POSITIONING CANADA AS A GLOBAL TRADING HUB

ADVISORY COUNCIL ON ECONOMIC GROWTH
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Introduction

International trade in goods and services has long been an important driver of world economic growth. Canada continues to be committed to international trade, but faces a world in which other countries appear to be turning towards protectionism. The risk is that Canada's access to world markets will decline as other countries become increasingly inward looking. For a small economy such as Canada, the costs associated with such an outcome cannot be overstated.

The recent increase in anti-trade sentiment around the world should be acknowledged. At home, the dislocations created by greater trade should be proactively addressed. But neither global sentiment nor addressable costs should dissuade Canada from seeking its place as a major trading hub within the global economy. Far from it: in fact, we have an economic imperative to do so. The relatively small size of our economy requires us to trade for continued growth and prosperity. Larger and more diversified developed economies have other sources of growth For example, international trade accounts for 65 percent of GDP in Canada but only 30 percent in the United States.[1]

Beyond the imperative to continue trading, Canada has the right ingredients to become a global trading hub and a nexus for global supply chains. This is an enviable position, and one that Canada is well-equipped to capture. We are located next to the world's largest economy, and our various Atlantic and Pacific ports provide valuable access to international markets. Canada's highly educated and multicultural population connects us economically and culturally to the world. We have rich endowments of natural resources and robust agricultural and advanced manufacturing industries. We should build on these advantages.

To become a global trading hub, the Council recommends four specific policy directions:

1. Nurture and improve our trading relationships within North America. Canada should deepen and modernize its current trading relationships through a "Team Canada" approach that includes both private sector and government networks and efforts.

2. Develop significantly better and deeper trading links with large and fast-growing economies, particularly in Asia. Canada should seek new, preferential trade arrangements with large and fast-growing nations, especially in Asia, and more specifically with China, Japan and India. In addition, Canada should provide "aftercare" for its trade agreements—strategies aimed at championing our country abroad and offering Canadian companies easy, understandable access to trade information and support.

3. Invest in trade infrastructure to improve our physical access to global markets. Over the next decade, Canada should make trade infrastructure a priority through the newly proposed Canadian Infrastructure Development Bank. One example is the expansion of the Asia Pacific gateway.

4. Address disruptions from future trade flows. Canada should improve the resilience of its workforce to changes brought about by both international trade and technological change. The Council has proposed a mechanism – the FutureSkills Lab – to help upskill and "reskill" workers to participate in the new economy. This should be complemented by ongoing efforts to improve basic education and increase workforce participation.

The benefits of trade

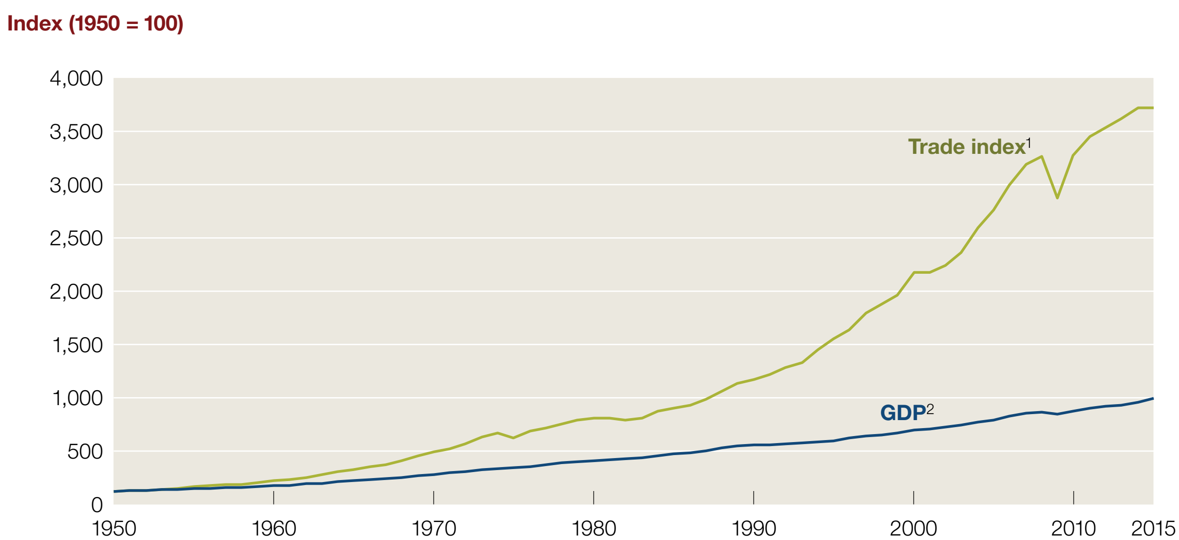
The relationship between trade and growth is clear. Total world income, as measured by real gross domestic product (GDP), grew by about nine times from 1950 to 2015; over the same period, the volume of global merchandise exports grew by more than 35 times (Exhibit 1).[2] International trade accelerated in the 1990s and declined sharply during the global financial crisis. While the decline has since reversed, observers do not expect a return to the rapid growth experienced in the years before the Great Recession. This "new normal" will have a direct impact on future GDP growth.[3]

Despite the role of trade in spurring global growth and lifting entire segments of the population out of poverty, the future of large multilateral trade agreements, such as the Trans-Pacific Partnership (TPP), is clearly at risk. Similarly, growing anti-globalization sentiment in some European countries may obstruct the full and timely implementation of the Canada–EU Comprehensive Economic and Trade Agreement (CETA). Finally, the future of trade relationships between the US, Canada and Mexico is increasingly uncertain as well.

Globalization creates valid concerns

While open economies have broadly benefited from globalization, the middle classes within these countries haven't always participated equally in its rewards. As has long been known, greater trade flows between countries often lead to the disruption of traditional economic patterns, creating costly transitions for the affected workers and firms, particularly those displaced when economic activity flows to other

Exhibit 1 **Growth in world trade and income, 1950–2015**



[1] As measured by global merchandise export volumes.
[2] GDP index is for world GDP.

Source: World Trade Organization

countries and foreign imports replace domestically produced goods. These costs were especially acute in the years that witnessed the entry of large, low-wage countries such as China into global trade and investment flows. Policy makers have not always recognized these watershed moments, or addressed them effectively.

At the heart of today's anti-trade sentiment is an understandable anxiety about job losses, economic dislocation, and an increasingly unequal distribution of income and wealth. While the concerns are real, the great majority of job losses these days tend to be linked to automation rather than jobs being exported abroad. Canada must be highly responsive to these changes and adopt forward-looking policies to help manage dislocation. The Council's FutureSkills Lab recommendation is one way to enable workers to participate in the future economy.

Canada benefits in many ways from international trade

Trade benefits our economy and society in many ways. Our imports of goods and services, together with foreign competition from global firms, give our consumers a greater choice of products and help domestic firms to increase their productivity by lowering their business costs. Access to foreign markets also raises productivity by exposing our economy to innovation and providing an opportunity for our domestic companies to achieve larger scale. Firms competing across borders are more productive and resilient to downturns, grow faster, and pay higher wages than firms competing only domestically.[4] What's more, the most connected countries enjoy GDP growth rates that, on average, are 40 percent higher those of other OECD countries.[5] Economies active in international trade also benefit from bigger inflows of foreign direct investment (FDI) in production facilities, research labs, distribution centers, office buildings, and the like. These inward FDI flows often embody the latest and best technologies and therefore enhance Canada's productive potential. (See the Council's *Bringing Foreign Investment to Canada* recommendation.)

Why Canada can become a global trading hub

With an enviable geographic position, rich natural resources, skilled labour force, strong political traditions, and diverse population, Canada already has many of the elements required to vault into the top tier of global trading nations.

Multicultural human capital. Canada's labour force is not only among the best educated of the member nations of the Organization for Economic Co-operation and Development (OECD) but also incredibly diverse.[6] Our pool of labour and management talent is multicultural, multilingual, and, in many cases, globally connected. These advantages can be leveraged by our businesses to project themselves overseas and for foreign companies operating in Canada to manage their operations here effectively.

Natural resources. Canada has a rich endowment of natural resources that will continue to be in demand for many years to come. Our petroleum deposits alone make us a global energy superpower: on a worldwide ranking of exports, we are third in crude oil, fourth in natural gas, fifth in agricultural products, and eighth in coal.[7] We also excel in the expertise and innovation required to develop these resources—from hydroelectric engineering and pipeline control to mining safety and the design of complex water systems. Canada gains by selling this expertise to the world.

Geography. Our country is well situated to serve as a central hub for global trade.[8] On its densely populated southern border lies the United States, the world's largest single-country consumer market with 320 million people. Our coastal ports provide unbounded and direct maritime access to Europe, Asia, and South America; our inland ports on the Great Lakes provide easy access to several US states.

Preferential market access. Canada has long been active in bilateral and multilateral treaties to liberalize trade. In 1994, for example, we joined the United States and Mexico in the North American Free Trade Agreement (NAFTA). When the Canada–EU CETA goes into effect, our exporters will gain improved access to the European Union's vast and relatively affluent consumer market, containing over half a billion people.

Recommendations

To build on Canada's strengths and transform it into a central global trading hub, we recommend four major initiatives. If implemented, these initiatives would enhance trade within North America, expand trade with other large and fast-growing economies, bolster Canada's trade infrastructure, and deliver more inclusive benefits for Canadians. All four would support inclusive economic growth for Canada.

Recommendation 1: Nurture and improve our North American trade relationships

The North American Free Trade Agreement has clearly enhanced the trading relationship between the United States, Canada, and Mexico, but even greater benefits would follow from further market integration. To deepen our economic ties with the United States, Canada should look to strengthen linkages with the American business community, and counter the current protectionist sentiment. Both the government and the private sector should push for better integration of Canadian and American businesses and should promote the benefits of engaging with Canadian businesses through cross-border trade and investments. Such an approach would recognize the fact that one of Canada's greatest economic assets is our proximity to and long history of trade with the United States, which receives nearly three-quarters of Canada's exports and provides half of our imports.

There is also an opportunity to improve trade linkages between Canada and Mexico. About 95 percent of the North American trade of both Canada and Mexico, in goods and services alike, is with the United States. Canada and Mexico hardly trade at all, and flows of FDI and immigration are negligible. Despite sharing the same continent with Mexico, Canada actually gets more FDI from Israel, South Africa, and Norway. In fact, in each year between 2000 and 2011 we received more immigrants from Colombia than from Mexico.[9] Canada should create specific strategies to increase trade with Mexico.

To deepen our trading relationships with the United States and Mexico, Canada should adopt the following key initiatives:

Remove regulatory barriers. Harmonize standards and regulations to encourage value-chain integration. The Regulatory Cooperation Council (RCC) has taken steps to improve regulatory cooperation between Canada and the United States. But barriers persist. For example, the required re-inspections of meat imports from Canada increase driving time by two to four hours and raise prices for consumers.[10]

Promote sector-specific "super-integration" strategies. Canada can play to its strengths by targeting important sectors to increase trading activity within North America. In energy and agriculture, for example, the federal government can work with value-chain councils (such as the one proposed in the *Council's Unleashing the Growth Potential of Key Sectors* recommendation) to boost productivity and capture market share within North America. Canada's energy and agri-food potential has yet to be unlocked. We should also develop sector-specific strategies for infrastructure—including, as a key component, investments to better integrate North American economies. Infrastructure projects such as the recently approved Enbridge Line 3, for example, will facilitate higher oil exports to the United States.

Improve infrastructure and enabling technology. To move people, natural resources, and goods more efficiently across the 49th parallel, Canada can improve the physical infrastructure and border-crossing process. In the manufacture of cars, for example, delays at the U.S. border can add hundreds of dollars to a vehicle's cost because components often cross the border several times before completion.[11] To reduce congestion at key crossings, we could pursue investments in joint border-monitoring stations or in terminals at remote locations.

Enable people flows. Customs processes—with proper security precautions—can expedite the flow of immigrants and visitors for tourism, employment, training, or education.

Recommendation 2: Strengthen our ties with large and fast-growing economies

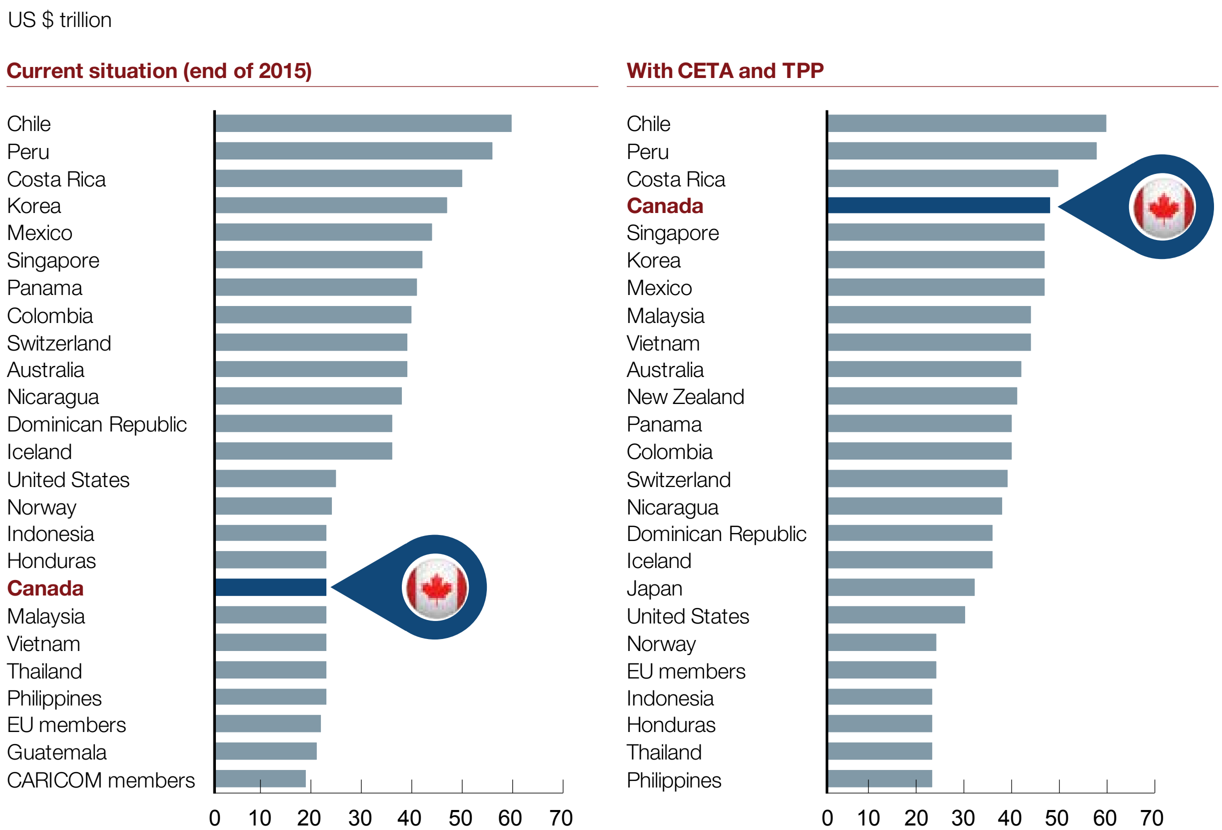
Canada stands to benefit by continuing its long-standing engagement with the World Trade Organization in its efforts to promote multilateral trade liberalization. It can also gain significantly by creating preferential trade agreements with certain large or fast-growing markets. Given the inherent limitations of time and resources, however, the Canadian government needs to set some priorities.

Given the size of the potential benefits to Canadians, as well as the current socio-political dynamics, the Council recommends prioritizing efforts for preferential trade with China, Japan and India. Such trade pacts would open up new markets for our companies, help them to achieve economies of scale, raise their productivity, give our consumers greater product choice and lower prices, and accelerate overall GDP growth.

No less important than signing such trade agreements is ensuring that Canada's businesses of all sizes understand how to benefit from them. Many small and medium-sized companies simply don't know what they must do to take their business overseas. Coaching them and providing "accompagnement" through organizations like Export Development Canada and private sector peer associations will be critical.

The TPP and CETA. Canada should not abandon the possibility of a successful Trans-Pacific Partnership (TPP). If the United States pulls out of the TPP, it cannot go ahead in its current form. That opens up the possibility that the more limited Regional Comprehensive Economic Partnership (RCEP), led by China, will eventually be implemented. In this context, Canada will need to develop an alternative approach to increase its trade relationship with Asia, including the possible development of a new agreement.

Exhibit 2 **Preferential trade access to global GDP**



Source: C.D. Howe Institute

Meanwhile, Canada should actively devote the resources necessary to ensure the full passage of the Canada–EU CETA. As Exhibit 2 shows, implementing the TPP and CETA agreements would substantially increase market access for Canada and thus the potential for enhanced growth.

The China opportunity. Canada has yet to benefit from trade with China as much as some other economies have. Although China's share of world trade has nearly quadrupled since 1995, Canada's share of that trade has fallen by about 25 percent as China expanded its links with other trading partners.[12] Canada should attempt to reverse this trend by continuing bilateral trade discussions based on clear mutual objectives. We are currently at a competitive disadvantage to nations that have trade agreements with China; for example, Australia, which has exports similar to Canada's, established the China–Australia Free Trade Agreement (ChAFTA) in December 2015. As China transitions to a more consumption-based economy, Canada will have opportunities to increase its exports. Our agricultural products, for example, are obvious candidates for export growth to China.

The Japan opportunity. Japan has indicated continued commitment to TPP. Given the risks associated with the proposed agreement, however, Canada should hedge its future trade relation with Japan by pursuing the negotiations that began in March 2012 towards a Canada–Japan Economic Partnership Agreement (EPA). This agreement was projected to generate annual GDP gains of up to $4 billion for both countries.[13] Japan is now our second-largest trading partner in Asia, but our trade volumes have generally fallen short of what they could be given that market's size and wealth. (In 2013, Canada did about $25 billion in total trade with Japan – a figure matched only by Canada's agfood exports to the USA that year.[14])

The India opportunity. India, with a US $2 trillion-plus GDP that is among the fastest growing in the world, has become a coveted trading partner. Initial negotiations for a Canada–India EPA began in November 2010. While the Council recognizes some of the difficulties associated with current negotiations, a productive agreement should be completed as soon as practical. India has the potential to be a cornerstone growth market for a future Canadian agfood strategy. (For illustrative purposes, we note how in 2015, India imported nearly one billion dollars' worth of lentils from Canada, up from $400 million the year prior.)[15]

Recommendation 3: Invest in trade-enhancing infrastructure

Canada can become the preferred location for trade among Europe, Asia, and North America. But that will happen only if we have the proper trade infrastructure, including modern transportation systems to support modern supply chains, as well as the digital infrastructure for information flows. (See Box 1 on page 11).

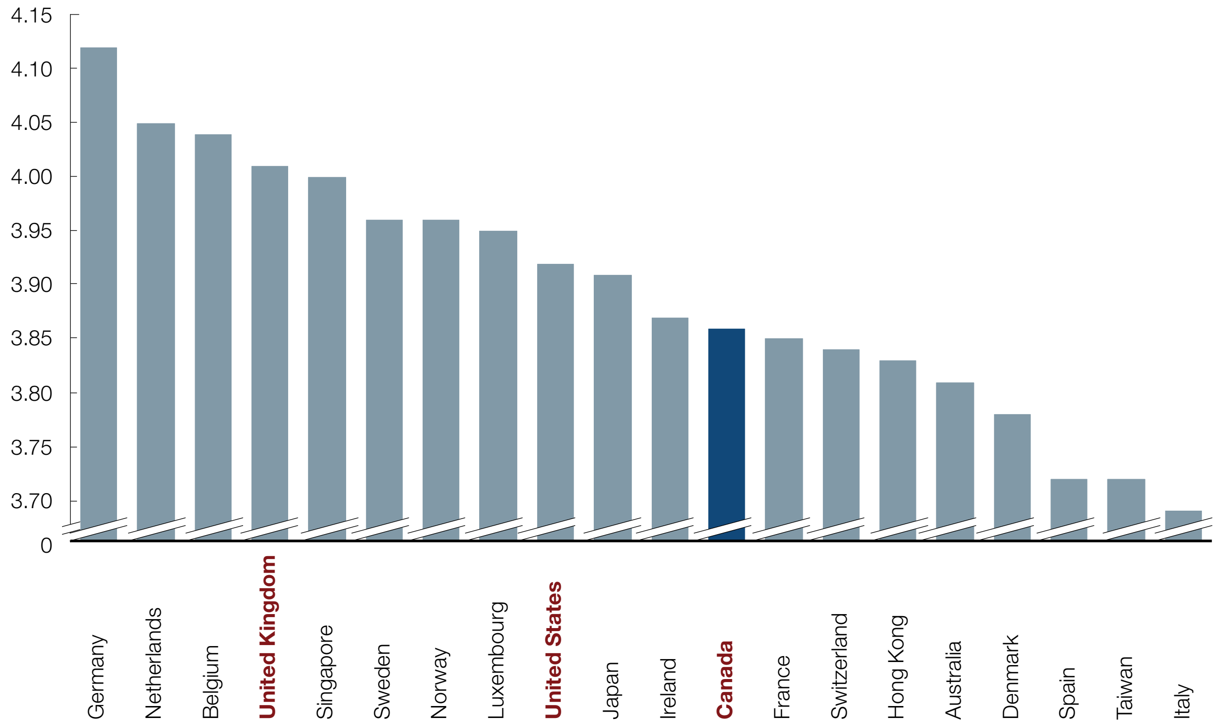
Today, Canada's transportation infrastructure ranks 12th among the nations on the World Bank's Logistics Performance Index (Exhibit 3). Transportation delays create heavy costs across global value chains. For example, the added expense of each extra day an unfinished product remains in transit has been compared to a tariff of 0.2 to 2.1 percent. Vehicle parts are most sensitive to these costly transportation delays,[16] and this is a large part of Canada's manufacturing sector. But such costly time delays make Canadian companies in many sectors less competitive.

To promote Canada as the preferred trading hub in North America, Canada should aim to score ahead of the United States (number nine) on the World Bank Logistics Performance Index. Although Canadian ports and airports have become bigger and more efficient conduits for international trade, domestic road congestion remains an important bottleneck. Improving our trade infrastructure can also help Canada attract more FDI, including infrastructure investments that bolster trade.

Pipelines, another type of trade infrastructure, offer the safest, least expensive way of getting our growing output of petroleum products to world markets. Until recently, the obstacles to building the capacity required to do so was a significant barrier to growth. The recent approval of Kinder Morgan's Trans Mountain Pipeline will notably improve Canada's access to large and fast-growing Asian markets.

The federal government should seriously consider the detailed recommendations of the Canada Transportation Act Review, such as developing a national plan, over 10 to 30 years, to improve both intermodal and sector-specific connectivity. The recommendation to invest in connectivity for northern Canada should also be reviewed for implementation.[17] A national Northern Corridor megaproject bundling roads, rail

Exhibit 3 **Top 20 countries, ranked by the World Bank's Logistics Performance Index, 2014**



Source: Institute for Research on Public Policy

lines, pipelines, and transmission lines in a relatively narrow right-of-way would significantly discount the construction costs. This kind of initiative would improve Canada's access to emerging markets and support the international shipping trend toward larger sea vessels that may make internal ports obsolete.[18]

The following ideas to improve Canada's trade infrastructure are complementary to the Council's *Unleashing Productivity* through Infrastructure recommendation:

- Make trade infrastructure a priority (alongside social, transit, and green initiatives) in the $120 billion Federal Infrastructure Plan.
- Create incentives for investment in intelligent transportation systems that use advanced digital technologies to manage roads, railways, ports, and other transport systems.
- Expand Canada's gateway and trade-corridor initiatives, such as Northern Corridor and Pacific Gateway.
- Improve the collection of data on the performance and state of repair of our trade infrastructure (e.g., ports, airports, rail). A lack of data now limits the ability to make informed decisions.

- Encourage cities and provinces to introduce well-designed road and bridge tolls to reduce the economic costs of traffic congestion.

- Work with our NAFTA partners to reinforce the bloc's competitiveness by adopting North America–wide approaches to planning transportation systems and infrastructure.

Recommendation 4: Address disruptions from future trade flows

Greater flows of international trade raise average living standards, as measured by per capita GDP. But the negative consequences of globalization must be taken seriously to ensure that all Canadians receive their fair share of its benefits. Only when policy makers address these concerns effectively can we expect Canadians to support an agenda that calls for increasing our global trade.

Our economic policies, including trade policies, must therefore promote inclusive growth, explicitly aiming to create opportunities for all members of our society, not just the lucky few.

Explaining the benefits of increased trade. Though international trade generates significant economic benefits for Canadians, many people continue to doubt its importance. Such doubts are only fuelled by the rising anti-trade sentiment seen in other parts of the world. Our government should take the communications challenge seriously by not only showing Canadians the nature and magnitude of the benefits of international trade but also by addressing its disruptive effects.

Employment dislocation. To minimize the downside of increased international trade, we recommend that the government implement programs to ease the process of adjustment. We recognize the difficulty of identifying the precise cause of any specific case of economic dislocation, and for this reason more flexible policies offer greater promise. The Council's FutureSkills Lab proposal—which supports innovative ways to develop skills, to identify and create new sources of information about them—exemplifies what we can do to help workers adapt to both global competition and disruptive technological change.

Commercial upside. The benefits of preferential trade must extend to Canada's small businesses which collectively account for 47 percent of business sector employment.[19] The majority of small businesses in Canada do not export at all, and do not know where to start. A recent survey showed that nearly 65 percent of Canadian companies do not understand how to sell their goods and services overseas.[20] Our country already has organizations like Export Development Canada and the Trade Commissioner Service that support companies engaged in international trade. We should promote these organizations more effectively to ensure that even small Canadian firms and their workers benefit from our expanding trade agreements and relationships.

■ ■ ■

Canada has a unique opportunity to become a global trading hub by strengthening its current trade relationships, building new ones, enhancing the infrastructure required to deliver goods and services, and preparing Canadians to take full advantage of trade ties. That kind of effort would build a foundation for sustained economic growth to the benefit of all Canadians. ■

Box 1

Canada's changing trade landscape: More services and digital flows

Four out of five Canadians are employed in producing services, including those that go into the manufacture of traded products. As nearly half of Canada's export value consists of services,[21] we have a keen interest in completing the Trade in Services Agreement (the negotiations were launched in 2013 with 23 World Trade Organization members representing 75 percent of global GDP). Working with other nations, particularly the United States, Canada should push for freer trade in services such as finance, telecommunications, e-commerce, and air and ground transport—not to mention the free, efficient movement of the people who produce and deliver them.

Our future trade efforts and negotiations should also account for emerging digital flows—an enabler of trade in goods as well as in services—which expanded 45 times over from 2005 to 2014.[22] Canada should support this digital commerce by ensuring that all new trade agreements cover it. At home, we can continue to invest in our digital infrastructure to expand broadband access and ensure cybersecurity. The federal government can also invest in technology education and encourage the development of clusters of digital businesses.

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