades, in part thanks to the success of the earlier regime. The development of much more fragmented production strategies, the ability to disperse production much more widely around the world, the emergence of new security threats, and the reality of a much wider range of cross-border transactions all point to the need to look at a new set of policy issues that threaten to disrupt the beneficial process of integration and specialization.

The effects of these new trade and production patterns and the limits of traditional trade negotiations and instruments are reflected in the relative decline of Canada's trade performance over the past decade. Canada weathered the 2008–09 recession better than most other OECD economies, thanks to prudent fiscal management and other reforms. Its trade performance, however, remains underwhelming, in part because of anemic demand in its major markets and in part because of self-imposed barriers to greater engagement in global markets.

In these circumstances, the federal government should pursue a trade strategy that leads to a much more open economy and recognizes that reforms begin at home. It should begin by dismantling a range of policy instruments, from tariffs and trade remedy measures to subsidies and government procurement preferences, that reflect an earlier reality. As a happy by-product, such reforms would strengthen Canada's productivity performance, reduce charges to the public purse, make a major contribution to restoring fiscal balance, and reduce cost differences between Canada and the United States. In an age when governments face rising education, health, and other social costs, savings from the elimination of programs that raise consumer costs and undermine the ability of Canadians to compete and create wealth in the global economy should be compelling.

Traditional trade negotiations have become much less important, in part because the trade negotiations of the past created a solid framework of rules and commitments by all major traders to keep their markets open. Remaining pockets of protection are more likely to be eliminated through smaller and more focused negotiations than the grand multilateral rounds of the past. Canada needs to tailor its approach to such negotiations more strategically, focusing scarce resources on issues and markets that are likely to make a material difference to Canadian producers and consumers.

On the Canada-US front, the continued presence of a heavily administered border, similar but differentiated regulatory regimes, and inadequate institutional capacity to solve problems now undermines the ability of firms and individuals alike to reap the full benefits of deepening cross-border integration. In a world where firms have many more choices about what to produce and where, the smaller partner in a deeply integrationist relationship is particularly vulnerable to the impact of border delays and regulatory differences. In these circumstances, the federal government would be well advised to continue to invest in efforts to bring the framework of rules governing cross-border exchange into line with commercial and economic reality.

Beyond North America, Canada needs to focus its limited resources where they are likely to make a difference. Changes in both Canadian and global trade and production patterns indicate that engagement with East Asia should be a priority. To that end, Ottawa should avail itself of both existing and emerging opportunities to strengthen transpacific relations, from the TPP initiative to new institutional links and agreements.

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